ISLAMIC BANKING:
MAIN REQUIREMENTS FOR PROVISION OF ISLAMIC FINANCIAL
PRODUCTS AND THEIR ENHANCEMENT IN THE KENYAN
BANKING INDUSTRY

BY

MOHAMED AHMED RASHID

UNITED STATES INTERNATIONAL UNIVERSITY – AFRICA

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A Project Report Submitted to the Chandaria School of Business in Partial Fulfillment of the Requirement for the Degree of Masters in Business Administration (MBA)

UNITED STATES INTERNATIONAL UNIVERSITY – AFRICA

FALL 2016
STUDENT’S DECLARATION

I declare that this is my original work and has not been submitted to any other university or college institution except the United States International University - Africa in Nairobi for academic credit.

Signed: _________________________ Date: __________________________

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This project report has been submitted for examination with my consent as the appointed supervisor.

Signed: _________________________ Date: __________________________

Dr. Amos Njuguna

Signed: _________________________ Date: __________________________

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ABSTRACT

The purpose of this study was to establish the main Islamic products on offer in Kenya, the main requirements for provision of Islamic financial products and what could done to enhance their penetration Kenyan banking industry. The study sought to answer the following research questions: What are the main Islamic banking products on offer in Kenya?, What are the main requirements to provide Islamic financial products in Kenya?, and What can be done to enhance penetration of Islamic finance products in Kenya?

This study adopted descriptive and explanatory research design. The population for the study was all employees of Gulf African Bank (GAB) and First Community Bank (FCB), the population represents the total number of branches countrywide which was estimated at 20 for FCB and 15 for GAB, a total of 35 branches. The sample elements consisted of 32 Branch managers within Nairobi including the Head office. The study used both primary and secondary data. The primary data was collected using a structured questionnaire and the respondents targeted were branch managers of the two Islamic banks sampled. The study used quantitative data analysis. A Statistical Package for the Social Sciences (SPSS) tool was used to carry out a quantitative analysis. Inferential statistical analysis was undertaken by the use of correlation analysis.

The study showed that the banks offered debt-like financing structured as sales (Murabahah), purchases with deferred delivery of the products (Salam and Istisna), lease (Ijārah) with different options to buy, profit-sharing and loss-bearing (Mudarabah) products, pure profit-and-loss-sharing (Musharakah), services of safe-keeping contracts (Wadi’ah) for current deposit for customers, and safe-keeping contracts (Wakalah) for agency contracts. These were the major products that customers required and were provided by the banks, as well as Sukuk (Islamic bonds).

The study revealed that the banks were under the supervision of the Central Bank of Kenya and were being treated the same as other conventional banks. The banks had established their own separate Shariah Board that supervised and offered guidance to their operating systems and these boards had the appropriate experience, competency that ensured the banks puts in
practice professionalism and personal integrity. The banks’ board had the appropriate number of directors that were commensurate with the bank sizes and scope of operations and the banks had comprehensive guidelines that provided for how the banks dealt with consumer protection and consumer relations.

The study showed that development in the Islamic Capital Market had encouraged the banks to issue Sukuk (Islamic bonds) and that consumer education and awareness about Islamic banking was critical to the success and development of the banks. The banks had non-Muslim customers who preferred them because of their ability in being low risk alternatives, and culture affected the perception and standards of the banks’ consumers, thus affecting their selection of banks. The continuous review and improvement of Shariah-compliant products in the banks had led to a drastic development and marketing of the banks’ products that were still guided by the Sharia.

It can be concluded that the conventional banks in Kenya have the right to offer Shariah-compliant banking products subject to statutory and prudential requirements and that there are viable and attractive products being used to attract the players in the market towards Islamic banking. The study concludes that a huge gap exists in terms of the framework that facilitates Islamic banking expertise and uniformity and thus there is a need for employee and population training on both general and Islamic banking principles and the Shariah for an effective adoption and spread of Islamic banking as well as facilitate the existence of professionals in Islamic banking.

The study recommends that, concerted efforts should be directed to creating a separate and viable platform for Islamic banking to function effectively in parallel with conventional banking. The legal, regulatory and Kenyan framework of Islamic banking should strengthened further through the review of the existing laws and guidelines governing the industry. Code of ethics should among the core determinants in disciplining the industry with less emphasis on Central Bank’s intervention.
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DEDICATION

I would like to express special thanks and appreciations to my lovely wife Shamsa for her love, support, encouragement, prayers and mentorship during the entire duration of the course. I also dedicate this research project to my children Amaal, Khalid, Asiya and Muhammad. This research project may motivate them when they become of age.
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LIST OF ACRONYMS

BNM: Bank Negara Malaysia
CBK: Central Bank of Kenya
DIB: Dubai Islamic Bank
DPFB: Deposit Protection Fund Board
FCB: First Community Bank
FSA: Financial Services Authority
GAB: Gulf African Bank
GCC: Gulf Cooperation Council
ICM: Islamic Capital Market
IFS: Islamic Financial System
KBA: Kenya Banker’s Association
KDI: Kenya Deposit Insurance
KDIC: Kenya Deposit Insurance Corporation
MCos: Mudaraba Companies
MoF: Ministry of Finance
PLS: Profit-and-loss-sharing
QIB: Qatar Islamic Bank
SPSS: Social Sciences
SSA: Sub-Saharan Africa
UAE: United Arab Emirates
UK: United Kingdom
US: United States
CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Study

Islamic banking is viewed by many as the fastest growing segment of the banking sector in the world. The Islamic finance industry is a relatively new entrant to the world of finance because its operating principles differ from the conventional finance modes of operation traditionally practiced in the West. It operates in compliance with Islamic Sharia (Oundo, 2009). These raises the need for developing appropriate financial instruments and services for that industry. The major challenge facing the industry is the preservation of its excellence in providing services, expanding the scope of its financial activities, and exploiting in a beneficial way the developments in the financial markets (Nautiyal and Kavidayal, 2011).

The banking industry is a key sector in the Kenyan economy. As profit seekers, commercial banks are inclined to formulate policies that aim at diversifying their portfolio and thus guaranteeing some minimum rate of return. To achieve this objective of profit maximization, banks make decisions to invest excess cash in varying portfolios, involving not only the amount to invest but also the types of portfolios in which to invest (CBK, 2010). Conventional banking, which has been operating for the last three centuries on strong footing, has started tumbling steeply in the last few decades while Islamic banking has been expanding all over the world particularly in Muslim countries with fast speed (Chiu and Robin, 2006). The vertical growth of Islamic banking within short span of time has surprised everyone including western financial experts and analysts. Nazim (2013) disclosed that 970 books have been published on Islamic Finance recently while 2557 research articles on Islamic finance have been published in research journals.

Islamic or Shariah-compliant banking is a fast-growing segment of the financial sector in Kenya, since its inception. The impact of Islamic finance sent strong signals to Kenya’s financial services sector to the point of being highlighted in the latest amendments to the Finance Act (2008), which was amended to include a requirement by all institutions to pay a return on all savings accounts kept and operated in accordance with the Islamic law. The
amendment applied to institutions offering Islamic finance products which did not permit payment of interest (CBK, 2009).

Mang’eni (2009), says that already two Shariah-compliant banks were giving the rest of the conventional banks a run for their money. The two banks, Gulf African Bank (GAB) and First Community Bank (FCB), had created a strong appeal, not only to Kenya’s 8 million Muslim population, but to the rest of the conventional customers as witnessed by the numbers of conventional bank clients who switched over to these Islamic institutions (Financial Post, 2008). The entry of banks with Shariah-compliant products was perhaps one of the most critical developments in Kenya’s financial services sector given the key role this sector plays in the economic growth of the country.

According to Iqbal (2010), Shariah (or Islamic) law is meant to regulate all aspects of a Muslim’s way of life. It is broadly divided into two sets of rules: one relates to the obligatory worship of God (Ibadah) and the other relates to daily life outside the context of obligatory worship (Muamalat), including commercial and financial dealings. There are a number of key Shari’ah principles and prohibitions relevant to finance and commercial transactions which distinguish Islamic finance from the conventional finance.

Most importantly, the Shariah does not recognize the time value of money and it is therefore not permissible to make money by lending it. Money must be used to create real economic value and it is only permissible to earn a return from investing money in permissible commercial activities which involve the financier or investor taking some commercial risk (Jaffar and Manarvi, 2011). This prohibition is the main driving force behind the development of the modern Islamic finance industry. The supply of Islamic finance is highly concentrated in a few countries, with the top three countries (Indonesia, Bangladesh, and Afghanistan) accounting for 80% of global outreach (Farah, 2014).

Shariah-compliant banking is viewed by many as the fastest growing segment of the banking sector in the world. In Africa, Islamic banking is a fast growing financial sector attracting all customers even of different religious orientation. The uptake of Islamic banking is projected
to grow exponentially in Sub-Saharan Africa (SSA). Kenya is among other African countries that are taking up the lead in Shariah-compliant banking services (Ndung’u, 2011)

The demand for Shariah-compliant financial products and services differs little from the demand for the conventional equivalents they are designed to replace as Muslims throughout the world are currently using conventional financial products. It is clear that the opportunity for the Islamic financial industry is huge. The migration of consumers from conventional to Islamic has already begun and in many countries conventional banks are beginning to feel pressure to offer Shariah-compliant products (Jaffar and Manarvi, 2011).

