CHALLENGES AND OPPORTUNITIES OF ISLAMIC BANKING AND FINANCIAL INSTITUTIONS IN MALAYSIA.

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ABSTRACT

The purpose of this research paper is to investigate the opportunities of development and growth by identifying the main challenges to Islamic banking and financial institutions in Malaysia. Malaysia is the first country in the world to have a dual system of banking and finance which comprises of Islamic and conventional banks. When Bank Negara Malaysia's Banking and Financial Institutions Act 1989 was amended in 1993, most conventional banks in Malaysia started to set-up full-fledged Islamic subsidiary. However, Islamic banking and financial institutions are facing some great challenges in the Malaysia because the conventional financial system is more beneficial. This research is a quantitative study using primary data and was disseminated among the banking authorities of Islamic banking and financial institutions. The questionnaire are based on fundamentals of Islamic banking, basic understanding of Muslim community, information system and the growth opportunities related to products and market development as well as difficulties and challenges in developing Islamic banking and financial institutions in the Malaysia. The research findings show that there are greater opportunities in Malaysia for development of Islamic financial banking because both the Muslim community and non-Muslim are longed to take Islamic financial products and they are willing to spend their lives according to their religion. The bank authorities need to improve the information system and Islamic banking institution is needed to work hard for survival and compete with conventional banking system in the sector of regulations and supervisions in Malaysia.

Keywords: Islamic banking, Islamic finance, opportunities of Islamic banking growth and Islamic banking challenges in Malaysia.

1.0 Introduction

1.1 History of Islamic Banking and Financial Institutions

The background of the Islamic banking has been started since the time of Prophet Muhammad. He started as a businessman trading from one country to another. He shows how to trade and how to deal in the business using a Shariah way. The Islamic Finance has expanding widely until the modern world now . In 1963, the first financial institution which worked under Shariah principle was established in Egypt. Mit Ghamr, a savings institution that operated under cooperative basis, allowed their depositors to take out small portion of loan for productive usage and to provide possible returnon the money of depositors. The saving project ran on a profit-sharing basis. In 1971 the project was incorporated in Nasser Social Bank. Around the same time as the establishment of Mit Ghamr cooperative organization, Islamic financial services were also began in Malaysia. In September 1963, Perbadanan Wang Simpanan Bakal-Bakal Haji (PWSBH) was set up. This was the first Islamic banking in Malaysia which established for the purpose to assist Muslims to save their Haji expenses to pilgrimage to Mecca. In 1969, Lembaga Urusan dan Tabung Haji (now known as Lembaga Tabung Haji) established as results from the merging between PWSBH and Pejabat Urusan Haji.

In 1979, the first Islamic and Commercial Bank, Faisal Islamic Bank started in Egypt. It provides funding to support financial activities through Zakat fund. It was followed by the establishment of Bahrain Islamic Bank (BisB) in the same year, the first Islamic commercial bank in Kingdom of Bahrain. The milestone of Islamic banking and financial institution in Malaysia started in 1983, when Bank Islam Malaysia Berhad was founded. The establishment of Bank Islam in Malaysia is a significant of development of Islamic banking in Malaysia. In 1991, Bahrain realised that there is a need to set up an accounting and auditing standard to standardize and regulate the operation for Islamic Financial Institution. Hence, the accounting and auditing standard was established. Malaysia formed an Islamic Financial Services Board (IFSB) in 2002 to regulate the Islamic financial services industry by established a supervisory standard and principles that compliance with Shariah.

Beyond years 2000, Islamic Financial Institutions develop progressively. There are numerous of Islamic financial institutions established all over the world. Aplenty of conventional banks in Western countries started to offer Islamic financial services. For example, Citi Islamic Investment Bank, Al Rayan Bank in United Kingdom, Lariba American Finance House in United States, Arab Bank (Switzerland) Ltd, MCCA Islamic Finance & Investments in Australia, Kuveyt Turk, the largest Islamic bank in Turkey which launched a full-fledged Islamic bank in Germany in July 2015. The development of Islamic financial institutions in South East Asia countries tends to be more progressive than Western countries due to the religion background – Islam. As an example, Islamic Financial Institutions located in Malaysia includes Alliance Islamic Bank Malaysia Berhad, HSBC Amanah, CIMB Islamic Bank Berhad, Public Islamic Bank Berhad and Al Rajhi Bank. Al Baraka Bank (Pakistan) Limited, Bank Islami, Meezan Bank and Bank Alfalah can be found in Pakistan while Islamic Banks in Iran includes Bank Melli Iran and Bank Markazi Jomhouri Islamic Iran.

1.2 Introduction of Islamic Banking and Financial Institutions

Islamic banking is a banking system that compliance with Islamic Law – Shariah. The rules and practices under Islamic banking are in accordance with the primary sources of Shariah Law, such as Quran and Sunnah. In the absence of such specific practices which does not stated under the primary sources, secondary sources which developed by Muslim jurists such as Ijma, Qiyas, Ijtihad will be used as reference. Islamic banking emphasizes on profit and loss sharing. They do not allow excessive earning that does not involved with real hard work and productivity. The investments under Islamic financial institutions involved with real assets instead of financial assets. Under Islamic banking, the returns are not guaranteed since they share the profit and loss together with depositors. Islamic banking operates banking business with the following principles:

i. Prohibition of Riba (Interest) or Usury

Under Islamic finance transaction, it is strictly disallowed the charging and receiving of interest between both parties. This is because interest is deemed as profit which had been generated without involving the actual productivity. Under Islamic financial institutions, all the profits gained must involved with the "real" hard work in the kind of business which permitted by Shariah. The money provided by lender is only a medium of exchange, which do not have any intrinsic value itself. It could only become valuable as a return if the money is employed in a productive manner.

If interest exists, it will causes severity effects to the entire economy system since investors will not care on the nature of the business activities that undertakes by the invested company, even if the nature of business carrying on by the invested company is prohibited in Shariah. What the investors concern about is just the rates of returns on their investments capital. If this scenario happens, it will affect the well being of society. Moreover, if interest is charged, it causes a severe socioeconomic imbalance between poorer and wealthier group. The purpose of borrowers to borrow money is because they are facing financial difficulty. If interest is charged on the loan, borrowers will become poorer since they have to pay more out of their loan while lenders will become richer because they will earn extra profit from their original contribution.

ii. Prohibition of Gharar and Maysir

Gharar refers to the uncertain outcome results from a risky transaction due to insufficient knowledge and information available to predict the nature and the quality of the subject matter. Under Islamic Law, transaction exposes to excessive risk are prohibited to execute. Hence, most of the conventional financial instruments such as forwards, futures, options, short selling and speculation are strictly forbidden to be execute because they involve with the uncertainty of the price for the underlying asset in future date.

The purpose of Islamic financial institutions to do so is to ensure all parties involving in transaction are free from losing their money in exchange contracts that are risky and uncertainty. Islamic financial institutions emphasizes on justness, they make sure the financial operations undertaken based on transparent and accurate information which are available to all parties. Transparency and fully disclosure of information is vital to avoid any of the party to exploit the advantages over the other party. This principle had reduces the unpredictable losses for all parties to the minimum.

Maysir refers as gambling activities or any kind of games of chance that winning just based on lucks. Businesses related to lotteries, casino or gambles are banned by Shariah. All these activities involve uncertainty and the obtaining return is not based on hard work and productivity. It goes against the concept of money in Islamic banking that "money is just a medium of exchange". Money will only become valuable if it's invested in productive manner.

iii. Ethical Standards

Under Islamic investing, it is crucial for the investors to clarify whether the invested company or businesses are compliance with *Shariah.* Certain activities are strictly forbidden to be invested in Islamic banking such as businesses that involved with gamble, pork and alcohols. When investors would like to make investment, they have to overview the background of the potential company, including the company's policy, products and services produced, method for company to operate the business and the positive or negative impacts of the products or services contributed to the society.

iv. Moral and Social Values

Same as others religions, Islamic Law emphasizes on the moral value of caring and sharing to poorer by wealthier peoples. Peoples with more financial ability have to aids and support the destitute. Welfare of destitute is strongly concern under Islamic Financial Institutions. This is also one of the reasons that Riba is prohibited since it will increase the burden of the borrower by paying extra (interest).

A kind of interest-free loan, called as Al Quard Al Hasan has being offered to the needy in Islamic finance. Under this profit-free loan, the borrower only require to pay back the principal amount of loan without needing to pay extra for interest, mark up cost or others.

Besides the profit-free loan, Zakat is offered to support for needy. Zakat acts as religious tax which is compulsory to be contributed by every Muslim. The concept of collection Zakat is to promote the moral values by providing financial support for needy and poor from peoples who have greater financial abilities.

v. Liability and Business Risk

All parties in Islamic transaction must share together both risk and profit. Profit must bear together with liability. As the lender financing the borrower, lender has to provide some contribution as an exchange for his return. He has to either accept the investment risk involved in the business or provides some relevant services to the invested project such as offering an asset. All the profits gained must derived from hard work. Hence, Islamic Law emphasizes the lawful profits from others kind of gaining through this principle.

In order to ensure all the Islamic financial institutions operate under these principles, Shariah Board is established to meet the objective. Shariah Board is formed by individuals who have a professional knowledge in Islamic jurisprudence and finance. They serve as corporate governance for Islamic financial institutions. They are responsible to monitoring the operation of Islamic financial institutions to make sure they are running their business with the compliance of Shariah Law. In addition, they also responsible in managing the Shariah non-compliance risks to make sure Islamic financial institutions run their businesses efficiently with a minimum risk.

1.3 Introduction of Islamic Banking Products

Islamic banking products are increasing day by day and previous studies found that Islamic banking products are on a par with conventional banking products, according to Haidi and Malik (2006). There is a lot of Islamic banking products in Malaysia, however there are some common Islamic products that will be discussed briefly in this section.

i. Bai' al 'inah (sale and buy-back agreement)

Bai' al 'inah is a contract which involves sell and buy back transactions of an asset by a seller to the customer. The seller will sell the asset on spot basis but the customer will buy back the asset on deferred payment at a price higher than the cash price. In other words, subsequently the asset is sold to the customer on a deferred-payment basis and the price is payable in installments.

ii. Bai' bithamanajil / BBA (deferred payment sale)

BBA refers to the sale of goods on a deferred payment basis at a price, which includes a profit margin agreed to by both parties. It means that the Islamic bank will purchase certain assets on a deferred payment basis and then sell the goods back to the customer at an agreed price including some margin or profit requested by the customer. The customer will paid in installments over an agreed period.

iii. Murabahah (mark-up)

Murabahah is a cost-plus financing contract where a sale is made at a specified profit margin. It establishes a form of mutual contract between two parties where they agree to the mark-up. The bank acts as an intermediary and purchases the goods requested by the customer. The bank will later sell the goods to the customer in a sale and purchase an agreement, whereby the lender re-sales to the borrower at a higher price agreed on by both parties. Murabahah is derived from the root word which means profit, gain or a legal addition.

iv. Mudarabah (trust financing)

Mudarabah is a form of partnership where one party (rab al-mal) provides the funds and the other party (mudarib) assumes the role of the entrepreneur through effective management. While rab al-mal is the sleeping partner in the partnership contract, the mudarib is directly involved in the day-to-day running of the business. The parties share the profit of the business venture based on agreed percentage and bear any loss incurred. In the event of losses the entrepreneur loses his or her labor and the financier loses the capital.

v. Musharakah (partnership contract)

Musharakah is a word of Arabic origin meaning 'sharing'. It is a form of shirkat al-amwal where all partners invest capital into the joint-venture. Musharakah emphasizes practical participation of parties in the partnership business and it is a form of partnership between two or more parties based on mutual trust. Musharakah means partnership whereby the Islamic financial institution provides the capital by the customer with the understanding that they both share the profit and loss according to a formula agreed before the business transaction is transacted.

vi. Ijarah (leasing)

Ijarah is a financing mechanism involving rental of an asset or hire purchase where a form of rental fee is paid for a stipulated period of time agreed by the parties. This is more in accordance with the Shariah concept of leasing where the bank acquires ownership based on the promise and leases back to the client for a given period. The customer pays the rental but the ownership still remains with the bank. As the ownership remains with the lessor (bank), who is responsible for its maintenance, it continues to give the service for which it was rented.

vii. Istisna (Manufacturing contract)

Istitna is a manufacturing contract of a made-to-order asset based on a deferred delivery basis. It is a transaction on a commodity before the commodity is produced. The manufacturer is morally obliged to produce items which are at the agreed time and in accordance with specifications (price, quality, description). The price, specification, description and quality of the commodity to be manufactured should be fixed with the consent of the parties to the contract. Normally, Istisna is used to finance construction and manufacturing projects.

viii. Takaful (Islamic insurance)

Takaful is a conventional Islamic insurance and also is an alternative form of cover that Muslims can avail themselves against the risk of loss due to accident. It is depend on the concept of what is uncertain with respect to an individual may cease to be uncertain with respect to a very large number of similar individuals. Insurance by combining the risks of many customers enables each individual to enjoy the advantage provided by the law of large numbers.

1.3 Current Development Stage of Islamic Banking and Financial Institutions in Malaysia

Malaysia plays a representative role in Islamic banking and also is a front runner in the global arena at present. Malaysia is the first country in the world to have a dual system of banking and finance. When Banking and Financial Institutions Act 1989 was amended in 1993, most conventional banks in Malaysia started to set-up full-fledged Islamic subsidiary.

As its know the operations of Islamic banking are driven by the rule of Shariah which defines the nature and character of the deposits mobilized and financing provided. The basic concept which is Islam prohibits interest (Riba) and permits trade (Tijara). Hence, the profits in Islamic banking operations are derived from the contract of trade (Al-bai'), unlike the profit in conventional banks which are derived largely from interest-bearing loans. In the principle of Islam, it is business risk taking to forms the basis for profits and is not financial risk taking. The Al-bai' principle is manifested by an exchange of money with an underlying asset, whereas a contract of interest- bearing loan entails an exchange of money for more money.

Besides, risk sharing and real sector connectivity are distinguishes Islamic banking from conventional banking. In Islamic banking, all financial transactions must related to the real economy with no space for the sake of financing. In the Islamic paradigm, the financial sector is inextricably linked to the real sector of the economy, which means that the financial sectors would not exist on its own. In other words, in the Islamic order, the financial sector primarily functions as the facilitator for the real sector.

Nowadays, Islamic banking in Malaysia was started off with a single wholesome Islamic bank enjoying an enviable 'monopoly' position devoid of competitive pressures. The second stage state that the emergence of Islamic 'windows' in many conventional banks, amidst concerns that funds might get mixed up in 'common kitchens'. In the third stage, more wholesome Islamic banks, both domestic and foreign, appeared on the scene. And in the fourth stage, conventional banks' Islamic windows were replaced by full-blown Islamic subsidiaries, both local and foreign, rendering the 'common kitchen' concern a non-issue.

Since Malaysia is a multiracial country, the Bank Negara Malaysia (BNM) has approved a system of parallel Islamic and conventional banking. With a strong Islamic banking gradually, the past two years shown many conventional banks rushing to register and obtain a full Islamic license in order to set up an Islamic bank in Malaysia. Malaysia is the first country to successfully adopt a dual banking system, where a full-fledged Islamic system operates side by side with the conventional banking system within a single bank (Sadar, Noraini and Yahya, 2003). Currently, there are probably twelve Islamic banks which are running under a full Islamic license. Of these, three are foreign Islamic financial institutions. In early January of 2008, Bahrain's Unicorn Investment Bank (UIB) has received a license from Bank Negara Malaysia to operate an Islamic bank under the Malaysian International Islamic Financial Centre (MIFC) initiatives (BIS Review, 2006). Their license is given to create any Islamic banking product and take deposits as long as they are in non-ringgit currency. Other foreign banks like Kuwait Bank and Al Rajhi Bank have already set up branches in Malaysia.

This study would contribute to the existing body of knowledge from the local research context which were highlighted that Islamic financial institutions are undergoing challages by several local researchers, it futher elaborated in the problem statement. However, for the purpose of this paper researchers would expend these study contexts by observing at the challenges faced by Islamic financial institutions from the prespective of banking authorities (i.e. bankers and financial investors). In which, researchers would be motivated to view constructs such as financial intermediations and products, risk management functionality, misunderstanding and lack of standardization and legal system. Researchs are interested to indentify which are the main challenges faced by Islamic financial institutions in Malaysia.

1.4 Problem Statement

According to the Annual Banking Statistics of Bank Negara Malaysia (2007), Malaysia Islamic banking and financial industry obtained assets of approximately USD 65.6 billion, with an average growth rate of 18 to 20% annually. This result indicates that Malaysia has successfully establishes a domestic Islamic banking and financial industry over the past 30 years.

However, there are several studies founded that the development of Islamic banking and financial institutions in Malaysia is still facing some challenges. According to Dusuki and Abdullah (2007), one of the major issue in development of Islamic banking and financial institutions in Malaysia is that the awareness of public towards Islamic financial industries is severely low. In order for the public to clearly understand the concept of Islamic banking and financial institutions, public educations and campaigns are required to be organized intensively.

According to Fahmy and Yusof (2008), some Malaysians claim that Islamic banking is just a change in name of conventional banking as they argue that the interest rate under conventional banking is just converted to the profit rate in Islamic banking only. As refer to the research of Halim and Hamid (2001), the marketing effort provided by Islamic banking and financial institutions to their clients is still inefficient. Compared to conventional banks, Islamic banks involve only minimum effort to marketing their products and services.

Islamic banking contains an important position in the financial sector of the Malaysia but it is necessary to look at the factors of its adoptability for its growth among both the Muslim and non-Muslim. Although Malaysia is the Muslim country, but its banking and financial rules are most in favor of conventional banking system due to the fact that Islamic banking is facing some difficulties in the way of its progress. In other words these problems are great challenges for Islamic banking. If banks authorities work harder, Islamic banking could be developed in a short span of time.

In this paper, study would be related to the challenges and opportunities of Islamic banking and financial institutions in Malaysia.

1.5 Research Question

i. Is the limited market-based financial intermediations and products becomes the challenge of developing Islamic banking and financial institutions in Malaysia?
ii. Is the limited risk management functionality becomes the challenge of developing Islamic banking and financial institutions in Malaysia?
iii. Is misunderstanding and lack of standardization of Islamic financial concept becomes the challenge of developing Islamic banking and financial institutions in Malaysia?
iv. Is the legal system becomes the challenge of developing Islamic banking and financial institutions in Malaysia?

1.6 Research Objective

The objective of this research is to find out the main challenges which are currently faced by Islamic banking and the opportunities for development and growth of Islamic banking in Malaysia. The research questions is divided in four different areas such as limited market-based financial intermediations and products, limited risk management functionality, misunderstanding and lack of standardization of Islamic financial concept and legal challenges to find out whether there is any opportunity for growth and development in the Malaysia and which kind of challenges is faced by Islamic banking in Malaysia.

1.7 Hypotheses

H1: Limited market-based financial intermediations and products is the challenge of developing Islamic banking and financial institutions in Malaysia.

H2: Limited risk management functionality is the challenge of developing Islamic banking and financial institutions in Malaysia.

H3: Misunderstanding and lack of standardization of Islamic financial concept is the challenge of developing Islamic banking and financial institutions in Malaysia.

H4: Legal system is the challenge of developing Islamic banking and financial institutions in Malaysia.

2.0 LITERATURE REVIEW

2.1Limited Market-Based Financial Intermediations and Products

The banking system has been established to work as the intermediaries between the customers and the financial institutions.The financial intermediaries have an important role to the overall economic in the country. In case of Malaysia, Malaysia has a unique financial system. The financial institutions in Malaysia have full fledged system, dual banking system and subsidiries. Most of the financial institutions for instance banks and insurance companies offered Islamic products. The Central Bank in Malaysia approved most of conventional bank in Malaysia to offer and sell the Islamic banking products.

Financial intermediations refer to the middleman who operates under financial institution that responsible to collect excess funds from depositors (surplus units) and to provide funds to borrowers (deficit units).

The major responsible of financial intermediations is to match the demand of borrowers with depositors. The amount of funds contributed by each of the household depositors is limited. In order for the financial institutions to borrow funds to the deficit units, financial institutions have to pool the limited resources provided by small depositors and repackages them into larger size to lend to the borrower who demand for great amount of funds.

Secondly, financial institutions safeguard the resources of depositor. Financial institutions provide security to the resources of savers. All the commercial banks together with the licensed financial institutions have to operate under Banking and Financial Institutions Act 1989, Malaysian Anti Money Laundering Act 2001 and Corporate Governance.

In addition, financial institutions provide liquidity to the consumers by transforming their assets into cash via payment tools such as ATM machines, checking accounts and debit cards and etc. Liquidity defined as the period taken for an asset to turn into cash. Financial intermediaries are experience in measuring risk of various types of investments. They are expert in using tools to collect and process information. Financial intermediaries have the ability to gather financial information easily which could hardly obtained by individuals. According to Maria Abdul Rahman (2016), most of the financial institutions are facing fierce competition between Islamic and conventional to gain market share. Most of the financial institutions need to market different Islamic products to gain customers.

All of the above functions of financial intermediaries are able to perform efficiently with the supporting markets which provide liquidity, risk transfer, and insurance. However, under Islamic financial intermediaries, there is an insufficient of supportment by Islamic financial markets. According to *John Wiley and Sons (2011),* the Islamic financial intermediaries expose themselves to liquidity problem due to the lack of developed money market and the shortage of short term investment securities such as treasury bills and marketable securities which offer limited capital risk with optimum returns. The reason why those kinds of money instruments are prohibited is due to the reason that profit generated is not based on productive and real business. At the same time, there is still lack of such alternative instruments to offer liquidity function as the former. As Shariah law prohibited Islamic financial institutions to execute the borrowing activities based on Riba, it caused Islamic financial institutions hardly to handle liquidity shortage and excess liquidity effectively. As result, portfolio management hard to execute effectively and these reduce the diversification chances. As refer to Archer and Karim (2006) where the major is the difficulty to develop the Islamic financial institutions is due to the incompleteness of traditional financial instruments which applied to the Shariah Law. Unlike conventional banks, Islamic banks are prohibited to issue treasury securities to maintain liquidity.

Under the study of Sundararajan and Errico (2002), the mismatching possibility between assets and liabilities is high due to the underdeveloped of financial securities. The majority of conventional risk hedging instruments such as options, futures and forward are prohibited as compliance to Shariah. Under the current development stage of Islamic financial institutions, they are still lack of alternatives to perform such functions. Askari, Iqbal, and Mirakhor (2011) supported that the significant gaps in Islamic financial institutions is the limited risk-sharing financial products. Risk sharing, partnership-based, and equity-style financing and investment play critical role to broaden the Islamic financial sector efficiently. In their research, they claimed that the Islamic banks' actual proportion of assets are minimum as compared to the partnership and companies. As refer to Mokhtar, Abdullah, and Al-Habshi (2006) the smaller size of Islamic financial institutions as compared to conventional financial institutions had make the creation of a larger size local Islamic liquidity market become challenging due to the smaller economies of scale.