The ever changing consumer needs, innovative financial products, deregulation, information technology upgrades, and the onset of multiple delivery channels are reshaping the financial services industry (Nautiyal and Kavidayal, 2011). To remain competitive in the new landscape, banks have continued to expand their product lines and add new delivery channels to develop more effective marketing systems and techniques, and enhance the service quality levels. Use of alternative channels such as electronic banking and mobile banking continue to be the frontiers upon which banks seek to enhance access to customers as well as differentiating their products (Sumiyu, 2013). Tremendous growth has also been evidenced in agency banking conducted by commercial banks. As at December 2012, there were 10 commercial banks that had contracted 16,333 active agents facilitating over 38 million transactions valued at Ksh. 195.8 billion (CBK, 2012).

Islamic banking industry has gone a long way in a rather short span of time and according to some estimate, is growing at an annual rate of 15 to 20 percent per year (Zaher and Hassan, 2014). Kenyan Islamic banks, GAB and FCB, outpaced their rivals by recording triple-digit rise in profit helped by lending to peers, households and companies. GAB posted a 154 per cent growth in net profit to Ksh. 242.2 million in the year to December boosted by income from lending, which was up 53.1 per cent to Ksh. 1.47 billion (CBK, 2013). FCB profits rose 238% to Ksh. 241.3 million helped by lending and earnings from deposits with rival banks through a special window called Tawaruq. Tawaruq refers to lending to other financial institutions with the money used to finance Islamic products only. The triple-digit growth
come in a year when Kenya’s entire banking sector posted a profit growth of 20% to Ksh. 107 billion - underlining the potential of Islamic banking (Mwaniki, 2013). The future indicates an intensified competition in the banking sector arising from the introduction of Islamic banking. The banking sector is expected to sustain its growth momentum on the backdrop of a stable macro-economic environment, domestic and regional expansion by banks and the increased economic activities through the devolved system of government (CBK, 2013).

1.2 Problem Statement

A considerably large volume of literature is available on Kenyan commercial banks but few studies have focused on Shariah-compliant financial products offered by Islamic banks in Kenya. Sumiyu (2013) established that the new market innovation strategies adopted by commercial banks were availability of resources and capabilities, creating and nurturing strong brands, aggressive anti-competitors marketing campaigns, creating value through pricing, environmental analysis and response to changes, customer satisfaction and retention. The study also established that commercial banks adopted product innovation strategies which helped the banks to earn more profit, faster business growth, invest more and also in improving the firm’s productivity.

The study carried out by Gerrard and Cunningham (2012) found that, Islamic religious belief and social responsibility are the two most important factors that determine bank selection. Cost benefit is the third most important factor considered in bank selection. Clients of conventional and Islamic banks share a number of motives, but they differ significantly on a few motives in relation to bank selection, the clients of Islamic banks are more familiar with the products/services that conform to the Shariah. However, the study by Erol and El-Bdour (2009) contradict the findings of other studies and argue that religious motivation did not appear to play a primary role in bank selection. Significant number of customers would withdraw their deposits if an Islamic bank did not generate sufficient profit to make a distribution in any one year hence motivated by higher dividend payments instead.
The study by Oundo (2009) suggested that there was poor supply of Shariah-compliant products in Kenya’s financial institution. The challenges in the supply side of Shariah-compliant financial services was illustrated by one bank that wrote Cheques to suppliers for their Muslim clients who were uncomfortable with receiving credit in cash against the Shariah. There was high demand for Islamic financial products against a negligible supply of the same meaning that Islamic finance clients had few options (if any) and financially neglected by the microfinance sector.

Ndung’u (2011) highlighted that among the challenges facing Kenya’s ambition to be a hub of Shariah-compliant investment products to compliment the Islamic banking in the country are lack of Shariah-compliant investment vehicles, an enabling legal and regulatory framework and awareness by majority of the populace that hinder the uptake of these investments. For the country to fully embrace Islamic Finance, there is need to extend beyond the offering of Shariah-compliant products by introducing such investment vehicles like unit trusts, corporate bonds (Sukus) and insurance (takaful) products and Shariah-compliant treasury bills and bonds (government Sukuk). It is against this background that there is need to establish the main Islamic products on offer in Kenya, the main requirements for provision of Islamic financial products and what can be done to enhance their penetration Kenyan banking industry.

1.3 Purpose of the Study
The purpose of this study was to establish the main Islamic products on offer in Kenya, the main requirements for provision of Islamic financial products and what could be done to enhance their penetration Kenyan banking industry.

1.4 Research Questions
The study sought to answer the following research questions:

1.4.1 What are the main Islamic banking products on offer in Kenya?
1.4.2 What are the main requirements to provide Islamic financial products in Kenya?
1.4.3 What can be done to enhance penetration of Islamic finance products in Kenya?
1.5 Significance of the Study

1.5.1 Gulf and First Community Banks
The research may help the two Islamic banks to better strategize and better illuminate the future opportunities that Islamic banking can seize for greater profits and growth in the future. Potential commercial banks looking to venture into Islamic banking could also use this study to better understand the viability of future investments in Islamic banking.

1.5.2 Investors and Customers
The study may help investors assess the future prospective of the Islamic banking in Kenya hence could guide them in their investments, financing, and savings decisions. By understanding the available products and provisions that guide Islamic banking, these stakeholders may be in a better position in terms of taking up banks that will facilitate their investment plans.

1.5.3 Regulatory Authorities
The study may facilitate understanding of the impact of the recent trends in Islamic financial innovations and thus assist regulatory authorities such as Kenya Banker’s Association (KBA) and Central Bank of Kenya (CBK) to its continuous process of pursuing policies that facilitate an enabling environment for Islamic banking in the country.

1.5.4 Government
The study may be of significance to the government at large and specifically the Ministry of Finance (MoF). The study may facilitate the better understanding of Islamic banking and thus enable the Ministry to create policies as well as provide institutional infrastructure that may ensure that there is an enabling environment for the Islamic banking sub-segment growth.

1.5.5 Researchers
Lastly, the study builds on the existing body of knowledge and points out area for further research work. Researchers who wish to study the area of financial innovation have been made aware of the contribution of financial innovation for Islamic banking in Kenya and the gaps that exist have been mentioned, setting a foundation for future research.
1.6 Scope of the Study
The scope of the study comprised of two banks operating Islamic or Shariah-compliant banking which was still relatively new in the Kenyan market with just about six years since inception. The data available for the study was limited to the views of a small sample of practitioners which included GAB and FCB Management and Shariah Boards, and researchers in the field of Islamic finance. The narrow range data limited the study in relation to the data availability since only data for a few months in 2016 was obtained.

1.7 Definition of Terms
1.7.1 Financial Innovation
Financial innovation is the act of creating and then popularizing new financial instruments as well as new financial technologies, institutions, and markets (Sumiyu, 2013).

1.7.2 Competitive Advantage
Competitive advantage is a situation whereby companies are able to satisfy customer needs more effectively than their competitors (Porter, 1998).

1.7.3 Shariah-Compliant
An act or activity that complies with the requirements of the Sharia, or Islamic law. The term is often used in the Islamic banking industry as a synonym for “Islamic” for example, Shariah-compliant financing or Shariah-compliant investment (Iqbal, 2010).

1.7.4 Takaful (Islamic Insurance)
Structured as charitable collective pool of funds based on the idea of mutual assistance, Takaful schemes are designed to avoid the elements of conventional insurance (that is, interest and gambling) that are problematic for Muslims (Gerrard and Cunningham, 2012).

1.7.5 Sukuk
According to Jaffar and Manarvi (2011), Sukuk is the Arabic name for a financial certificate that can be viewed as an Islamic equivalent of the government bond.
1.7.6 *Tawaruq*

*Tawaruq* refers to lending to other financial institutions with the money used to finance Islamic products only (Gerrard and Cunningham, 2012).

1.8 Chapter Summary

The first chapter provided background information of the study discussing the background of Islamic banking and its concepts. The problem statement was given. The general objectives of the study, the research questions, and the importance of the study and scope of the study have also been highlighted. The next chapter will provide a detailed literature review of previous research work relevant to this study. The third chapter will discuss the research methodology that will be used in conducting the research. The fourth chapter will present the results and findings from the research conducted while the fifth chapter will provide the discussions, conclusions and recommendations based on the results presented in chapter four.
2.0 LITERATURE REVIEW

2.1 Introduction

This chapter seeks to explore relevant literature related to Islamic Banking around the world in Kenya and the flow of literature will be guided by the main Islamic banking products on offer, the main requirements for provision of Islamic financial products and what can be done to enhance their penetration in the Kenyan banking industry.

2.2 Main Islamic Banking Products

Islamic banking and finance is an emerging global industry founded on Islamic ethical precepts. Just as in the case of conventional banks, Islamic banks are expected to offer products that consider the needs of their customers (Amin, Rahman, Sondoh Jr, and Hwa, 2011). Islamic banking is banking according to the values and ethos of Islamic *Shariah*. *Shariah* is an Arabic word that means practicing as per the Islamic values and law. The Islamic law, that is, the *Sharia* prohibits Muslims from dealing in *riba* (interest), which literally means increase, addition, rise or growth (Khattak and Rehman, 2010).