***H1**: Limited market-based financial intermediations and products is the challenge of developing Islamic banking and financial institutions in Malaysia.*

2.1.1 Concentrated Banking: Limited Risk Management Functionality

Islamic banks tend to have a concentrated base of deposits or assets. According to Iqbal (2007). Islamic banks often concentrate on a few selected sectors and avoid direct competition as one Islamic bank may focus on Information Technology sectorin financing, while another Islamic bank might do the same financing in the agricultural sector, and neither attempts to diversify to other sectors. This practice makes functionality of risk transfer is very limited, because of the no organized markets for offloading risks to achieve diversification. Hence, Islamic banks are easy expose themselves to cyclical shock in a particular sector. In accordance with a small number of sectors, it will appears the problem lack of diversification increases their exposure to new entrants, especially foreign conventional banks that are better equipped to meet these challenges.

The challenges of concentrated Islamic banking are debated that concentrated banking will leads to various pathological situations: mechanism of interest rate, abuse of the credit system and derivative market. In practice, there is no real control over such huge institution by the official authorities. Big banks, knowing that they are "too big to fail", can take exceedingly high risks refers to the (Carletti and Hartmann, 2002).

According to John wiley and Sons (2011), he stated that the Islamic financial markets have not introduced any viable mechanism for transferring risk. This has causing the serious consequences for the Islamic financial intermediaries, who are exposed to a wide array of credit, market, and operational risks but are unable to properly hedge most of their risks. This concentration in the base of deposits or assets reflects a lack of diversification, which increases their exposure to risk. Islamic banks' assets are concentrated on few products. There have two types of risk faced by Islamic banks which are financial risk and non-financial risk. Financial risk comprises of credit, market and liquidity risk. For non- financial risks includes operational risk, regulatory risk, business risk, legal risk, strategic risk and banking risk. All the risk are governed by a sound risk management to help to reduce their exposure to risks and enhance their ability to compete in the market.

Islamic banking is underutilized the benefits or advantages that come from both product diversification and the geographic factor. Currently, they just rely mainly on maintaining good relationships with depositors. However, these relationships can be tested during times of distress or changing market conditions, likes interest and exchange rates will affects the general trading climate and are not just a matter of direct costs, competitor existing, and the new technologies and innovations that could change the market and increase or reduce the demand for your existing product or service, when depositors tend to change loyalties and shift to another financial intermediaries they perceive to be safer.

This risk of losing depositors raises a more serious exposure known as "displacement risk." Displacement risk refers to a situation where, in order to remain competitive between the competitor, an Islamic bank pays its investment depositors a rate of return higher than what should be payable under the "actual" terms of the investment contract; it does this by forgoing part or all of its equity holders' profits, which may adversely affect its own capital. Islamic banks practice in this kind of method to induce investment account holders or depositors not to withdraw their funds. According to the John Wiley and Sons (2011), Islamic banks could reduce their exposure to displacement or withdrawal risks through diversifying their base of depositors. With the changing face of banking and the introduction of internet online banking, achieving a high degree of geographic diversity on the liabilities side is conceivable and should be encouraged.

***H2**: Limited risk management functionality is the challenge of developing Islamic banking and financial institutions in Malaysia.*

2.1.2 Misunderstanding and Lack of Standardization of Islamic Financial Concept

Some peoples misunderstand the concept of Islamic financial institutions, they thought that Islamic financial institutions only available for Muslims. Although Islamic financial institutions are compliance to Shariah Law, it is not only applicable for Muslims. Under the study of Gerrard and Cunningham (2003) there are only few numbers of Muslims aware to the Islamic banking operation while there is almost none of non Muslims have a clear concept for the Islamic finance culture. It proves that the customer awareness on Islamic finance sector is unfavorable. In Malaysia, the education provided to customers regarding to the Islamic banking products are still insufficient. According to the research done by Doraisamy, Shanmugam and Raman (2011), the amount of residents in Sungai Petani who are familiar with Islamic banking operation are still low and the promotion about Islamic banking still unoptimistic. A study from Metawa and Almossawi (1998) found that most of the education background for Islamic finance customers are high educated. There are approximately 40% of Islamic finance customers own high school certificates and approximately 50% of them achieve bachelor degree education level or above. It indicates that education is an essential tool to boost the awareness of Islamic banking.

Some peoples hard to differentiate the operation concept between conventional and Islamic financial institutions and they deemed that Islamic banking is merely a change in name without any others special features. They argue that the "profit rate" used under Islamic banks is just a substitution for "interest rate" under conventional banks. Hence, they claim that the operation of Islamic banking in Malaysia involves with interest element. According to Muslehuddin (2007) any extra gains exceed the principal is known as Riba, including usury and interest. Haidi and Malik (2006) stated the first impression of Islamic banking is the fixed rate concept, "halal" loan serves as the substitution for conventional loan. The study by Dusuki and Abdullah (2007) showed that the awareness of Islamic financial industries in Malaysia is severe low. Public educations and campaigns are required in order for Malaysian to differentiate the banking concept under conventional and Islamic banking.

Usually, most of the conventional banks offered the Islamic product based of different terms for example Wadiah or saving account. Most of the window or subsidiaries will use the familiar terms for market the products.Currently, in Malaysia, there are significant numbers of Islamic banks operating in the country. The Central bank of Malaysia established and introduced waqf and zakah to their transactions in the banks. Islamic banks in Malaysia have offered to their customers to place deposits as waqf contributions. These activities are the new innovation to bring forward the new product under Islamic banking.

One of the major reasons that causing the concept of Islamic financial system become ambiguous is because of the inconsistent point of view among different scholars. Based on research of Venardos (2012), there are four common methodologies applied under Islamic financial institutions, which are: *ijtihad* (interpretation by using existing sources), *ikhtiyar* (choice), *darura* (necessity) and *hila* (legal artifice). The application of different methodology will lead to the inconsistent of fiqh rulings.

According to Karbhari, Naser and Shahin (2004), the difference Islamic cultures and societies within different country causing the interpretation of Shariah principles goes inconsistent among each of the Muslim schools. Due to the lack of standardizations, Western regulators hard to understand the pure concept of Islamic financial institutions, lead the development of Islamic financial sector in Western countries become challenging. The inconformity towards the Shariah views and different methodologies make the concept of Islamic financial institutions become unclear. In the study of Tahir (2004), he urged that the standardization of vocabulary of Islamic financing is required especially in the Islamic financial products such as Islamic financing instruments, documentation and the relevant pricing formulas. For example, the deferred payment financing instrument in Islamic banking known as Murabahah. But there are some minority who called it as Al Bai Bithaman Ajil /BBA. It is crucial to standardize the name of the products to avoid confusing. The origin of Islamic banking terms are based on Shariah Law and the translation of Arabic words are sometimes being interpreted inconsistently. As example, the deferred payment financing tools known as Murabahah.

Due to the ambiguous concept for Islamic financial institutions, there are insufficient experienced professional in Islamic finance sector which retard the development of Islamic financial institutions. Research paper of Iqbal, Aḥmad and Khan (1998), stated that there is an extreme insufficient of scholars available, who obtain working experience of both Islamic fiqh and modern economics and finance. In addition, many existing employees under Islamic banking are not been trained well in the use of Islamic financing modes. This leads the development problem of Islamic financial institutions occur.

According to Shaffaii (2008), Malaysia was facing difficulties in finding qualified profession in Islamic finance industry to meet the target to convert 20% of conventional banking sector into Islamic finance in 2010. In 2008, there was only approximately 5% of banking sector had been converted into Islamic finance. There are still approximately 15% gaps in order to achieve the ambitious plan within 2 years. They claimed that the main blockage for the growing of Islamic finance industry is the shortage of qualified employees who are capable to charges for the position. To improve this situation and to boost the development of Islamic banking industry, several academic training are offer in Malaysia such as the training programmes offered by Islamic Banking and Finance Institute Malaysia (IBFIM) - Certified Qualification in Islamic Finance (CQIF), Advanced Qualification in Islamic Finance (AdvQIF), Intermediate Qualification in Islamic Finance (IQIF), Associate Qualification in Islamic Finance (AQIF), Fundamental Certificate in Islamic Banking and Takaful (FCIBT), Islamic Financial Planner (IFP), Basic Certificate Course in Takaful Broking (BCCTB) and Takaful Basic Examination (TBE).

The same situation is found as in Bangladesh where it is very difficult to employ qualified manpower to work under the Islamic financial institutions. This statement is also supported by the research of Karbhari, Naser and Shahin (2004). In their research, they noticed that the main reason for the slow innovation of Islamic financial products is related to the lack of training and professional courses for Islamic banking. The shortage and insufficient learning centre provided results unqualified Islamic banking personnel. Choudhury and Hussain (2005) emphasized that the most effective way to expand Islamic financial institutions is to offer human resources development in Islamic banking. In order to do expand the Islamic finance sectors, the employees of Islamic banks should offer the true quality services to their clients and should not assumed that the customers are willing to deal with Islamic banks just because of their religions holding. In United Arab Emirates, Bley and Kuehn (2004) found that customers of Islamic banking makes their banking decision solely based on the religious consciences, some of them even do not fully understand the Shariah principles. The prior reason for Muslim customers to choose for the Islamic banking services are because of their religion holding instead of the quality services. The research done by Abdullah and Rahman (2007) discovered that 80% of Muslim businessmen in Malaysia prefer using Islamic banking transaction because of the religious reason. There are 58% customers of Islamic banking were truly understand the concept of Islamic banking and they feel that Islamic banking brings proper rights to people.

H3*: Misunderstanding and lack of standardization of Islamic financial concept is the challenge of developing Islamic banking and financial institutions in Malaysia.*

2.1.3 Legal Challenges

According to Iqbal, Aḥmad and Khan (2009), Islamic banking is lack of effective supervisory framework and it is one of the weaknesses of the prevailing system and deserves serious attention. The roles of both the Shariah advisory boards and the Central banks need to be stream lined and strengthened. Islamic banks have devised their own practices and procedures to accomplish their banking activities. However, commercial banking and company laws appropriate for implementation of Islamic banking and financial contracts do not exist. Hence that depend the problem of tax discrimination, Islamic banking contracts are treated as buying and selling properties and hence are taxed twice.

According to Oseni and Ahmad (2015) the legal system in Malaysia has undergone many reforms to make sure there is no dispute. In Malaysia, bank customers will ultimately prefer financial institutions that are consumer friendly, especially when it comes to dispute management. The regulatory authorities , such as Bank Negara Malaysia have the challenges regarding the contract agreement .

The commercial, banking and company laws contain provisions that are narrowly defined and prohibit the scope of Islamic banking activities within conventional limits. It is necessary that special laws for the introduction and practice of Islamic banking be put in place. Governance issues are equally important for Islamic banks, investors, regulators, and other stakeholders. The role of Shariah boards brings unique challenges to the governance of Islamic financial institutions. The legal framework of Islamic banking and finances might include the following:

i. Islamic banking courts

The disputed cases of the Islamic banks are subject to the same legal system and are dealt with the same court and judge as the conventional one while the nature of the legal system of Islam is totally different. To ensure a proper, speedy and supporting Islamic legal system, amendments in existing laws, which are repugnant to injunctions of Islam, are required to promulgate Shariah compliant law for resolution of disputes through special courts. At present, in Malaysia, all the litigation process dealt with Muamalat Bench of the Commercial Division in the High Court of Malaysia. The entire dispute regarding underlying contract will be resolved in the Muamalat Bench. According to Ernst and Young (2013), there have more than 91% of Malaysians are multi banked.

ii. Islamic banking law

In the absence of Islamic banking laws, the enforcement of agreements in courts may require extra costs and effort. Therefore, banking and companies' laws in several countries require suitable modifications to provide a level playing field for Islamic banks. Furthermore, international acceptance of Islamic financial contracts requires them to be Shariah compatible as well as acceptable under the major legal regimes such as Common law and Civil law systems.

iii. Amendment of existing laws

Islamic banking has some laws and regulations that as similar as universal banking, therefore, laws and regulations have to be amended accordingly to accommodate this new concept such as sections 7 (forms of business in which the banking company can engage) and 9 (prohibition of trade) of the Banking Companies Ordinance 1962 while Islamic banks are big or wholesale traders in reality.

iv. Islamic banking balance sheet

Islamic banks do not show out the assets financed through Al-Ijara, Murabah, Wadiah, Istitsna, Salam etc., on balance sheet because section 7 of Banking Ordinance 1962 does not allow a bank to own property or asset which section 9 prohibits to enter into any kind of trade. However, all the assets owned by Islamic banks be mentioned in their balance sheets only.

v. Monthly payment agreement

The housing finance is executed on the basis of Diminishing Musharakah by the Islamic banks. Under this mode the house and property is jointly owned by the bank and the customer. The bank rents out its share to the customer on Ijarah basis concept. The Islamic bank while executing Ijarah with the partner or customer, uses the term 'Monthly Payment Agreement' instead of having the Ijarah agreement with the customer. It is so named as to safeguard the bank's interest in case of refusal by the customer to pay rentals. There is no legal cover is provided to the Islamic banks to overcome the risk.

vi. PLS deposits

Deposits in Islamic banks are usually based on principle of profit and loss (Musharakah or Murabahah). The concept of profit-and-loss sharing in an enterprise, as a basis of financial transactions is a progressive one as it distinguishes good performance from the bad and the mediocre. If something happens and the bank suffers loss it has to be transferred to the depositor directly. This loss is the biggest barrier to deposit mobilization in Islamic banks. In some case, it leads to withdrawal of funds. The depositors should be provided withsome kind of protection.

***H4**: Legal system is the challenge of developing Islamic banking and financial institutions in Malaysia.*

3.0 Research Methodology

3.1 Research Design

The independent variables used in this study are specific the four main challenges of developing Islamic banking and financial institutions in Malaysia. Dependent variables are the opportunities in Malaysia for development and growth of Islamic banking and financial institutions. This study will be conducted using quantitative research approach. The primary data is based on respondent of our self-administered questionnaires collected. The unit of analysis will be Islamic banking authority employees in Malaysia. The time horizon of this study is cross-sectional study as the data will be collected at a single moment in time. Furthermore, the secondary data will based on others related literature materials such as electronic journal and articles.

3.2 Research Location

The research location has conducted within the seven main Islamic banks which are Maybank Islamic Bank, CIMB Islamic Bank, OCBC Al-Almin, HSBC Amanah, RHB Islamic, Public Islamic Bank and Hong Leong Islamic Bank. Those Islamic banks have been selected as the reason that it is the strategically location in Kuala Lumpur and are the representatives of Islamic Banking

industry. Besides that, the location of these Islamic banks is nearby, it will be convenient and easy to distribute questionnaires and collect from the target sample. The questionnaires will be distributed to the banking authorities within the seven main Islamic banks.

3.3 Population, Sample Size, and Sampling Method

3.3.1 Target population and the sample size

The target population of this study is the banking authorities of Islamic bank in Malaysia in the assortment of age among 21 to above 50 years, staying or living in Malaysia. Because of the limited time and source, researchers are only able to choose total number of 100 sample size respondent over seven Islamic banking to answer the hardcopy questionnaires for research and analysis. A preliminary prescreening had conducted orally to ensure that respondents in questionnaire research are currently agreed the four main challenges of developing Islamic banking and financial institutions in Malaysia. A 95% of confidence level and 5% margin of error will be required in this study.

3.3.2 Sampling method

This study will employ convenience sampling method which is one of the non-probability sampling methods which is convenient, quick and less expensive. The most common types of non- probability sample which is called a convenience sample had been approached. Not because of such samples are essentially easy to recruit, it is because researchers are able to use whatsoever persons are accessible instead of choosing from the whole population. Those respondents in our research are those who are banking authorities and they are willing to give cooperative.

3.4 Variable Measurement

The questionnaires will be used in this final year project is primary data, with the intention to figure out the challenges, opportunities and also the development of Islamic bank and financial institutions in Malaysia.

The questionnaire is divided into three sections. Section A collects the basic demographic information of the respondents. Section B is about the independent variables which are the four main challenges of developing Islamic banking and financial institutions in Malaysia: Limited Market-Based Financial Intermediations and Products, Limited Risk Management Functionality, Misunderstanding and Lack of Standardization of Islamic Financial Concept and Legal Challenges. Section C is about the dependent variables which are the opportunities of Islamic banking and financial institutions in Malaysia.

The section B and section C closed question, using the 5 point Likert scale. The respondents will be asked to circle the number that represents how strongly they agree or disagree with the statement, from the range strongly disagree (1), disagree (2), neutral (3), agree (4) and strongly agree (5).

Table 3.1: The Usefulness of Each Part of Questionnaire

Content	**Usefulness**	**Items**
Section A: General and demographic information about respondents (banking authorities).	To understand the background of the respondents.	Gender, Age, Education Qualification, Profession Level and Religion.
Section B: Measurement of challenges of developing Islamic banking and financial institutions in Malaysia.	To measure the level of challenges of developing Islamic banking and financial institutions in Malaysia.	Total of 20 questions Question 1 to question 20 Divided into 4 part (4 IV) 5-point Likert scale
Section C: Measurement of opportunities of Islamic banking and financial institutions in Malaysia.	To define and measure the level of opportunities of Islamic banking and financial institutions in Malaysia.	Total of 5 questions Question 1 to question 5 Divided into 1 part (1 DV) 5-point Likert scale

3.5 Data collection

The questionnaires will be distributed to Islamic banking authorities under Maybank Islamic Bank, CIMB Islamic Bank, OCBC Al-Almin, HSBC Amanah, RHB Islamic, Public Islamic Bank and Hong Leong Islamic Bank in Kuala Lumpur. The data collection process will be taken place by distributing questionnaires to Islamic banking employees. Total target respondents are 100 peoples.

For each bank, researchers will take the service number in service counter and wait for our turn to be called. When it reaches our turn, researchers will approach banking employees and explain the purpose of our research. Researchers will request customer service employees to help us to distribute questionnaires to the internal management employees. To make sure the data collection process goes smooth, respondents are given sufficient time to answer the questionnaire. Researchers will wait in the seating area until the questionnaires are completed by respondents. Computing process is conducting after researchers gathered back the filled questionnaires to make sure the amount of questionnaire researchers collected is accurate.

3.6 Data Analysis Method

The IBM SPSS software is used to conduct data analysis. Data analysis involves the process of data entries, coding, checking and handling missing data, normality test, hypothesis testing and others. Reliability test is conducted to ensure that the measuring test is consistent in order to produce an accurate result. To test for hypothesis, T-test and probability value are used to test the hypothesis. Demographic information of each respondent will be presented using percentage and frequency. Lastly, the dependent variable and entire independent variable which is limited market-based financial intermediations and products, limited risk management functionality, misunderstanding and lack of standardization of Islamic financial concept and legal challenges will be used to identify whether each of the independent variable is affecting the dependent variable. The table over leaf will show the method that used to test the hypotheses.

Hypothesis	Data Analysis
H1: Limited market-based financial intermediations and products is the challenge of developing Islamic banking and financial institutions in Malaysia.	T-test and probability test
H2: Limited risk management functionality is the challenge of developing Islamic banking and financial institutions in Malaysia.	T-test and probability test
H3: Misunderstanding and lack of standardization of Islamic financial concept is the challenge of developing Islamic banking and financial institutions in Malaysia.	T-test and probability test
H4: Legal system is the challenge of developing Islamic banking and financial institutions in Malaysia.	T-test and probability test

3.6.1 Descriptive Analysis

Descriptive statistics analysis such as frequency, percentage, mean and standard deviation were used to calculate the background of respondents. Descriptive analysis is used to explain and describe the data that collect from respondents under the descriptive statistic. In our study, researchers will use descriptive statistics to understand more about the relationship between the challenges and opportunities of Islamic banking and financial institutions.

3.6.2 Reliability Test

Cronbach's Alpha will be using to measure the reliability coefficient in IBM SPSS software. The Cronbach's Alpha testing was used by way of the most well accepted reliability test tools practical by social researcher. According to Sekaran and Bougie (2010),a questionnaire consider attain a high level of reliability when the value of Cronbach's Alpha exceed 0.70. The closer the Cronbach's Alpha value is to 1.0, the higher the internal consistency reliability of the questionnaire.

Cronbach's Alpha measures as below:

1. Reliability less than <0.6 considered poor.
2. Reliability in the range 0.7 is considered to be acceptable.
3. Reliability more than >0.8 are considered to be good

3.6.3 T-Test

Researchers apply T-test to test for the hypothesis (relationship between independent variables and dependent variable). Researchers apply Correlation analysis to measure the strength of the association (linear relationship) between two variables, where the correlation is only concerned with strength of the relationship and no causal effect is implied with correlation. If the result t-stat > t-significant, H1, H2, H3 and H4 will be accepted, and hence there is a sufficient evidence to show that linear relationship exists between IVs (Limited Market-Based Financial Intermediations and Products, Concentrated banking: Limited risk management functionality, Misunderstanding and Lack of Standardization of Islamic Financial Concept and Legal challenges) and DV (Opportunities of Islamic Banking and Financial Institutions in Malaysia).

Contrary, H1, H2, H3 and H4 will be rejected if the result t-stat < t-significant. This indicates there is no sufficient evidence to show that linear relationship exists between IVs (Limited Market- Based Financial Intermediations and Products, Concentrated banking: Limited risk management functionality, Misunderstanding and Lack of Standardization of Islamic Financial Concept and Legal challenges) and DV (Opportunities of Islamic Banking and Financial Institutions in Malaysia).

3.6.4 Probability Value

Probability value method determines the probability with the assumption that the null hypothesis was correct in observing a more extreme test statistic in the direction of the alternative hypothesis than the one observed. The significance level used in this study is 5% ($p < 0.05$). If the independent variables have significance value of less than 5%, it indicates a significant relationship exist between independent variables and dependent variable. Otherwise, significant relationship does not exist if the significance value is more than 5%.

3.6.5 R-Square

According to *Basic business statistics, 2006 Prentice Hall, Inc*, R-square defines as coefficient of determination. The coefficient of determination is the portion of the total variation in the dependent variable that is explained by variation in the independent variable. Where r2 must in between 0 to 1

4.0 Result Analysis And Discussion

Total of 100 Islamic banking employees from Maybank Islamic Bank, CIMB Islamic Bank, OCBC Al-Almin, HSBC Amanah, RHB Islamic, Public Islamic Bank and Hong Leong Islamic Bank had contributed to this questionnaire survey.

Statistical Package for the Social Sciences (SPSS) was used to analyze the data that were obtained from questionnaire. The results show the analysis of the data analyzed method applied which includes Reliability Test, Hypothesis Testing (T-Test and Probability Value), R-square, intercept and slope coefficient.

4.1 Demographic Profile of Respondents

The demographic information includes the following characteristics: gender, age, level of education, profession level and religion.

Table 4.1 Summary of Demographic Profile of Respondents

	No. of respondents	% of respondents
Gender		
Male	44	44
Female	56	56
Total	100	100
Age		
21-30 Years Old	63	63
31-40 Years Old	26	26
41-50 Years Old	8	8
Above 50 Years Old	3	3
Total	100	100
Education qualification		
Secondary	9	9
Bachelor	85	85
Master	6	6
Total	100	100
Profession Level		
Lower level management	3	3
Middle level management	94	94

Top level management	3	3
Total	100	100
Religion		
Islam	57	57
Non Islam	43	43
Total	100	100

From the 100 respondents in this study, 56 out of 100 (56%) of respondents are female and the remaining 44 respondents (44%) are male. Majority of the employees in Islamic banking and financial institutions are aged between 21-30 years old (63%), following by the range 31-40 years old (26%) and 41-50 years (8%). Those respondents above 50 years old are the least percentage among all, only occupied 3% compare to other age range.