2.2.1 Islamic Finance Products

According to Hussain, Shahmoradi and Turk (2015), Islamic finance products are contract-based and may be classified into three broad categories: Debt-like financing structured as sales, which could be sales with mark up and deferred payments (*Murabahah*) or purchases with deferred delivery of the products (*Salam* for basic products and *Istisna’* for manufactured products), and lease (*Ijārah*) with different options to buy. Pure lending is allowed only when benevolent (*Qard*) which is often used for current deposits is offered.

Profit-and-loss-sharing (PLS)-like financing with two modalities: (i) profit-sharing and loss-bearing (*Mudarabah*) whereby the financier (investor, bank) provides capital and the beneficiary provides labor and skills (profits are shared, but losses would be borne by the financier who does not have the right to interfere in the management of the financed operation, unless negligence, misconduct, or breach of contract can be proven); and (ii) pure profit-and-loss-sharing (*Musharakah*) where the two parties have equity-like financing of the
project and would share profits and losses; and services, such as safe-keeping contracts (Wadi’ah) as for current deposits, or agency contracts (Wakalah), which are also increasingly used for money market transactions (Amin et al., 2011).

2.2.1.1 Musharakah (Partnership Finance)

This is a partnership between parties in which financial capital and/or labor act as shared inputs and profit is distributed according to the capital share of the partners or in some agreed upon ratio. The loss, however, is distributed according to the share of the capital. Though there can be different kinds of partnerships based on money, labor, and reputation, one case of sharikah is participation financing or musharakah in which partners share both in capital and management of the business enterprise. Thus partners in musharakah have both control rights and claims to the profit (Erol and El-Bdour, 2009).

2.2.1.2 Mudharabah (Trust Financing)

According to Hussain, Shahmoradi and Turk (2015), Mudarabah is similar to the concept of silent partnership in which financial capital is provided by one or more partner(s) (rabul mal) and the work is carried out by the other partner(s) mudarib. The funds are used in some activity for a fixed period of time. The financiers and the managers of the project share the profit in an agreed upon ratio. The loss, however, is borne by the financiers according to their share in the capital. The manager’s loss is not getting any reward for his services. As the rabul mal is sleeping partner, he/she has a claim on profit without any say in the management of the firm (Jaffar and Manarvi, 2011).

2.2.1.3 Murabahah/ BaiMuajjal (Deferred Payment Sale)

Murabahah is a sale contract at a mark-up. The seller adds a profit component (mark-up) to the cost of the item being sold (Nazim, 2013). When the purchase is on credit and the payment for a good/asset is delayed, then the contract is called bai-muajjal. A variant would be a sale where the payments are made in installments. These contracts create debt that can have both short and long-term tenors. In these debt contracts the supplier of the good has claims on a fixed amount that must be paid before arriving at profits (Aggarwal and Yousef, 2010).
2.2.1.4 Salam/ Istisna (Purchase Order)

Salam sale is an advance purchase of a generic good. In a salam contract, the buyer of a product pays in advance for a good that is produced and delivered later. The product-deferred sale contract applies mainly for agricultural goods (Zaher and Hassan, 2011). Istisna or commissioned manufacturing is similar to salam contract with the difference that in istisna the good is produced/ built according to the specifications given by the buyer (Azizul, 2009). This applies mainly to manufactured goods and real estate. The client asks the financier to provide an asset (such as real estate) built and the payments are made over a period of time in the future. In istisna the payments can be made in installments over time with the progression of the construction/ production (Zaher and Hassan, 2011). In this case the financier can opt to have a parallel istisna and sub-contract the project to a third party for its completion (Azizul, 2009).

2.2.1.5 Ijarah (Leasing)

Ijarah is an operating lease in which the lessee pays rent to the lessor for use of usufruct. In ijarah the ownership and right to use an asset (usufruct) are separated. It falls under a sale-based contract as it involves the sale of usufructs (Nautiyal and Kavidayal, 2011). A lease contract that results in the transfer of an asset to the lessee at the end of the contract is called ijarah muntahia bit tamleek. Ijarah muntahia bit tamleek combines sale and leasing contracts and use the hire-purchase or rent-sharing principles (Salman, 2010). As the periodic payments include rent and part of the asset price, the ownership of the asset is transferred to the lessee at a nominal price or a gift after the contract period is over.

Islamic banks were mostly successful in promoting the importance of applying Sharia principles in the economic and financial spheres. Islamic banks provided fully Islamic financial products such as Mudaraba, Istisna, and Murabaha which are in full compliance with Sharia principles and guidelines (Dar, Azeem and Masood, 2013). However, they failed in other products, such as in certain forms of Musharaka that are based on trust (Amana), because it is difficult to accomplish it in practice. Also, the absence of the method or tool to
ascertain its presence, a fact which makes it difficult for Islamic banks to expand in providing it (Al-Alaywi, 2012).

Idries et al. (2013) examined Mudaraba loans and found that Mudaraba loans have inverse relationship with various profitability indicators. The implications of this result is that Islamic banks who work in countries with Hybrid banking system (Islamic and conventional banks) face a serious problem with Mudaraba loans because the borrowers prefer to transact with conventional banks when they expect high return for their project while they prefer Islamic banks when they expect low return for their project.

Dar, Azeem and Masood (2013) argue that PLS features marginally in the practice of Islamic banking and finance. Whatever the degree of success of individual Islamic banks, they have so far failed in adopting PLS-based modes of financing in their businesses. Even specialized Islamic firms, such as Mudaraba Companies (MCos), which are supposed to be functioning purely on a PLS basis, have a negligible proportion of their funds invested on a Mudaraba or Musharaka basis. Most Islamic banks and finance companies have so far been engaged in short term financing. Mudaraba and Musharaka, being long term financing instruments, have as a result been ignored (Idris et al., 2013). Hence, there is a need to innovate in designing short term PLS contracts, for example, to stage the financing, as is common in venture capital financing.

2.2.1.6 Sukuk Development Tool

Another development in the area of Islamic financial instruments is a new form of debt known as Islamic Sukuk, in their diversity and capability to provide funds (Benaissa, Jopart and Tanrikulu, 2007). These are Islamic bonds that act like regular bonds but comply with the rules of Sharia. Their risks are similar to those of bonds; they rely on the financial soundness of the issuer. Sukuk are Islamic investment certificates, where each holder owns an undivided beneficial ownership interest in the underlying assets (Al-Alaywi, 2012). Consequently, Sukuk holders are entitled to share in the revenues generated by these assets, as well as being entitled to share in the proceeds of their realization. They can be considered a development tool and not a financial instrument (Azizul, 2009).
According to Aggarwal and Yousef (2010), Islamic banks issue *Sukuk* as a mechanism to mobilize savings, and their issuance can be diversified and expanded to benefit from the opportunities existing for these financial market instruments. However, the growth in the *Sukuk* instruments will only be accomplished when liquidity is provided to its bearers. Jaffar and Manarvi (2011) state that, *Sukus* will bolster the activities of Islamic banks, as it is considered an acceptable instrument from the *Sharia* standpoint for investing liquid funds, achieving returns, and lowering risk.

Using *Sukuk* as a financial instrument of various capabilities is suitable for a wide variety of economic performance aspects on an international scale. Some of *Sukus*’ main advantages are to increase the capital available to develop major economic projects, to control liquidity (Al-Manea, 2012), to use funds in an optimum manner, and to increase the size of capital markets for investors (Al-Miraj, 2012; Al-Musallam, 2012). Several indices were developed to measure their performance in the financial marketplace. The Dow Jones Islamic Market Index and the Dow Jones Citigroup *Sukuk* Index measure the performance of *Sukuk*. In Kuwait, the Al-Madar Finance Company developed a *Shariah*-compatible Index-Series; a series of 12 *Shariah*-compliant indexes for the Kuwait equity market (Ainley et al., 2014).

### 2.3 Main Requirements for the Provision of Islamic Financial Products

Banking sector is one of the most regulated institutions around the world and a number of reasons can be given for this heavy and costly burden of government supervision (CBK, 2012). For instance, it protects the safety of the public’s savings, controls the supply of money and credit in order to achieve a nation’s broad economic goals (such as high employment and low inflation), ensures equal opportunity and fairness in the public’s access to credit and other vital financial services, promotes public confidence in the financial system so that savings flow smoothly into productive investment and payments for goods and services are made speedily and efficiently, avoids concentrations of financial power in the hands of a few individuals and institutions, provides the government with credit, tax revenues, and other services; and to help sectors of the economy that have special credit needs (such as housing, small business, and agriculture) (CBK, 2012).
However, regulation must be balanced and limited so that, financial firms can develop new services the public demands and competition in financial services remains strong to ensure reasonable prices and an adequate quantity and quality of service to the public and private-sector. Decisions are not distorted in ways that waste scarce resources (such as by governments propping up financial firms that should be allowed to fail) (CBK, 2010).

2.3.1 The Banking Act (Chapter 488)

The banking industry in Kenya was issued by Parliament on October 27, 1995 to regulate the business of banking, and other matters connected with it and is primarily governed by the Banking Act (Chapter 488, Laws of Kenya) (the “Banking Act”), and by the Central Bank of Kenya Act (Chapter 491, Laws of Kenya) (the “CBK Act”) (CBK, , 2013). The Banking Act. The act covers: licensing of institutions; prohibited businesses; reserves and dividends; accounts and audit; information and reporting requirements; inspection and control of institutions; deposit protection fund; and miscellaneous provisions (CBK, 2013).

The requirements for provision of Islamic financial products are stipulated under Chapter 488 of the Banking Act with the only two exemptions that Shariah compliant banks get to operate in the country: in exercise of powers conferred by section 53 of the Banking Act, the Cabinet Secretary of the National Treasury exempts “Islamic Bank X”, from the provisions of Section 12 (a) and (c) for a period of 5 years- (upon which the subject bank seeks a renewal after the lapse of the period); and Section 12(c) of the Act, from which the bank was also exempted, prohibits lenders from “engaging, alone or with others, in wholesale or retail trade, including import or export trade, except in the course of the satisfaction of debts due to it (Farah, 2014).

Any person who undertakes “banking business”, “financial business” or the business of a “mortgage finance company” must be licensed by the CBK. When the CBK reviews an application for a license, the criteria it must consider include the financial condition and history of the institution, the professional and moral suitability of the persons proposed to manage or control the institution, and the public interest which will be served by granting the
license. The CBK has the right, when granting a license, to endorse such conditions as it considers necessary, and may from time to time add, vary or substitute such conditions as it deems appropriate (Beck et al., 2010).

According to Wako, Kamaria and Kimani (2014), Islamic banks in most countries are put under the supervision of the central bank of the country and are given the same treatment given to conventional banks. With only a few instances where special Islamic banking legislation are approved to define a new relationship between Islamic banks and the central bank. This position is supported by Azizul (2009) who believes that most Islamic banks in the contemporary world operate in a mixed environment in which interest based banks function side by side with Islamic banks. The central banks subject Islamic banks to the same controls, conditions, and regulations that they apply to interest-based banks. Ainley et al. (2014) notes that there are certain factors such as lack of understanding of the correct nature of Islamic financing techniques, however, that requires that Islamic banks be treated on a different footing. For instance, Central Banks usually pay interest on deposits which Islamic banks cannot accept, Central Banks function as lenders of last resort to conventional/commercial banks providing loans at times of liquidity crunch (Wako, Kamaria and Kimani, 2014).

Although the concept of Islamic Finance and Banking has generated a lot of interest and overwhelming support from both Muslim and non-Muslim population in Kenya, as a regulator, CBK has faced by certain challenges which need to be addressed. Wako, Kamaria and Kimani (2014), in their literature review noted CBK cautioning of possibility of Islamic Banks operating within the existing legal and regulatory framework, which posed a great challenge. In part, all banks offering Islamic banking have established their own separate Shariah Board to supervise and offer guidance to their respective banks on Islamic banking system (Kinyanjui, 2013).

The Prudential Guidelines significantly cover most aspects of governance and internal controls of banks in Kenya. It provides that the board should possess, both as individual board members and collectively, appropriate experience, competencies and personal
qualities, including professionalism and personal integrity (KBA, 2013). Furthermore, professionals such as lawyers, accountants and valuers involved in the provision of professional services to a licensed institution are not eligible to be appointed as directors, and senior officers and non-executive directors of a government regulatory body are similarly not allowed to be appointed as directors of an institution where there may be a conflict of interest (Beck, Demirguc-Kunt and Merrouche, 2013). The Prudential Guidelines further provide that the board must have an appropriate number of directors that is commensurate with an institution’s complexity, size, scope and operations. In addition, the Prudential Guidelines introduce comprehensive provisions on consumer protection which did not exist under the previous guidelines (KBA, 2013). The Prudential Guidelines provide that the relationship between an institution and a customer should be guided by five key principles: fairness, reliability, transparency, equity and responsiveness (Beck, Demirguc-Kunt and Merrouche, 2013).

Currently, there are two fully-fledged Shariah-compliant banks in Kenya, that is, the GAB and FCB, and a growing number of conventional banks have an Islamic banking division (KBA, 2013). The challenge for Kenyan banks offering Islamic financing has been the lack of a proper legal framework, which prevented them from providing certain products (Beck, Demirguc-Kunt and Merrouche, 2013). In addition, there is ambiguity in respect of the tax treatment of Shariah-compliant financial instruments (Beck et al., 2010). The regulatory bodies have identified the challenges and when proper legal framework and policies are in place, the country is expected to see a significant growth in Islamic financing (Beck, Demirguc-Kunt and Merrouche, 2013).

The key areas of current regulatory focus in the banking sector include licensing of new institutions that wish to be licensed to conduct banking, mortgage or financial business in Kenya. The Prudential Guidelines have introduced some stringent requirements with regard to licensing of new institutions (KBA, 2013). The CBK has also sought to govern agency banking, because of the increased interest by banks in that sector (CBK, 2013).
The Kenyan banking sector has recently experienced some significant changes, especially following the banking crisis that started in 2008. The Kenya Deposit Insurance (KDI) Act, 2012, which has been assented to but is yet to commence, provides for the establishment of an autonomous body called the Kenya Deposit Insurance Corporation (KDIC) which will replace the current Deposit Protection Fund Board (DPFB), a department of the CBK. The KDI Act provides for the setting up of a deposit insurance system, and the receivership and liquidation of deposit-taking institutions (Beck, Demirguc-Kunt and Merrouche, 2013).

The CBK has been conducting a comprehensive review of the banking sector, legal and regulatory framework. There have been a number of proposed laws and regulations relevant to the sector put forward by the CBK. For instance, the Banking (Amendment) Bill, 2011 (the “Bill”) has been published to amend the Banking Act so as to put a cap on the rate of interest charged by banks and financial institutions for loans or monetary advances (CBK, 2013). The Bill also proposes to fix the minimum rate of interest that banks or financial institutions must pay on deposits held in interest-earning accounts. The Bill passed through its first reading on 10th November, 2011 (Beck, Demirguc-Kunt and Merrouche, 2013).

The government and government-influenced banks represent about a fifth of total branches in urban districts, over half in rural districts, three-quarters in semi-arid districts, and almost ninety percent in arid districts. This suggests that government influence has a positive impact in promoting access to financial services but, in the absence of an analysis to assess the costs of government-influenced banks’ poor lending practices, it should not be concluded that government ownership is either the best or the cheapest way in which to maintain rural access to the banking system (Beck et al., 2010). The depth of outreach remains a serious problem for the Kenyan financial sector. The banks best positioned to maintain or extend outreach are government-owned banks that are also in most in need of efficiency improvement (Beck, Demirguc-Kunt and Merrouche, 2013).

In Kenya, just like elsewhere, legal and regulatory challenges on lending products exist. Islamic banking prohibits interest but allows profit sharing, and therefore Shariah-compliant lending products have an element of “trading” and “holding of fixed assets” as bank has to
buy and sell financed assets (Zaher and Hassan, 2011). But Section 12 of the Banking Act restricts trading and holding of fixed assets and hence the Banking Act was amended in 2006 to enable exemption of innovative products such as Shariah compliant banking lending products from trading and holding of fixed assets restrictions (CBK, 2013). However, CBK carries out detailed due diligence on such products before such exemptions are granted to ensure adequacy of risk management. Further, section 16 of the Banking Act requires banks to pay interest on savings accounts so long as the minimum balance is maintained, but Shariah-compliant banking principles prohibit receipt of interest. So the Banking Act amended effective 1\textsuperscript{st} January 2009 to incorporate concept of “return” for Shariah-compliant (Wako, Kamaria and Kimani, 2014).

2.3.2 Shariah Board
The Islamic Financial System (IFS) is a product of Islamic principles and philosophy and is thus based on Sharia functions. Since this system is part and parcel of Islam, IFS recognizes man as the vice gerent of God on earth. According to Mabrouk and Mamoghli (2010), any wealth earned by a man is seen to be merely entrusted upon him and he holds the wealth as a trust from God, and does not have absolute ownership of the wealth. As such, in IFS, freedom of enterprise as well as financial decisions made either by individuals or corporations should be on the basis of guidelines provided by Islam which do not prohibit profit making as the target, as long as the interest of society and the nation as a whole are protected and preserved meaning that profitable undertaking is permissible under Sharia (Nazim, 2013).

Islamic banking is more complex than traditional banking in that products must conform not only to the secular laws of a country but also to interpretations of the holy Qur'an by local Islamic scholars (Ali, 2011). According to Siddidi and Nejatuallah (2014), a central tenet of Sharia is riba, the prohibition of interest, moreover, Islamic law does not permit use of funds for investments or purchases related to activities it deems impermissible (haram), such as alcohol consumption or gambling. Ali (2011) writes that in general, anything not defined as haram is considered permissible (halal) under Sharia.
According to Siddiqi and Nejatuallah (2012), due to interest, Islamic financial institutions have had to develop products and services which are not contradictory with the Islamic law. The products and services that are offered by conventional banks are then tailored to fit the Sharia. According to Ali and Ali (2009), this has been accomplished by innovating various types of financial products and services, whereby both the borrowers and depositors are considered to be operating in an alliance where an element of risk is attached. The rate of return or profit is based on the performance of the borrowers and depositors.

Furthermore, according to Zaher and Hassan (2011), the PLS principle creates a clear engagement among the parties involved in a transaction. All business transactions should be based on this principle. Islamic financial institutions try to ensure that their business activities avoid prohibited activities and that their financial products permit the financing of individuals or commercial enterprises through the profit and loss sharing principle. According to Gerrard and Cunningham (2012), since interest is forbidden, suppliers of funds become investors instead of creditors. The provider of financial capital and the entrepreneur share the business risks in return for a share of the profits. The relationship between the investors and the financial intermediary is based on PLS principle, and the financial intermediary shares the risks with the investors (Van Greuning and Iqbal, 2008).