Moreover, among the 100 respondents, 85 (85%) of the respondents are Bachelor, following by 9 (9%) of them are from secondary, while the least 6 (6%) are respondents with master qualification. On the other hand, through the distribution of the questionnaire, most of our respondents are from middle level management (94 respondents, 94%), while the lower level management and top level management are only 3 (3%) each. Last for the religion, there are 57 respondents (57%) from Islam and the remaining 43 (43%) are non-Muslim.

4.0 Pilot Test

As mentioned earlier, researchers distributed 5 set of questionnaires for pilot testing purpose. Researchers distributed the questionnaires to Maybank Islamic Bank before conduct the real questionnaires. Researchers applied some feedbacks from respondents to enhance our questionnaire quality. Researcher conduct reliability test after the questionnaires were gathered.

Table 4.2: Reliability Statistics (by SPSS)

Reliability Statistics

Cronbach's Alpha	N of Items
.897	5

Reliability test is use to test for the consistency of our survey. It assesses the degree to which our questionnaire is able to produce stable and consistent results. The result of reliability test under pilot testing is 89.7%. It means that the variables items in the questionnaire that use to test the items have proven the significant relationship towards this research objective.

4.1 Reliability Test

Table 4.3: Reliability Statistics (by SPSS)

Reliability Statistics

Cronbach's Alpha	N of Items
.943	5

From Table 4.3, it shows that the result of reliability for the actual questionnaire is 94.3%, which means the variables items in the questionnaire that use to test the items have proven the significant relationship towards this research objective.

4.2 T-test

T-test is use to test the relationship between independent variable and dependent variable. Firstly, researchers' key in the data collected from questionnaire into SPSS system and the result of relationship between each independent variable and dependent variable will shown. After that, researchers applied T- test to determine the linear relationship at 5% significance level. A 5% of significant level indicates that there will be a risk of 5% difference when the test was conducted accurately with no actual difference.

If the result of t-st at > t-significant, then our hypothesis will be accepted. It means that there is a significant relationship between independent variable and dependent variable. Otherwise, hypothesis will be rejected if t-stat < t-significant. It indicates that there is no significant relationship exists between independent variable and dependent variable.

4.2.1 Limited Market-Based Financial Intermediations and Products

Table 4.4: T-test result for Limited Market-Based Financial Intermediations and Products (by SPSS)

Paired Samples Test

	Paired Differences					t	df	Sig. (2-tailed)
	Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference Lower	Upper			
Pair 1 Mean IV 1 - Mean DV 5	.2380	1.2297	.1230	-.0060	.4820	1.935	99	.056

From Table 4.4, the result of T-test (t-stat 1.935> t-significant 0.056) indicates a significant relationship exist between limited market-based financial intermediations and products and challenges of Islamic banking and financial institutions in Malaysia. Therefore, hypothesis H1 is accepted.

4.2.2 Concentrated Banking: Limited Risk Management Functionality

Table 4.5: T-test result for Concentrated Banking: Limited Risk Management Functionality (by SPSS)

Paired Samples Test

	Paired Differences					t	df	Sig. (2-tailed)
	Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference Lower	Upper			
Pair 1 Mean IV 2 - Mean DV 5	.1600	1.2518	.1252	-.0884	.4084	1.278	99	.204

For IV2, the result shows t-stat 1.278> t-significant 0.204, which means a significant relationship exist between concentrated banking: limited risk management functionality and challenges of Islamic banking and financial institutions in Malaysia. Therefore, hypothesis H2 is accepted.

4.2.3 Misunderstanding and Lack of Standardization of Islamic Financial Concept

Table 4.6: T-test result for Misunderstanding and Lack of Standardization of Islamic Financial Concept (by SPSS)

Paired Samples Test

	Paired Differences					t	df	Sig. (2-tailed)
	Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference Lower	Upper			
Pair 1 Mean IV 3 - Mean DV 5	.1310	1.2613	.1261	-.1193	.3813	1.039	99	.302

Table 4.6 shows the result of T-test (t-stat 1.039> t-significant 0.302). It represents the existence of significant relationship between misunderstanding and lack of standardization of Islamic financial concept and challenges of Islamic banking and financial institutions in Malaysia. Therefore, hypothesis H3 is accepted.

4.2.4 Legal Challenges

Table 4.7: T-test result for Legal Challenges (by SPSS)

Paired Samples Test

		Paired Differences					t	df	Sig. (2-tailed)
					95% Confidence Interval of the Difference				
		Mean	Std. Deviation	Std. Error Mean	Lower	Upper			
Pair 1	Mean IV 4 - Mean DV 5	.1640	1.3033	.1303	-.0946	.4226	1.258	99	.211

For IV4, the result shows t-stat 1.258> t-significant 0.211. There is a significant relationship between legal challenges and challenges of Islamic banking and financial institutions in Malaysia. Hence, hypothesis H4 is accepted.

4.3 Probability value (p-Value)

Probability value method determines the probability with the assumption that the null hypothesis was correct in observing a more extreme test statistic in the direction of the alternative hypothesis than the one observed. The significance level used in this study is 5% ($p < 0.05$). If the independent variables have significance value of less than 5%, it indicates a significant relationship exist between independent variables and dependent variable. Otherwise, significant relationship does not exist if the significance value is more than 5%.

4.3.1 Limited Market-Based Financial Intermediations and Products

Table 4.8: p-Value result for Limited Market-Based Financial Intermediations and Products (by SPSS)

Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B	
	B	Std. Error	Beta			Lower Bound	Upper Bound
1(Constant)	1.483	.323		4.593	.000	.842	2.123
Mean IV 1	.458	.096	.435	4.784	.000	.268	.649

a. Dependent Variable: Mean DV 5

The result shows a p-value of 0.000. Since it is less than 0.05, it shows a significant relationship exist between limited market-based financial intermediations and products and challenges of Islamic banking and financial institutions in Malaysia. Therefore, hypothesis H1 is accepted.

4.3.2 Concentrated Banking: Limited Risk Management Functionality

Table 4.9: p-Value result for Concentrated Banking: Limited Risk Management Functionality (by SPSS)

Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B	
	B	Std. Error	Beta			Lower Bound	Upper Bound
1 (Constant)	1.579	.311	.424	5.045	.000	.958	2.200
Mean IV 2	.439	.095		4.629	.000	.251	.627

a. Dependent Variable: Mean DV 5

The result under Table 4.9 shows a p-value of 0.000. Since it is less than 0.05, it indicates a significant relationship between concentrated banking: limited risk management functionality and challenges of Islamic banking and financial institutions in Malaysia. Therefore, hypothesis H2 is accepted.

4.3.3 Misunderstanding and Lack of Standardization of Islamic Financial Concept

Table 4.10: p-Value result for Misunderstanding and Lack of Standardization of Islamic Financial Concept (by SPSS)

Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B	
	B	Std. Error	Beta			Lower Bound	Upper Bound
(Constant)	1.606	.302		5.350	.000	1.010	2.202
Mean IV 3	.434	.091	.433	4.754	.000	.253	.615

a. Dependent Variable: Mean DV 5

The result shows a p-value of 0.000. Since it is less than 0.05, there is a significant relationship exist between misunderstanding and lack of standardization of Islamic financial concept and challenges of Islamic banking and financial institutions in Malaysia. Therefore, hypothesis H3 is accepted.

4.3.4 Legal Challenges

Table 4.11: p-Value result for Legal Challenges (by SPSS)

Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B	
	B	Std. Error	Beta			Lower Bound	Upper Bound
(Constant)	1.657	.277		5.981	.000	1.107	2.207
Mean IV 4	.413	.082	.452	5.013	.000	.250	.577

a. Dependent Variable: Mean DV 5

The result under Table 4.11 shows a p-value of 0.000. Since it is less than 0.05, it indicates a significant relationship between legal challenges and challenges of Islamic banking and financial institutions in Malaysia. Hence, hypothesis H4 is accepted.

4.4 R-square test

4.4.1 Limited Market-Based Financial Intermediations and Products

Table 4.12: R 2 result for Limited Market-Based Financial Intermediations and Products (by SPSS)

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.435[a]	.189	.181	1.0733	.189	22.884	1	98	.000

a. Predictors: (Constant), Mean IV 1

R-square 0.189 indicates 18.9% of variation in the challenges of Islamic banking and financial institutions in Malaysia can be explained by variation in limited market-based financial intermediations and products.

4.4.2 Concentrated Banking: Limited Risk Management Functionality

Table 4.13: R 2 result for Concentrated banking: Limited risk management functionality (by SPSS)

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.424[a]	.179	.171	1.0799	.179	21.424	1	98	.000

a. Predictors: (Constant), Mean IV 2

R-square 0.179 indicates 17.9% of variation in the challenges of Islamic banking and financial institutions in Malaysia can be explained by variation in concentrated banking: limited risk management functionality.

4.4.3 Misunderstanding and Lack of Standardization of Islamic Financial Concept

Table 4.14: R 2 result for Misunderstanding and Lack of Standardization of Islamic Financial Concept (by SPSS)

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.433[a]	.187	.179	1.0746	.187	22.604	1	98	.000

a. Predictors: (Constant), Mean IV 3

From Table 4.14, R-square of 0.187 indicates 18.7% of variation in the challenges of Islamic banking and financial institutions in Malaysia can be explained by variation in misunderstanding and lack of standardization of Islamic financial concept.

4.4.4 Legal Challenges

Table 4.15: R 2 result for: Legal Challenges (by SPSS)

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.452[a]	.204	.196	1.0635	.204	25.128	1	98	.000

a. Predictors: (Constant), Mean IV 4

Table 4.15 shows R-square of 0.204. It indicates 20.4% of variation in the challenges of Islamic banking and financial institutions in Malaysia can be explained by variation in legal challenges.

4.5 Interpretation of Beta

Linear equation formula: $Y = a + bX$

Where Y = value of the Dependent variable, X= value of Independent variables,
a= intercept,
b= beta coefficient of X /the slope of the regression line.

Beta defines how much does Y changes for each of the one-unit of X changes.

4.5.1 Limited Market-Based Financial Intermediations and Products

Table 4.16: Co-efficient result for Limited Market-Based Financial Intermediations and Products (by SPSS)

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B		Correlations			Collinearity Statistics	
		B	Std. Error	Beta			Lower Bound	Upper Bound	Zero-order	Partial	Part	Tolerance	VIF
1	(Constant)	1.483	.323		4.593	.000	.842	2.123					
	Mean IV 1	.458	.096	.435	4.784	.000	.268	.649	.435	.435	.435	1.000	1.000

a. Dependent Variable: Mean DV 5

Equation $\hat{y} = 1.483 + 0.458$ x. For each 1 unit changes in limited market-based financial intermediations and products, the challenges of Islamic banking and financial institutions in Malaysia changes 0.458 units.

4.5.2 Concentrated Banking: Limited Risk Management Functionality

Table 4.17: Co-efficient result for Concentrated Banking: Limited Risk Management Functionality (by SPSS)

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B		Correlations			Collinearity Statistics	
		B	Std. Error	Beta			Lower Bound	Upper Bound	Zero-order	Partial	Part	Tolerance	VIF
1	(Constant)	1.579	.313		5.045	.000	.958	2.200					
	Mean IV 2	.439	.095	.424	4.629	.000	.251	.627	.424	.424	.424	1.000	1.000

a. Dependent Variable: Mean DV 5

Equation ŷ = 1.579 + 0.439 x. For each 1 unit changes in concentrated banking- limited risk management functionality, the challenges of Islamic banking and financial institutions in Malaysia will changes 0.439 units.

4.5.3 Misunderstanding and Lack of Standardization of Islamic Financial Concept

Table 4.18: Co-efficient result for Misunderstanding and Lack of Standardization of Islamic Financial Concept (by SPSS*)*

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B		Correlations			Collinearity Statistics	
		B	Std. Error	Beta			Lower Bound	Upper Bound	Zero-order	Partial	Part	Tolerance	VIF
1	(Constant)	1.606	.300		5.350	.000	1.010	2.202					
	Mean IV 3	.434	.091	.433	4.754	.000	.253	.615	.433	.433	.433	1.000	1.000

a. Dependent Variable: Mean DV 5

Equation ŷ = 1.606 + 0.434 x. For each 1 unit changes in misunderstanding and lack of standardization of Islamic financial concept, the challenges of Islamic banking and financial institutions in Malaysia changes 0.434 units.

4.5.4 Legal Challenges

Table 4.19: Co-efficient result for Legal Challenges (by SPSS)

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B		Correlations			Collinearity Statistics	
		B	Std. Error	Beta			Lower Bound	Upper Bound	Zero-order	Partial	Part	Tolerance	VIF
1	(Constant)	1.657	.277		5.981	.000	1.107	2.207					
	Mean IV 4	.413	.082	.452	5.013	.000	.250	.577	.452	.452	.452	1.000	1.000

a. Dependent Variable: Mean DV 5

Equation ŷ = 1.657 + 0.413 x. For each 1 unit changes in legal challenges, the challenges of Islamic banking and financial institutions in Malaysia changes 0.413 units.

4.6 Description of Independent Variables (IVs)

4.6.1 Limited Market-Based Financial Intermediations and Products

Table 4.20: Frequency result for Limited Market-Based Financial Intermediations and Products

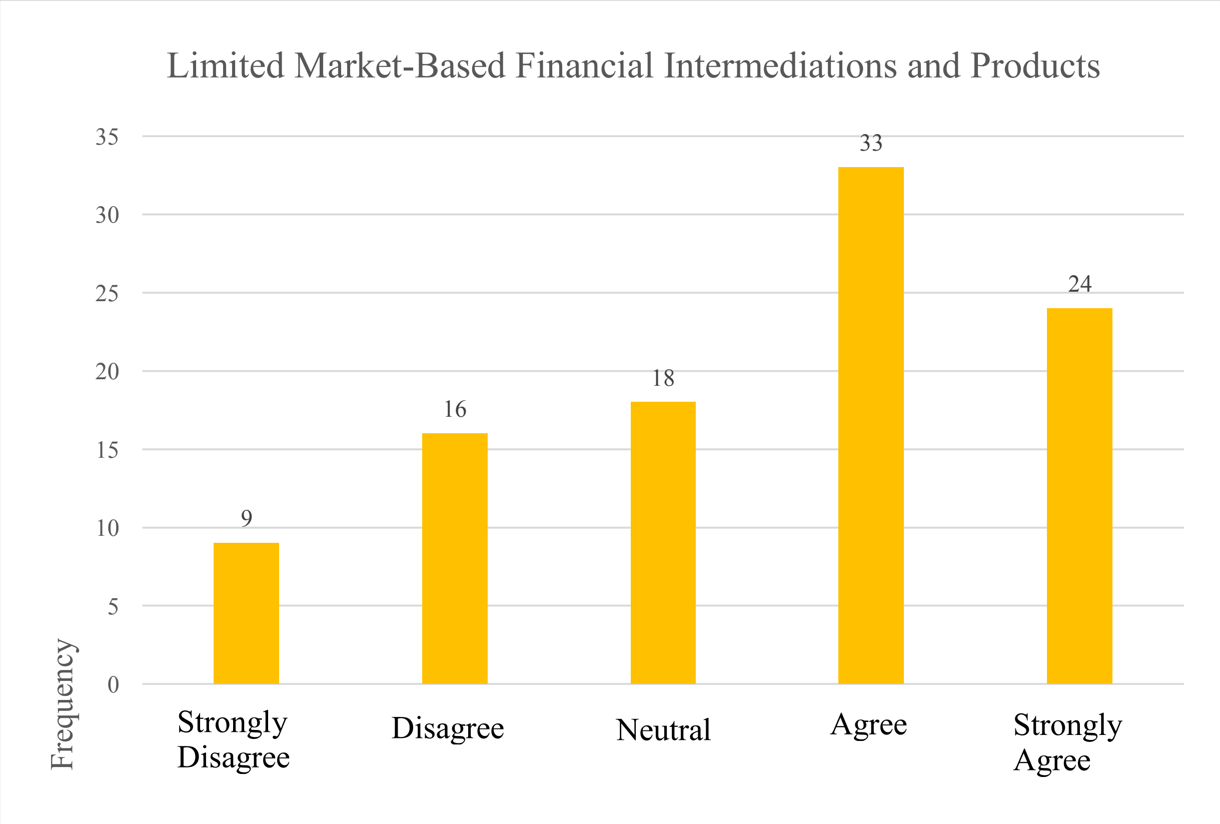
Limited Market-Based Financial Intermediations and Products	**Strongly Disagree**		**Disagree**		**Neutral**		**Agree**		**Strongly Agree**		**Total**
	(N)	**(%)**	**(N)**	**(%)**	**(N)**	**(%)**	**(N)**	**(%)**	**(N)**	**(%)**	

1. There are no much choices on Islamic banking products compare to Conventional banks.	11	11	20	20	6	6	39	39	24	24	100
2. Islamic banking exposes themselves to liquidity problem due to the lack of developed money market and the shortage of short term investment securities.	20	20	19	19	15	15	26	26	20	20	100
3. There is incompleteness of traditional financial instruments in Islamic banking.	39	39	16	16	1	1	16	16	28	28	100
4. The major difficulty to develop Islamic banking is because of the limited financial instruments.	30	30	28	28	3	3	15	15	24	24	100
5. Creation of a larger size of local Islamic liquidity market become challenging due to the smaller economies of scale compared to conventional banking industry.	9	9	12	12	10	10	36	36	33	33	100

There are 69 respondents (69%) claimed that the "creation of a larger size of local Islamic liquidity market become challenging due to the smaller economies of scale compared to conventional banking industry." This statement supported the research done by Mokhtar , Abdullah and Al- Habshi (2006). The research mentioned that the development of Islamic banking and financial institutions is challenging because their size is smaller than conventional banks, which lead to an ineffective economies of scale. A company achieves economies of scale when it is able to expand its operation with cost reducing. However, Islamic banking and financial institutions facing inefficient economies of scale because they are unable to spread the cost due to their limited operation size than conventional bank.

However, 58 respondents (58%) disagree that "the major difficulty to develop Islamic banking is because of the limited financial instruments." They think the major obstacle in the development of Islamic banking is because Islamic banking and financial institutions are smaller in size than conventional banks which lead to inefficient of economies of scale.

Diagram 4.1: Frequency graph for "Limited Market-Based Financial Intermediations and Products is one of the challenges of developing Islamic banking and financial institutions in Malaysia."



From Diagram 4.1, it showed that most of the respondents agree “Limited Market-Based inancial Intermediations and Products” is one of the challenges of developing Islamic banking and financial institutions in Malaysia.”

4.6.2 Concentrated Banking: Limited Risk Management Functionality

Table 4.21: Frequency result for Concentrated banking: Limited risk management functionality

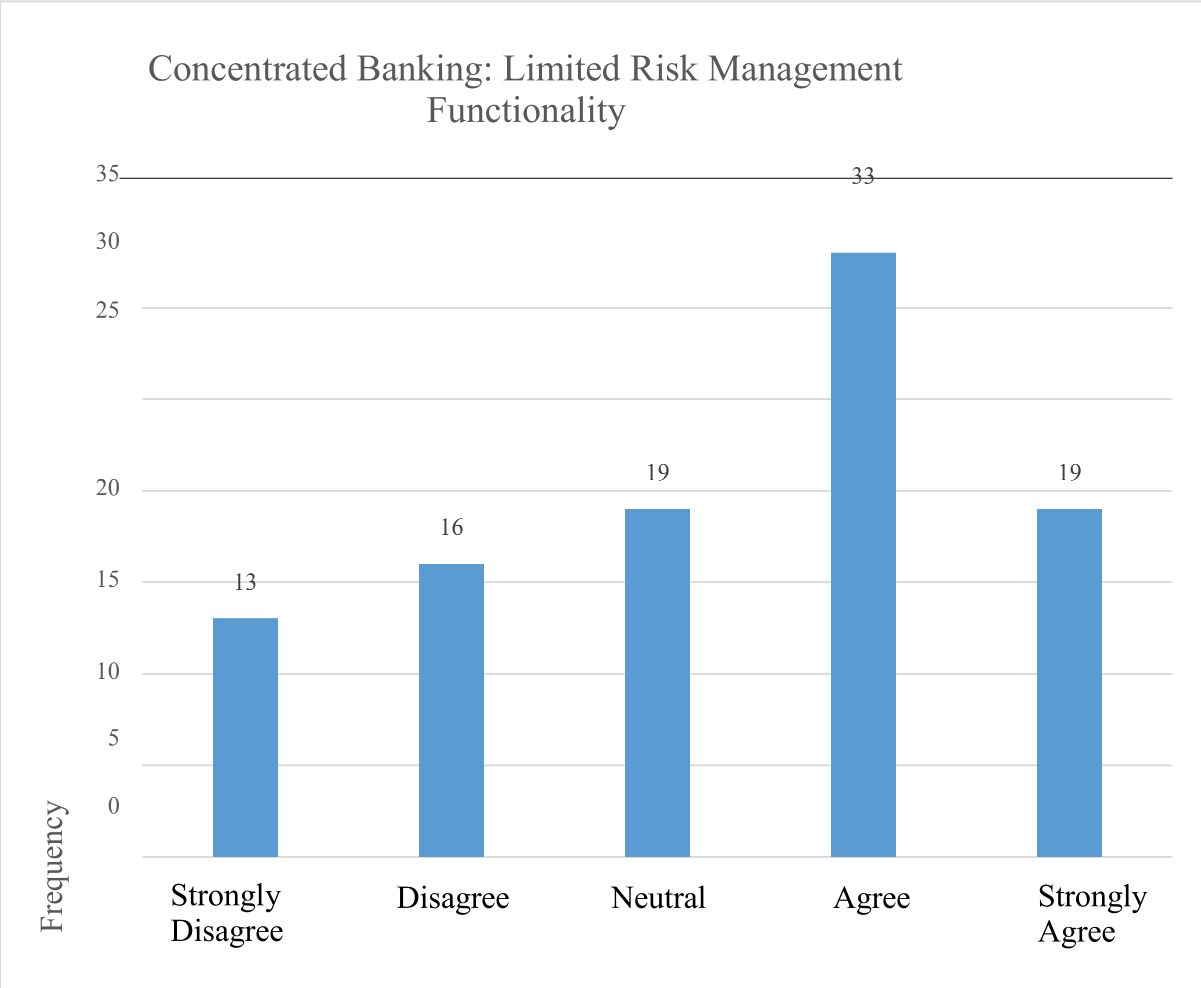
Concentrated banking: Limited risk management functionality	**Strongly Disagree**		**Disagree**		**Neutral**		**Agree**		**Strongly Agree**		**Total**
	(N)	**(%)**	**(N)**	**(%)**	**(N)**	**(%)**	**(N)**	**(%)**	**(N)**	**(%)**	
1. Islamic banking makes functionality of risk transfer very limited, because of the no organized markets for offloading risks to achieve diversification.	1	1	17	17	9	9	52	52	21	21	100
2. Islamic bank has lack of policy of diversifying investment across different sectors.	0	0	37	37	10	10	38	38	15	15	100

3. Concentration in the base of deposits reflects a lack of diversification, which increases their exposure to risk.	17	17	12	12	18	18	16	16	37	37	100
4. High concentration of Islamic banking and financial institutions are risky for investors.	4	4	10	10	9	9	55	55	22	22	100
5. High concentration of Islamic banking and financial institutions will lead to low levels of competition and high prices.	11	11	31	31	6	6	25	25	27	27	100

77% of respondents admit that high concentration of Islamic banking and financial institutions are more risky for investors. Here to prove that Greuning and Iqbal(2008), Islamic banks often concentrate on a few selected sectors and avoid direct competition as one Islamic bank may focus on Information Technology sector in financing, while another Islamic bank might do the same financing in the agricultural sector, and neither attempts to diversify to other sectors. This practice makes functionality of risk transfer is very limited, because of the no organized markets for offloading risks to achieve diversification. Researchers argues that concentrated banking will leads to various pathological situations: mechanism of interest rate, abuse of the credit system and derivative market.