Clearly, as Islamic products and services enter these markets, an important consideration is the attitudes, perceptions and knowledge of market participants towards these new methods of finance (Farah, 2014). According to Van Greuning and Iqbal (2008), for individual consumers and business firms, these factors determine the extent to which they choose to patronize these alternative products and services. Key concerns include the influence of religious persuasion and the relative pricing, costs and benefits, convenience and access of Islamic products and services vis-à-vis conventional bank products and services (Iqbal and Molyneux, 2010).

All Islamic banks have either an advisory Shariah board or Shariah advisor(s), and as a result all the products they trade are Shariah-compliant because they have been approved by the Shariah board or advisor (Benaissa, Jopart and Tanrikulu, 2007). However, there has been
criticism of some practices of Islamic banks. Dusuki and Abozaid (2012) called for the revitalization of Islamic banking and finance practices based on a proper understanding and implementation of the *maqasid* of *Sharia*. According to Siddiqi and Nejatuallah (2012), Islamic banks, as business entities that strive to meet religious obligations, need to compete with other banks to win customers. Therefore, Islamic banks need to meet two objectives: run profitable operations for investors and satisfy religious obligations. According to Wako, Kamaria and Kimani (2014), it is necessary that Muslims in Kenya be able to access financial services that do not violate their principles and beliefs. The way Islamic banks conduct their business may motivate clients to choose a bank that uses Islamic *Sharia* principles as a base for all products and services.

### 2.4. Enhancing Penetration of Islamic Finance Products in Kenya

Being a nascent idea, Islamic banking has the potential for attracting new customers and, consequently, enhancing a bank’s market share. This phenomenon may explain the increase in the branches of some Islamic banks, for example, the Faisal Islamic Bank which has established many branches in one country and then moved to expand to other different countries (KBA, 2013). On the negative side, however, this high potential for expansion would motivate new entrants to the industry, and, as a result provoke stiff competition.

#### 2.4.1 Development of Islamic Capital Markets and Consumer Awareness

Demir, Mustafa and Toprak (2014), states that the creation of Islamic money market and capital market are another landmark development in the area of Islamic finance. A wide range of instruments have been developed to facilitate the effective management of liquidity and funding by the Islamic financial institutions. This has facilitated the smooth flow of funds in the IFS. The encouraging development in the Islamic Capital Market (ICM) has encouraged major Islamic banks to issue *Sukuk* (Islamic bonds).

Consumer education and awareness about Islamic banking is critical to its success and future development. A consumer education program needs to be developed to enhance public awareness of the features of Islamic banking products and services (Dusuki and Abdullah, 2012). Islamic banking institutions offer products that address not only the needs of Muslims
but anyone in the society including individuals and corporations. Among the customers of Islamic banking institutions include men, women, Muslims, non-Muslims, students, business people and companies (Financial Post, 2008). Non-Muslim investors have also begun to look for less risky alternatives since the onset of the global credit crisis over a year ago cast doubt on many Western risk management practices (Sumiyu, 2013).

Mabrouk and Mamoghli (2010) identified that culture is also an important factor that affects the consumer standards for selection of a financial institution. The attitude of customer in Malaysia is different from the Pakistani customers that affect the decision of customer to use the Islamic banking products and services. Dusuki and Abdullah (2012) also find that for Muslims religious views are the important and main factor that stimulates the individuals to go on Islamic banking system instead of conventional banking. Ainley et al. (2014) show that religious factor may or may not be important the main thing is potential profit taken by the investor.

A study conducted by Mansori (2010) revealed that customers of Islamic and conventional banks in Pakistan were satisfied with the facilities provided by their banks – clients of Islamic banks were satisfied with the facilities provided their banks but the customers of conventional banks were more satisfied than the customers of Islamic banks. In their analysis, findings proved that economic benefits, financial position of banks, interest on deposits, strong global image and network reputation were the factors that were motivating customers towards conventional banks. Factors which motivating customers towards Islamic banks were: interest free loan, financial position of bank, Islamic teaching and Shariah knowledge on Islam and religious environment in the city were the factors which motivating customers towards Islamic banks.

A study carried out on the factors influencing development of Islamic banking in Kenya by Ndung’u (2011), revealed Islamic banking was driven by religious compliance and customers need being met. It also revealed that continuous review and improvement of Shariah-compliant products together with diversifying market niche will lead to drastic development and marketing of Islamic banking products.
2.4.2 Enactment of Islamic Banking Law

Ensuring adequate and comprehensive legal infrastructure. According to Salman (2010), the enactment of an Islamic banking law is an important part of this process. For conventional banks offering Islamic banking products, amendments to the existing banking legislation may be necessary to allow such banks to undertake trade-related activities and other multi-faceted functions. According to Iqbal and Molyneux (2010), the investment policy of the Government may need to be reviewed to provide for the issue of Islamic investment instruments to facilitate the liquidity operations of such banking institutions. In addition, Salman (2010) states that, a legal fraternity that is competent in both Sharia and civil laws is very important including the tax legislation that accord neutrality in treatment between Islamic and conventional banking products.

Islamic banking institutions are growing fast not only in the Muslim world but also in countries that have Muslim minorities (Financial Post, 2008). According to Dusuki and Abozaid (2012), buoyed by the potential and the growing of the assets of these Islamic institutions, regulations are being put in place which tries to balance religious conformity with the economic reality that they offer. Many countries, according to Beck et al. (2010), both Islamic and non-Islamic, are putting ambitious infrastructure programs and regulations aimed at establishing Islamic banking institutions hence attracting part of the huge assets available in the sector.

Countries are developing comprehensive changes in their banking laws and acts to fit the Islamic banking system in their existing banking environment (Mabrouk and Mamoghli, 2010). Even countries that once opposed the establishment of Islamic financial institutions on their soil are now enacting laws to allow such institutions to operate; these include Italy, France and Australia. Even the United States (US), which has long opposed amending laws or creating new ones especially for Islamic banking, announced in 2009 that it is considering using Islamic banking to fight the global crisis, according to the US Secretary of the Treasury Robert Kimmitt (Vogel and Hayes, 2009). In Italy, though a non-Muslim country, regulations and mechanisms are being put in place by the government to attract Islamic financial
institutions to enter the Italian market. Bakkar (2008) notes that an effective legal infrastructure is important for the development of any type of industry in any country, especially in the Islamic finance sector which he considers to be enjoying a renaissance.

In France, the government requested the Paris financial markets authorities to produce a report analyzing the necessary measures in order to make this marketplace a competitive one worldwide in the provision of Islamic products and services in April 2008. A month later, the Senate hosted roundtable discussions with politicians, bankers and Shariah experts to discuss how to support Islamic finance and banking by raising awareness and changing the legal, banking and fiscal framework (Dusuki and Abozaid, 2012). Big Gulf Cooperation Council (GCC) Islamic banks such as the Qatar Islamic Bank (QIB) and Dubai Islamic Bank (DIB) open Islamic banks both in the Muslim and western countries to also facilitate investment opportunities for both individual and corporate investors who want to invest in a Shariah-compliant manner in these countries. In France, the first French Qatari Islamic bank is set to open in 2010 (Siddidi and Nejatuallah, 2014).

Elsewhere in the world, Central Banks have already put mechanisms and amendments in their Banking Acts to allow the operation of Islamic banks and Islamic banking windows in conventional banks (Bakkar, 2008). In England, the government has taken important measures to promote Islamic banking and finance. Following the same, the Bank of England through the Financial Services Authority (FSA) authorized the Islamic Bank of Britain, the first wholly Islamic retail bank in a non-Muslim country (Ainley et al., 2014). England today has four Islamic banks (Bakkar, 2008).

Over the world, Central Banks have paved the way to allow more than 180 Islamic banks and other financial institutions to operate by issuing them with licenses (Gerrard and Cunningham, 2012). In Malaysia for example, the Bank Negara Malaysia (BNM) which is the Central Bank had by 1983 put in place the Islamic Banking Act. Under the Islamic Banking Act, the BNM has licensed more than 8 Islamic banks to both local and foreign banks. In addition, the BNM has approved the opening of many Islamic banking windows and subsidiaries to conventional banks (Nazim, 2013).
The background of Islamic banking in Kenya started with various inquiries on Islamic Banking in late 90’s and early 2000’s. However, first serious expression of interest was lodged with CBK in 2004 (CBK, 2013). To develop capacity in this banking niche, CBK undertook a study tour to United Arab Emirates (UAE) and United Kingdom (UK) in 2005, including extensive research on legal and regulatory frameworks of other jurisdictions carrying out Islamic Banking (for example, Malaysia, Indonesia, Bahrain, and Kuwait). Kenya’s Islamic banking policy position therefore, follows the results of this study tour and research, in which CBK identified three policy options: (i) regulate Islamic banks within existing legal and regulatory framework, (ii) amendment of existing legal and regulatory framework to accommodate Islamic banks, and (iii) enactment of separate Islamic Banking Act. After careful consideration and need for level playing field, CBK recommended to MoF to regulate banks operating under Islamic Banking principles within existing legal and regulatory framework; this Policy position was approved by Treasury in late 2005 (CBK, 2010).

Tenets of CBK’s policy position on Islamic banking included the fact that, Islamic Banks are not separately defined in the Banking Act; all banks including those operating pursuant to Islamic banking principles are subject to the requirements of the Banking Act, in whole (CBK, 2013). Thus, the keyword is Shariah-compliant banking products. Further, it noted that all banks can offer Shariah-compliant banking products subject to statutory and prudential requirements (Oundo, 2009). Development of Islamic banking in Kenya began with applications for two institutions proposing to operate under Islamic banking principles received in late 2006 and early 2007. Applications were reviewed and approved in 2007 and institutions commenced operations in December 2007 and May 2008. Up to 5 other commercial banks are also offering Shariah-compliant banking products alongside conventional products (KBA, 2013).

2.4.3 Strategic Innovation and Development of New Products and Processes
The growth of Islamic financial industry cannot be achieved without having viable and attractive product to attract the players in the market. Islamic financial institutions have to be
creative in coming up with the products which are Sharia compliant and at the same time attractive and competitive (Demir, Mustafa and Toprak, 2014). According to Laldin (2011), Islamic financial institutions in Malaysia offer more than 40 Islamic financial products and services that may be offered by the banks using various Islamic concepts such as Mudharabah, Musyarakah, Murabahah, Bai’ Bithaman Ajil (Bai’ Muajjal), Ijarah, Qardhul Hasan, Istisna’ and Ijarah Thumma Al-Bai’. These help the banks meet and satisfy the needs of a wide range of customers.

The three main types of Shariah-compliant retail financing products use different contracts between the bank and customer with the contracts differing regarding ownership of the goods, nature of payments, and sharing of profit and loss. Instead of charging interest, the banks charge administrative and management fees that cover their costs and provide them a profit margin (Laldin, 2011). According to Siddiqi and Nejatuallah (2012), all three contract types can be used for home financing, although the ijara and musharaka contract forms are the most commonly used.

According to Mabrouk and Mamoghli (2010), most Islamic banks also offer two unique profit-free financing types to individuals. Hajj financing which is provided for Muslims wishing to participate in the Hajj, the annual religious pilgrimage to Mecca (all followers of Islam who are physically able and can afford to do so are required to make the pilgrimage at least once during their lifetime) is typically unsecured and may require only evidence of the customer’s travel plans (Dusuki and Abdullah, 2012). The second unique product to Islamic banking is qard alhasan (or qardhasan) a profit-free financing funded by the bank and based on the applicant’s hardship or charitable need (Mabrouk and Mamoghli, 2010). According to Nazim (2013), Hajj and qardhasan financing reflect the ethical role of Islamic banks.

According to Ndung’u (2011) the developments of Islamic banking have enabled the formerly unbanked Kenyans and specifically the Muslim communities in the marginal areas have access to financial services adding to the wealth creation in the economy. This is a solid testimony of the vast potential of Islamic finance in Kenya, which should be tapped, and opportunities explored in the insurance (takaful) and capital market segments using Shariah-
compliant vehicles. There are many people who could never bring themselves to enter a conventional bank’s office and make use of the bank’s services. If an Islamic bank sets up shop in their neighborhood, the fact that it is Islamic might be just the incentive they need to enter the world of formal finance (Demir, Mustafa and Toprak, 2014).

2.4.4 Establishing Islamic Financial Institutions

Islamic banking is a very fast industry that does not lack capital but expertise and uniformity (Laldin, 2011). As the sector continues to grow, it is becoming increasingly important for banks to ensure that their employees receive the training and resources to follow both Sharia principles and traditional compliance laws (Vogel and Hayes, 2009). Banks must act now to provide documentation and training for their employees. It is only with a knowledgeable, educated staff that Islamic financial institutions can survive and compete (Eagle, 2014). In their research, Dusuki and Abozaid (2012) present evidence that one of the main challenges of Islamic banking is the lack of expertise to perform the Shariah review. Most of the time, auditors lack the Shariah background and the Shariah employees lack also the experience and training to perform effective and efficient Shariah-compliant operations.

In England where the Islamic finance is the most developed in Europe, it has been widely acknowledged that there is a shortage of qualified professionals in the Islamic finance sector. There is need for a clear scope for more education and training in the field (Finance Post, 2008). In response to this, universities have designed degrees and professional training programs (Ainley et al., 2014). Iqbal and Molyneux (2010) pointed out the issues of under-qualified employees and their training. They noted that most of the managers in Islamic financial institutions were not very well trained in the use of Islamic modes of finance.

Most professional and training courses tend to be geared towards conventional banking rather than Islamic banking. In reality, there is a limited number of institutions and schools which offer training for Islamic institutions (Nazim, 2013). So, after properly documenting all policies and procedures, there is need for Islamic financial institutions to educate their personnel to understand the principles of Shariah (Gerrard and Cunningham, 2012). However, training for employees on both general and Islamic banking principles does not
have to be a costly or timely expenditure. E-Learning is a cost effective way to educate employees on general banking principles, as well as on Islamic banking law (Eagle, 2014). The author added that, by providing e-Learning training to its employees, a financial institution will eliminate the need for costly and time-consuming in-house training. E-Learning eliminates or greatly reduces the cost of travel, instructor time, materials and lost work days, and provides a program that can be used for refresher training and new-hire training. Many larger conventional banks have a specialized function to educate employees and ensure on going adherence to Islamic principles (Farah, 2014).

Training will not only help bank employees to become familiar with general banking principles, it will also teach them about the complex regulations that apply to Islamic products and services (Ainley et al., 2014). Through these training programs, employees will gain the knowledge and tools needed to benefit the customer-banking relationship (Eagle, 2014). This has seen the emergence of Islamic courses been offered by Kenyan colleges and universities and with time Islamic banking in Kenya will be having more qualified personnel who understand fully the Islamic banking principles.

2.5 Chapter Summary
Islamic banking has been growing at an impressive rate. Its presence in Kenya as a financial intermediary can be viewed positively as a compliment to conventional banking. It has created an environment of competition and we expect that there will be an improvement of the overall services provided by the banks. The government has to come up with improved policies for an enabling environment to foster for a friendly investment conditions. There are lot of opportunities to be tapped with rich oil producing Middle-East countries were the hub of Islamic banking is concentrated. The government can immensely benefit through the issue of Islamic bonds (Sukuk) which they can be used to finance various infrastructures projects.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction
This chapter discusses the research methodologies employed to achieve the above research questions. Section 3.2 presents the research design adopted, followed by section 3.3 explaining the population and sampling design and then Section 3.4 describing the data collection methods applied in carrying out the research. Section 3.5 presents the research procedures adopted in conducting the research. This chapter further discusses the data analysis in section 3.6 followed by chapter summary in Section 3.7.

3.2 Research Design
Orodho (2004) defines research design as the scheme outline or plan that is used to generate answers to research problems. It is the arrangement of conditions for collection and analysis of data in a manner that aims to combine relevance with research purpose. According to Sekaran and Bougie (2011) descriptive study is undertaken in order to ascertain and be able to describe the characteristics of the variable of interest in a situation. Descriptive studies are essential in many situations especially when using qualitative data in understanding the phenomena.

This study adopted descriptive and explanatory research design. The main focus of this study was quantitative in nature. However some qualitative approach was used in order to gain a better understanding and possibly enable a better and more insightful interpretation of the results from the quantitative study. A descriptive study was justified as it attempted to describe the characteristics associated with the subject population and based on the findings of the study; discovery of associations among different variables arose thus enabling the researcher to draw conclusions.

The researcher’s objective is to find out the effects of Islamic financial products offered by Islamic banks and how these products have given them competitive advantage over the other conventional banks in Kenya. To achieve this objective, the researcher employed the interview technique to collect information from people directly involved in Islamic banking.
The explanatory approach was used to investigate the competitiveness of Islamic bank financial products innovation and how these products have an effect on their performance in the banking industry in Kenya.

3.3 Population and Sampling Design

3.3.1 Population
According to Tull and Hawkins (2008), a population is the group the researcher wants to generalize or learn about whereas Cooper and Schindler (2008) define a population as the total of the elements upon which inferences can be made. A population is therefore the total collection of all elements about which one wishes to make some inferences (Cooper and Schindler, 2003). The population is the entire group of individuals, events, or objects having a common observable characteristic. For GAB and FCB, the population represents the total number of Branches countrywide which is estimated at 20 for FCB and 15 for GAB, a total of 35 branches. The target population in this study was Branch Managers of GAB and FCB both at the Head office and branch level.

3.3.2 Sampling Design
The basic idea of sampling is to select some elements of the population that facilitate the researcher’s ability to draw conclusions about the same entire population. Sampling presents benefits such as the advantages of lower research costs, greater accuracy on the obtained results, and greater speed of the data collection and the availability of the required population elements (Cooper and Schindler, 2008).

3.3.2.1 Sampling Frame
A sample frame is the list of elements from which the sample is actually drawn. Ideally it is a complete and correct list of population members only (Cooper and Schindler, 2003). The sampling frame used in this study was a list of the Branch managers in Nairobi of both GAB and FCB provided by their respective head office managers.

3.3.2.2 Sampling Technique
A sample is a smaller but hopefully representative collection of units from a population used
to determine truths about that population (Hyndman, 2008). Simple random sampling is applicable when population is homogeneous and readily available. Probability sampling is based on the concept of random selection – a controlled procedure that assures that each population element is given a known chance of selection (Cooper and Schindler, 2003). There are various ways of probability sampling, these include; stratified sampling, systematic sampling, simple random sampling, cluster or multistage sampling and probability proportional to size sampling. Simple random sampling was used for this research so as to increase the sample’s statistical efficiency and to provide adequate data for analyzing the various subpopulations.