Contrary, there are 42 respondents (42%) disagree that the "High concentration of Islamic banking and financial institutions will lead to low levels of competition and high prices." They disagree that this is one of the disadvantages of Islamic banking and financial institutions.

Diagram 4.2: Frequency graph for "Concentrated Banking: Limited Risk Management Functionality is one of the challenges of developing Islamic banking and financial institutions in Malaysia."



From Diagram 4.2, most of the respondents stated that "Concentrated Banking: Limited Risk Management Functionality is one of the challenges of developing Islamic banking and financial institutions in Malaysia."

4.6.3 Misunderstanding and Lack of Standardization of Islamic Financial Concept

Table 4.22: Frequency result for Misunderstanding and Lack of Standardization of Islamic Financial Concept

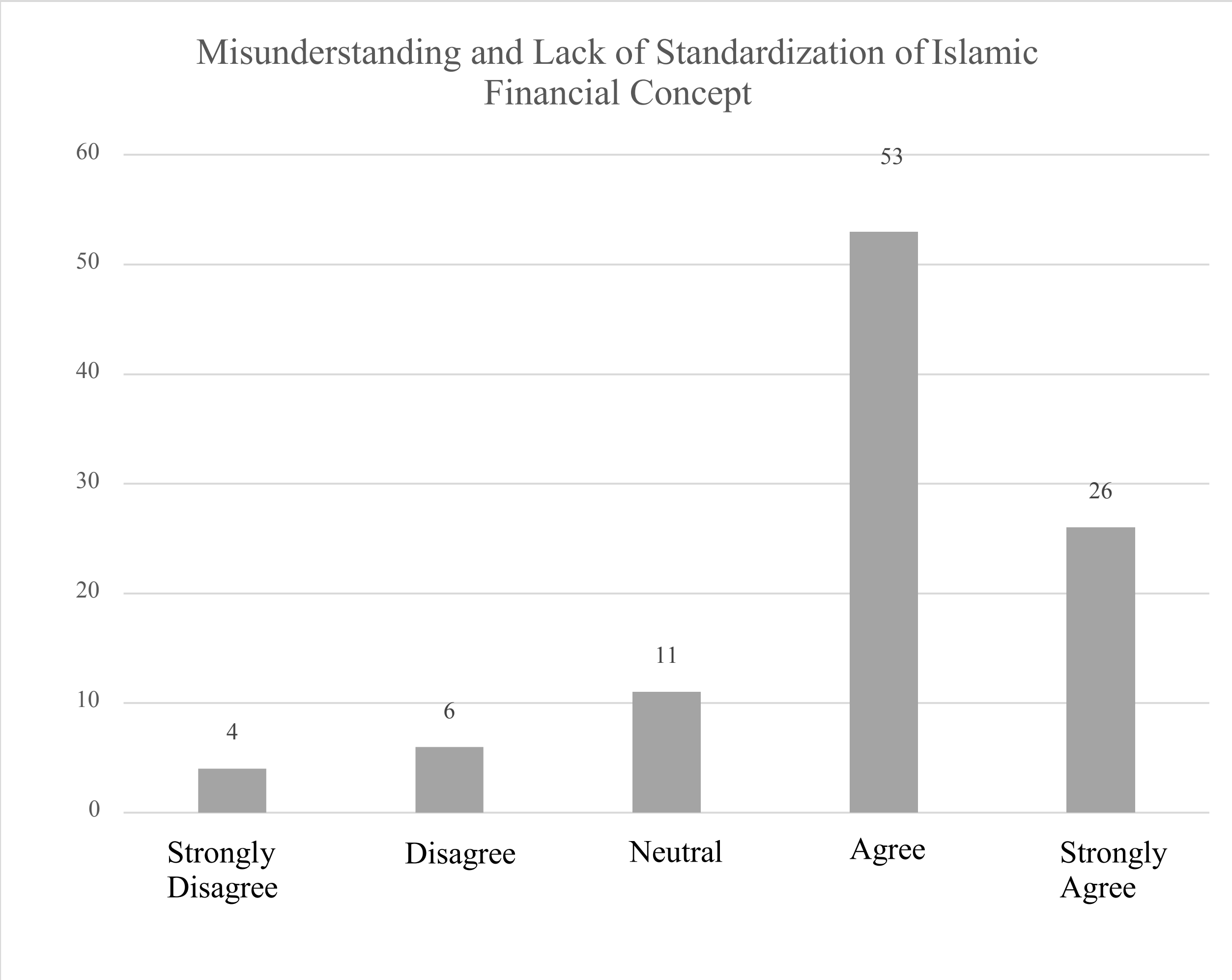
Misunderstanding and Lack of Standardization of Islamic Financial Concept	**Strongly Disagree**		**Disagree**		**Neutral**		**Agree**		**Strongly Agree**		**Total**
	(N)	**(%)**	**(N)**	**(%)**	**(N)**	**(%)**	**(N)**	**(%)**	**(N)**	**(%)**	
1. I have a clearly idea on how Islamic banking product works.	8	8	7	7	7	7	33	33	45	45	100

2. I understand the reason why interest is prohibited in Islamic banking and what are its affects on society and economy.	0	0	4	4	6	6	38	38	52	52	100
3. I think that Malaysian is still lack of knowledge on Islamic banking and financial institution.	5	5	6	6	12	12	48	48	29	29	100
4. Public educations and campaigns are still not effective to spread the awareness of Islamic financial industries to Malaysian.	2	2	5	5	8	8	57	57	28	28	100
5. Malaysia is facing difficulties in develop Islamic banking because the awareness of Islamic financial industries of public is still weak.	5	5	8	8	4	4	47	47	36	36	100

Most of the respondents (90%) understand the reason why interest rate is prohibited in Islamic banking and they know the harmful impacts of interest rate to the society and economy. This statement is supported by the research done by Abdullah and Abdul Rahman (2007). Under their research, they found that 58% of customers under Islamic banking were truly understand the concept of Islamic banking and they feel that Islamic banking brings proper rights to people.

However, there are only 7 respondents (7%) disagree that “the public educations and campaigns are still not effective to spread the awareness of Islamic financial industries to Malaysian.” They think that the development of Islamic banking and financial institutions in Malaysia facing challenges is not because of the ineffective of public educations and campaigns.

Diagram 4.3: Frequency graph for “Misunderstanding and Lack of Standardization of Islamic Financial Concept is one of the challenges of developing Islamic banking and financial institutions in Malaysia.”



From Diagram 4.3, “Misunderstanding and Lack of Standardization of Islamic Financial Concept is one of the challenges the respondents think that it affects the development of Islamic banking and financial institutions in Malaysia.”

4.6.4 Legal Challenges

Table 4.23: Frequency result for Legal challenges

Legal challenges	**Strongly Disagree**		**Disagree**		**Neutral**		**Agree**		**Strongly Agree**		**Total**
	(N)	**(%)**	**(N)**	**(%)**	**(N)**	**(%)**	**(N)**	**(%)**	**(N)**	**(%)**	
1. Islamic bank do not invest in industries with products and services involved (Alcohol, Pork and Gambling).	0	0	0	0	5	5	41	41	54	54	100

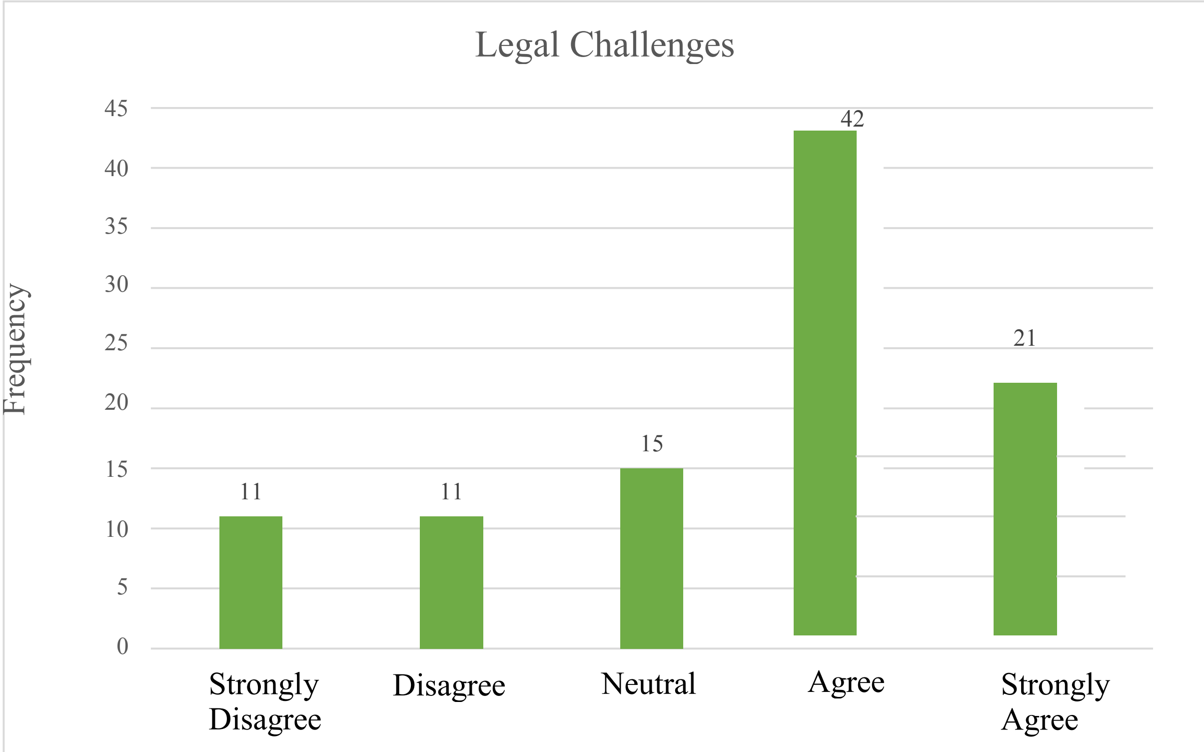
2. Islamic banking is lack of effective supervisory framework and it is one of the weaknesses of the prevailing system and deserves serious attention.	25	25	4	4	4	4	29	29	38	38	100
3. Lack of effective prudential regulation is one of the weaknesses of the Islamic banking industry in Malaysia.	9	9	2	2	11	11	36	36	42	42	100
4. Islamic banks have devised their own practices and procedures to accomplish their banking activities.	30	30	0	0	23	23	30	30	17	17	100
5. The role of Shariah boards bring unique challenges to the governance of Islamic financial institutions.	15	15	0	0	15	15	50	50	20	20	100

There are 78 of respondents (78%) agree that lack of effective prudential regulation is one of the weakness of the Islamic banking industry in Malaysia. This showed that Islamic banking and institution suffer from the lack of institutional support from specifically geared to their needs. Here to prove that Iqbal, Ahmad, and Khan (2009) stated that the Islamic banking is lack of effective supervisory framework and it is one of the weaknesses of the prevailing system and deserves serious attention.