### 3.3.2.3 Sample Size

While the population is the larger set of observations, the smaller set is referred to as the sample. How large a sample size should be is a function of the variation in the population perimeters under study and the estimating precision needed by the researcher (Cooper and Schindler, 2008). The goal of survey research is to collect data that is representative of a population. According to Holton and Burnett (1997), one of the real advantages of quantitative methods is their ability to use smaller groups of people to make inferences about larger groups that would be prohibitively expensive to study.

From the Population of 35 Branches for both Gulf African and First Community banks, (an average of 2 branch managers per Branch making total of 70 branch managers), a sample size of 32 Branch managers was selected. The sample elements consisted of 32 Branch managers within Nairobi including the Head office.

### 3.4 Data Collection Methods

The study used both primary and secondary data. The primary data was collected using a structured questionnaire and the respondents targeted were Branch managers of the two Islamic banks sampled. Questionnaires are generally less costly, less time consuming, and considerably less demanding with respect to such matters such as selection, training, and supervision of personnel. Being more uniform and standardized than interviews, questionnaires are also less susceptible to biases due to deviations from instructions and
method of administration (Cooper and Schindler, 2005). Finally, confidentiality and anonymity can be more effectively insured through the use of questionnaires.

The structured questionnaire contained questions on the level of education of the respondents and how long they had been in employment with the stated banks. The questionnaires also sought to get more information regarding the respective banks Islamic financial products which were used from Jan to June 2016. Structured questions were used since they were easier to analyze and facilitate harmonization of information that was obtained from the respondents.

3.5 Research Procedures
A pilot test is conducted to detect weaknesses in design and instrumentation and to provide proxy data or selection of a probability sample (Cooper and Schindler, 2003). A pilot test of the questionnaire was done using 10 branch managers of GAB and FCB chosen at random to respond to the questionnaire. The Head Office Manager handed out the questionnaires to managers of their respective Nairobi branches. The reason of doing this was to obtain feedback on any weaknesses and errors on the questionnaires. The questionnaires were then reviewed based on the comments and suggestions of those who responded to the pilot test.

After the pilot test, the instruments were fine-tuned and redesigned on the basis of the feedback that the researcher had received. In terms of validity, both content and criterion-related forms of validity were undertaken. On the other hand, stable reliability was considered before actual research was undertaken. The final version of the questionnaire was administered to the respondents selected in the sample size excluding the respondents who participated earlier in the pilot test.

The questionnaires were given to the Head Office Managers who handed them over to the branch managers over a period of 10 days. The researcher and the Head Office Managers consulted to ensure that the questionnaires were given to all the branch managers in order to gather responses that were as representative of the two banks. The filled questionnaires were
collected by the researcher from the Head Office Managers of the two banks respectively. The use of the Head Office Managers facilitated the collection of all questionnaires.

3.6 Data Analysis Methods
Data Analysis is the processing of data to make meaningful information (Saunders, Lewis and Thornhill, 2009). Burns and Grove (2003) define data analysis as a mechanism for reducing and organizing data to produce findings that require interpretation by the researcher. According to Hyndman (2008) data processing involves translating the answers on a questionnaire into a form that can be manipulated to produce statistics. This involves coding, editing, data entry, and monitoring the whole data processing procedure.

The study used quantitative data analysis. A Statistical Package for the Social Sciences (SPSS) tool was used to carry out a quantitative analysis. Quantitative data analysis refers to numerical data and can range from simple counts such as frequency of occurrences to complex data such as test scores, (Saunders, Lewis and Thornhill, 2009). Descriptive statistics of means and percentages was used to compare the study variables numerically and make interpretation easier. Pearson correlation analysis was used to determine the significance of the various study factors and a p value of <0.05 was the base for a significant relationship. Presentations were made using tables and figures.

3.7 Chapter Summary
This chapter has detailed the proposed research method, giving a description of the research design, population and sampling design, data collection method, research procedures. The population and sample size was also discussed. Justification was provided for the sample size that was used in the end. This was pertinent as it is imperative that the research reflects the views of the two Islamic bank's branch managers. The next chapter presents the study results and findings.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction
This section presents and discusses the study findings as guided by the research instruments and the methodology discussed in the previous section. The section gives presentations on respondents’ demographics, and the results of the study research questions.

4.2 Response Rate and Respondents’ Demographics

4.2.1 Response Rate
The researcher through the Head Office Managers handed out 32 questionnaires to the selected population and managed to receive all of them. After cleaning, the researcher found one incomplete questionnaire that was excluded from the analysis giving the study a response rate of 97% as shown in Figure 4.1 which was above the required threshold.

![Figure 4.1 Response Rate](image)

Figure 4.1 Response Rate

4.2.2 Level of Education
The researcher asked respondents to indicate their level of education and their response was as indicated in Figure 4.2. The figure shows that the banks had well educated employees since 50% had university degrees and an equal 50% had post graduate degree.
4.2.3 Years in Current Employment

The study sought to establish the number of years the respondents had been in the employment. Figure 4.3 illustrates that 14% of the respondents indicated less than 1 year, 26% indicated between 2 and 4 years, 39% indicated between 5 to 7 years, and 21% indicated 8 and above years. The findings imply that the respondents were appropriate for the study since they had worked for the banks long enough for them to be well aware of the Islamic products offered by the banks under study.

4.2.4 Duration of Islamic Bank Provision

The study sought to find out the number of years the banks had provided Islamic Banking. Figure 4.4 shows that 59% stated that their bank had provided Islamic Banking between 5
and 8 years and 41% stated that their bank had provided Islamic Banking between 9 and 12 years. These results correlate with the history of the banks since Gulf bank was incorporated on August 9th 2006 and First Community bank commenced operation on the 1st of June 2008.

![Figure 4.4 Duration of Islamic Bank Provision](image)

**4.2.5 Banks’ Financial System**

The study sought to find out the type of financial system the banks provided and figure 4.5 shows that both banks were providing 100% Islamic financial systems. The findings imply that by providing Islamic banking, the banks were committed to the vision of growing Islamic banking in the country and the region.

![Figure 4.5 Adopted Financial System](image)
4.3 Main Islamic Banking Products

4.3.1 Islamic Products Offered by Banks

The respondents were asked to rate the products that their banks offered/ provided using the scale (SD=Strongly Disagree, D=Disagree, N=Neutral, A=Agree, SA=Strongly Agree). The resulting mean of >3.0 shows that the two banks had well-established Islamic products and services, and the standard deviation of <1.5 shows that the difference of the responses given was insignificant (almost similar).

Table 4.1 Islamic Products Offered

<table>
<thead>
<tr>
<th>SD</th>
<th>D</th>
<th>N</th>
<th>A</th>
<th>SA</th>
<th>Mean</th>
<th>Std Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Our bank offers debt-like financing structured as sales (Murabahah)</td>
<td>0</td>
<td>0</td>
<td>19.4</td>
<td>48.4</td>
<td>32.3</td>
<td>4.13</td>
</tr>
<tr>
<td>Our bank offers purchases with deferred delivery of the products (Salam and Istisna’)</td>
<td>0</td>
<td>0</td>
<td>16.1</td>
<td>41.9</td>
<td>41.9</td>
<td>4.26</td>
</tr>
<tr>
<td>Our bank offers lease (Ijārah) with different options to buy</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>61.3</td>
<td>38.7</td>
<td>4.39</td>
</tr>
<tr>
<td>As a bank, we provide profit-sharing and loss-bearing (Mudarabah) products to our customers</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>48.4</td>
<td>51.6</td>
<td>4.52</td>
</tr>
<tr>
<td>As a bank, we provide pure profit-and-loss-sharing (Musharakah) products to our customers</td>
<td>0</td>
<td>0</td>
<td>3.2</td>
<td>51.6</td>
<td>45.2</td>
<td>4.42</td>
</tr>
<tr>
<td>As a bank, we provide services of safe-keeping contracts (Wadi’ah) for current deposit for our customers</td>
<td>0</td>
<td>0</td>
<td>12.9</td>
<td>67.7</td>
<td>19.4</td>
<td>4.06</td>
</tr>
<tr>
<td>As a bank, we provide safe-keeping contracts (Wakalah) for agency contracts</td>
<td>0</td>
<td>0</td>
<td>19.4</td>
<td>45.2</td>
<td>35.5</td>
<td>4.16</td>
</tr>
</tbody>
</table>
Table 4.1 shows that the banks offered debt-like financing structured as sales (Murabahah) as agreed to by 80.7% of the respondents with a resulting mean of 4.13 and a standard deviation of 0.718. The banks offered purchases with deferred delivery of the products (Salam and Istisna) as agreed to by 83.8% of the respondents with a resulting mean of 4.26 and a standard deviation of 0.729. The banks offered lease (Ijārah) with different options to buy as agreed to by 100% of the respondents with a resulting mean of 4.39 and a standard deviation of 0.495. The banks provided profit-sharing and loss-bearing (Mudarabah) products to customers as agreed to by 100% of the respondents with a resulting mean of 4.52 and a standard deviation of 0.508. The banks provided pure profit-and-loss-sharing (Musharakah) products to customers as agreed to by 96.8% of the respondents with a resulting mean of 4.42 and a standard deviation of 0.564. The banks provided services of safe-keeping contracts (Wadi’ah) for current deposit for customers as agreed to by 87.1% of the respondents with a resulting mean of 4.06 and a standard deviation of 0.574. The banks provided safe-keeping contracts (Wakalah) for agency contracts as agreed to by 80.6% of the respondents with a resulting mean of 4.16 and a standard deviation of 0.735.