In addition, there is almost all (95%) respondents agreed that “Islamic bank do not invest in industries with products and services involved (Alcohol, Pork and Gambling).” This is consistent with the principles of Islamic law and practical application through the development of Islamic economics. However, a more correct term for Islamic banking is based on Shariah compliant finance.

The data showed there are 30 respondents (30%) disagree that “Islamic banks have devised their own practices and procedures to accomplish their banking activities.”, therefore here is one of the challenges for Islamic banking because the respondents feel that Islamic banks do not have their own practices and procedures.

Diagram 4.4: Frequency graph for “Legal Challengesis one of the challenges of developing Islamic banking and financial institutions in Malaysia.



From Diagram 4.4, majority of respondents agreed with the variable that"Legal Challenges is one of the challenges of developing Islamic banking and financial institutions in Malaysia".

4.7 Description of Dependent Variable (DV)

4.7.1 Opportunities of Islamic Banking and Financial Institutions in Malaysia.

Table 4.24: Frequency result for Opportunities of Islamic Banking and Financial Institutions in Malaysia

Opportunities of Islamic Banking and Financial Institutions in Malaysia.	**Strongly Disagree**		**Disagree**		**Neutral**		**Agree**		**Strongly Agree**		**Total**
	(N)	**(%)**	**(N)**	**(%)**	**(N)**	**(%)**	**(N)**	**(%)**	**(N)**	**(%)**	
1. Islamic banking is a flexible financial system and easy to adopt.	14	14	28	28	28	28	14	14	16	16	100
2. Islamic banking has strong set up to product development.	8	8	11	11	8	8	27	27	46	46	100
3. Islamic bank has a good system to maintain the risk well.	11	11	13	13	4	4	14	14	58	58	100

4. The bank has in place a regular reporting system regarding risk management for senior officers and management.	7	7	12	12	7	7	21	21	53	53	100
5. Islamic banking system is helpful for growth of Malaysia's economy.	3	3	10	10	7	7	26	26	54	54	100

There are 73 respondents (73%) admit that the Islamic banking has strong set up to product development and 80 respondents (80%) agreed that the Islamic banking system is helpful for growth of Malaysia's economy.

Above the data showed that the Islamic financial system in Malaysia has evolved as a viable and competitive component on the overall financial system as a driver of economic growth and development. An Islamic financial system with well developing and a tremendous economic growth at the same time pull our attention to examine whether or not the Islamic banking system that currently applied in Malaysia really contribute in the long-run to economic growth of Malaysia. In opposite of that, there are 42 respondents (42%) disagreed that "Islamic banking is a flexible financial system and easy to adopt," the respondents feel that the Islamic banking may very hard to adopt and it's a fixed financial system based on the Shariah rules.

5.0 Conclusion And Recommendation

5.1 Summary of Findings

The purpose of our research is to indentify what are the main challenges and difficulties in developing Islamic banking and financial institutions in Malaysia. The improvement of those challenges would create an opportunities for Malaysia to enhance the Islamic banking and financial institutions system.

As a conclusion for our study, researchers found that "Misunderstanding and Lack of Standardization of Islamic Financial Concept" is the top challenge that is faced by Malaysia. Among all the other four challenges as per the independent contruct larger number of respondents has agree with this statement - "Misunderstanding and Lack of Standardization of Islamic Financial Concept" are the most (79%). It means that this is the most critical challenge that facing by Malaysian right now. The result of these challenges can be proved in a study by Hamzah (2010). In which it were study stated that there are four common methodologies applied under Islamic financial institutions, which are: *ijtihad* (interpretation by using existing sources), *ikhtiyar* (choice), *darura* (necessity) and *hila* (legal artifice). The application of different methodology will lead to the inconsistent fiqh rulings.Addition to that Karbhari,Naser,and Shahin (2004) claimed that the difference Islamic cultures and societies within different country causing the interpretation of Shariah principles goes inconsistent among each of the Muslim schools. The inconformity towards the Shariah views and different methodologies make the concept of Islamic financial institutions become unclear.

Haidi and Malik (2006) supported the statement of "Misunderstanding of Islamic financial concept." They stated that the first impression of Islamic banking is the fixed rate concept of a "halal" loan serves as the substitution for conventional loan. The second challenges which supported by 63% of respondents are "Legal Challenges". Iqbal, Aḥmad and Khan (2009) supported that legal challenges affected the development of Islamic banking and financial institutions as Islamic banking is lack of effective supervisory framework. It caused the prevailing system inefficiency and hence it deserves a serious attention. Legal challenges also exist when Ahmad Ibrahim (2004) found that commercial banking and company laws do not appropriate for the implementation of Islamic banking and financial contracts.

There are 57% of respondents voted for the "Limited Market-Based Financial Intermediations and Products" challenge. The study of John Wiley and Sons (2011) proved this challenge. He found that Islamic financial intermediaries expose themselves to liquidity problem due to the lack of developed money market and the shortage of short term investment securities such as treasury bills and marketable securities which offer limited capital risk with optimum returns. Not only this, Archer and Karim (2006) also proved that the development of Islamic financial institutions is challenging due to the incompleteness of traditional financial instruments which applied to the Shariah Law. Unlike conventional banks, Islamic banks are prohibited to issue treasury securities to maintain liquidity. There are still no other corresponded alternatives to substitute treasury securities to carry out the liquidity function.

The least challenge that supported by respondents is "Concentrated Banking: Limited Risk Management Functionality", contributed by 52% of respondents. This challenge can be proved by the study of Greuning and Iqbal (2007). In their study, they claimed that Islamic banks concentrate only on a few selected sectors and they are avoiding themselves into a direct competition among each other. This will lead the Islamic banks expose themselves to a cyclical shock in a particular sector easily.

5.2 Limitations of Study

The target respondent for our research is the Islamic banking and financial institutions employees. The reason for aiming Islamic banking employees as target respondent is that they are more familiar with Islamic banking operation concept. Since our research's hypothesis involves with some internal operation concept of Islamic financial institutions (e.g. liquidity issue and legal issue), Islamic banking and financial institutions employees who have a greater knowledge in Islamic finance will be the suitable candidate for our study. There are total number of 100 respondents involve in our study. Since our research location is under Islamic bank where Islamic banking employees are busy handling their daily duties and works, to serve customers with vital banking issue, researchers are not convenience to conduct our research to a greater number. In addition, researchers have been allocated by the Islamic banking staff to few limited departments in each bank, hence there is challenging for us to expand our respondent numbers. Researchers had conducted a quantitative research method. The questionnaire provided to respondents is based on the close-ended question, causing respondents' individual perspective and suggestion might fail to fully reflect in our study. Hence, the data collection method might not be fully captured the point of view of all 100 respondents due to limited option provided in the survey question.

5.3 Recommendation

5.3.1 Limited Market-Based Financial Intermediations and Products

Islamic Financial Intermediations and products specializing in Shariah-compliant products have been functioning based on the same business model and without much innovation in their mode of operations. Hence, financial intermediaries have to specialize in mobilizing deposits, identifying investment opportunities, structuring, packing securities and originating, while allowing the complementary financial to fill the remaining gaps and provide liquidity and risk sharing.

Islamic Financial institutions can continuously develop more products, for example they can develop the two types of development: vanilla products and new products. For the vanilla products, the Islamic financial intermediaries have to structuring the existing banking products Islamically. While the new product development is structuring or major change to an existing product.

Besides that, the financial intermediaries of Islamic financial institutions have the value proposition to launch Islamic market, Islamic banking and the products. They need to offer the right choice of innovative Islamic Finance products with a unique professional approach which is precise and timely. In additional, they also have to capture a significant share of Islamic banking market with the right distribution strategy.

5.3.2 Limited risk management functionality

Islamic banking makes functionality of risk transfer is very limited, not like the conventional finance develops hedging mechanisms through derivative products effectively. Hence, the Islamic financial intermediation has to take well with the risk management and develop an organized market for offloading risks to achieve the risk diversification.

Risk-transferring techniques include, among others, the use of derivatives for hedging, selling or buying of financial claims and changing borrowing terms. It is significant to mention that most of the conventional derivative instruments do not conform to Islamic law.

Some dangers cannot be extinguished or shifted and must be ingested by the banks. The beginning is due to the complexity of the risk and difficulty in distinguishing it from assets. A second risk is borne by the financial establishments as these are key to their clientele. These risks are taken because the banks specialize in dealing with them and are rewarded accordingly. Instances of these risks are the credit risk inherent in banking book activities and market risks in the trading book activities of money boxes.

There is a need to introduce a risk management culture in Islamic banks. One path to usher in this culture is to start some form of internal evaluation system. Specifically, the risk weighting of all their assets separately is called for. In the medium and longer-run these could develop into more sophisticated arrangements. Installation of such a scheme can be instrumental in filling the gaps in the risk management arrangement and thus raising the rate of these by the regulatory agencies and external credit assessment agencies.

Public educations and campaigns of Islamic Financial concept are still not effective to spread the awareness of Islamic Financial industries to Malaysian. Thus, the Shariah Supervisory Board and all the Islamic Financial intermediations in Malaysia have to provide more knowledge and create awareness to the public in order to get more opportunities and increasing the source of customers.

Firstly, the Islamic financial institutions are instantly at the verge of a new stage of growth. As researchers progress forward, the Islamic financial institutions can look to experience a different set of regulatory and supervisory standards which is contributing to its unique financial operations to the public. On that point is besides an increased consciousness and agreement amongst the international financial community on the distinct nature of Islamic banking and fiscal operations. Secondly, the Shariah Supervisory Board can promote more conversation and present to the public in order for them to explore more knowledge about Islamic finance and get the confidence to trade. For example, they can introduce the sustainable development of Islamic finance offers benefits for economic growth, reducing poverty and fostering shared prosperity. Islamic finance can significantly contribute to economic development, given its direct link to physical assets and the real economy. Besides that, the use of profit- and loss-sharing arrangements encourages the provision of financial support to productive enterprises that can increase output and generate jobs.

Thirdly, the government can recommend the Islamic instrument and those help strengthen financial stability. Basic instruments include: cost-plus financing (*murabaha*), profit-sharing (*mudaraba*), leasing (*ijara*), partnership (*musharaka*) and forward sale (*bay'salam*). These constitute the basic building blocks for developing a wide array of more complex financial instruments.

5.3.3 Legal Challenges

Supervision of Islamic banks is equally important. At present, lack of effective prudential regulation is one of the weaknesses of the Islamic institutions. Hence, Shariah Supervisory Board has to making an effective supervision framework to manage all the financial institutions in Malaysia and get more opportunities.

The roles of both the Shariah Advisory Boards and the Central banks need to be streamlined and strengthened. The regulatory bodies must oblige the banks to reveal crucial information to the investors and thereby increase the efficiency of financial markets.

Then, supervisions have to make clear the terminal points of supervision, as they will not always be able to be up to the public's expectations. This also calls for that supervision becomes more alive in public debates around the future structure of the financial sector. They are in a safe position to independently and impartially show the possible pros and cons of different choices for financial sector reform, of course solely as this pertains to financial stability and to the ability of the supervisor to effectively carry out its mandate.

5.4 Future Research

In the future research, the recommendation and the limitation of this research will be addressed and overcome. In future, the research will not solely focus on the distribution of questionnaire. In order to get a quality research result, the researchers should make a face-to-face interview with respondents to fully capture the perspectives and suggestions of each respondent. This will guarantee an efficient result.

Furthermore, through applying different research model can enhance the accuracy of the result. The research model can be expanded so that it can fully reflect the challenges facing in Islamic banking and financial institutions industry in Malaysia. Researchers of this study envisions that additional new independent variables can be substituted or add on to the existing independentvariables.

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