4.3.2 Correlations for Islamic Products Offered

A Pearson correlation test for the Islamic Products offered was carried out to determine their significance with the threshold set for any factor that was <0.05. The results were as shown in Table 4.2.

Table 4.2 that banks offering debt-like financing structured as sales (Murabahah) was significant (r=0.637, p<0.05). The banks offering purchases with deferred delivery of the products (Salam and Istisna’) was insignificant (r=0.316, p>0.05). The banks offering lease (Ijārah) with different options to buy was significant (r=0.698, p<0.05). The banks providing profit-sharing and loss-bearing (Mudarabah) products to customers was significant (r=0.542, p<0.05). The banks providing pure profit-and-loss-sharing (Musharakah) products to customers was significant (r=0.467, p<0.05). The banks providing services of safe-keeping contracts (Wadi’ah) for current deposit for customers was insignificant (r=0.222, p>0.05). The banks providing safe-keeping contracts (Wakalah) for agency contracts was insignificant (r=0.275, p>0.05).
Table 4.2 Correlations for Islamic Products Offered

<table>
<thead>
<tr>
<th>Description</th>
<th>Correlations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Our bank offers debt-like financing structured as sales (<em>Murabahah</em>)</td>
<td>.637**  .000</td>
</tr>
<tr>
<td>Our bank offers purchases with deferred delivery of the products</td>
<td>.316  .083</td>
</tr>
<tr>
<td>(<em>Salam</em> and <em>Istisna’</em>)</td>
<td></td>
</tr>
<tr>
<td>Our bank offers lease (<em>Ijārah</em>) with different options to buy</td>
<td>.698**  .000</td>
</tr>
<tr>
<td>As a bank, we provide profit-sharing and loss-bearing (<em>Mudarabah</em>) products to our customers</td>
<td>.542**  .002</td>
</tr>
<tr>
<td>As a bank, we provide pure profit-and-loss-sharing (<em>Musharakah</em>) products to our customers</td>
<td>-.467**  .008</td>
</tr>
<tr>
<td>As a bank, we provide services of safe-keeping contracts (<em>Wadi’ah</em>) for current deposit for our customers</td>
<td>.222  .230</td>
</tr>
<tr>
<td>As a bank, we provide safe-keeping contracts (<em>Wakalah</em>) for agency contracts</td>
<td>.275  .134</td>
</tr>
</tbody>
</table>

** Correlation is significant at the 0.01 level
* Correlation is significant at the 0.05 level

4.3.3 Islamic Financing Offered by Banks

The respondents were asked to rate the various financing options that their banks offered/ provided using the scale (SD=Strongly Disagree, D=Disagree, N=Neutral, A=Agree, SA=Strongly Agree). The resulting mean of >3.0 shows that the two banks had well-established Islamic financing services, and the standard deviation of <1.5 shows that the difference of the responses given was insignificant (almost similar).

Table 4.3 shows that the banks provided customers with *musharakah* (partnership financing) as agreed to by 100% of the respondents with a resulting mean of 4.48 and a standard deviation of 0.508. The banks provided customers with *mudharabah* (trust financing) as
agreed to by 100% of the respondents with a resulting mean of 4.55 and a standard deviation of 0.506.

Table 4.3 Islamic Financing Offered

<table>
<thead>
<tr>
<th>SD</th>
<th>D</th>
<th>N</th>
<th>A</th>
<th>SA</th>
<th>Mean</th>
<th>Std Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

As a financial institution, we provide our customers with *musharakah* (partnership financing)

0 0 0 51.6 48.4 4.48 .508

As a financial institution, we provide our customers with *mudharabah* (trust financing)

0 0 0 45.2 54.8 4.55 .506

As a financial institution, we provide our customers with *murabahah/baimuajjal* (deferred payment sales) and financing

0 9.7 16.1 61.3 12.9 3.77 .805

As a financial institution, we provide our customers *salam/istisna* (purchase order) financing

0 9.7 9.7 64.5 16.1 3.87 .806

As a financial institution, we provide our customers *ijarah* (leasing)

0 9.7 0 54.8 35.5 4.16 .860

As a bank, we face a serious problem with our *mudaraba* loans because our borrowers prefer the conventional banks

45.2 29 19.4 0 6.5 4.06 1.124

The profit-and-loss sharing features are marginally practiced in our bank

0 6.5 9.7 61.3 22.6 4.00 .775

Our organization employs the use of *Sukuk* to provide funds to our customers and bolster the activities in our banks

12.9 0 6.5 51.6 29 3.84 1.241

Table 4.3 shows that the banks provided customers with *murabahah/baimuajjal* (deferred payment sales) and financing as agreed to by 74.2% of the respondents with a resulting mean of 3.77 and a standard deviation of 0.805. The banks provided customers with *salam/istisna* (purchase order) financing as agreed to by 80.6% of the respondents with a resulting mean of 3.87 and a standard deviation of 0.806. The banks provided customers with *ijarah* (leasing) as agreed to by 90.3% of the respondents with a resulting mean of 4.16 and a standard deviation of 0.860. The banks did not face a serious problem with their *mudaraba* loans.
because their borrowers did not prefer the conventional banks as shown by 74.2% of the respondents with a resulting mean of 4.06 and a standard deviation of 1.124. The table shows that profit-and-loss sharing features were marginally practiced in the banks as agreed to by 83.9% of the respondents with a resulting mean of 4.00 and a standard deviation of 0.775. The organizations employed the use of Sukuk to provide funds to customers and bolster the activities as agreed to by 80.6% of the respondents with a resulting mean of 3.84 and a standard deviation of 1.241.

4.3.4 Correlations for Islamic Financing Services Offered

A Pearson correlation test for the Islamic financing services offered was carried out to determine their significance with the threshold set for any factor that was <0.05. The results were as shown in Table 4.4.

Table 4.4 Correlations for Islamic Financing Services

| Correlations |  
|--------------|---
| As a financial institution, we provide our customers with **musharakah** (partnership financing) | .356* .049 |
| As a financial institution, we provide our customers with **mudharabah** (trust financing) | -.808** .000 |
| As a financial institution, we provide our customers with **murabahah/baimuajjal** (deferred payment sales) and financing | .276 .133 |
| As a financial institution, we provide our customers with **salam/istisna** (purchase order) financing | .076 .684 |
| As a financial institution, we provide our customers with **ijarah** (leasing) | .426* .017 |
| As a bank, we face a serious problem with our **mudaraba** loans because our borrowers prefer the conventional banks | -.232 .210 |
| The profit-and-loss sharing features are marginally practiced in our bank | -.085 .650 |
| Our organization employs the use of **Sukuk** to provide funds to our customers and bolster the activities in our banks | .181 .330 |

** Correlation is significant at the 0.01 level
* Correlation is significant at the 0.05 level

Table 4.4 shows that the banks providing customers with **musharakah** (partnership financing) was significant ($r=0.356$, $p<0.05$). The banks providing customers with **mudharabah** (trust financing) was significant ($r=-0.808$, $p<0.05$). The banks providing customers with
murabahah/ baimuajjal (deferred payment sales) and financing was insignificant (r=0.276, p>0.05). The banks providing customers with salam/istisna (purchase order) financing was insignificant (r=0.076, p>0.05). The banks providing customers with ijarah (leasing) was significant (r=0.426, p<0.05). The banks not facing a serious problem with their mudaraba loans because of borrowers preferring the conventional banks was insignificant (r=-0.232, p>0.05). The profit-and-loss sharing features of the banks being marginally practiced in the banks was insignificant (r=-0.085, p>0.05). The banks employing the use of Sukuk to provide funds to customers and bolster their activities was insignificant (r=0.181, p>0.05).

4.4 Main Requirements for the Provision of Islamic Financial Products

4.4.1 Islamic Banking Guidelines

The respondents were asked to rate the various Islamic banking guidelines that affected their banks using the scale (SD=Strongly Disagree, D=Disagree, N=Neutral, A=Agree, SA=Strongly Agree). The resulting mean of >3.0 shows that the two banks were impacted by the guidelines, and the standard deviation of <1.5 shows that the difference of the responses given was insignificant (almost similar).

Table 4.5 shows that the banks have been put under the supervision of the Central Bank of Kenya and are treated the same as other conventional banks as agreed to by 74.2% of the respondents with a resulting mean of 3.94 and a standard deviation of 0.680. The banks have established their own separate Shari‘ah Board that supervised and offered guidance to their operating systems as agreed to by 74.2% of the respondents with a resulting mean of 4.29 and a standard deviation of 0.864. The banks had boards that had the appropriate experience, competency and that puts in practice professionalism and personal integrity as agreed to by 100% of the respondents with a resulting mean of 4.26 and a standard deviation of 0.445. The banks’ board had the appropriate number of directors that was commensurate with the bank size and scope of operations as agreed to by 100% of the respondents with a resulting mean of 4.74 and a standard deviation of 0.445. The banks’ guidelines had comprehensive provisions about consumer protection and consumer relations as agreed to by 100% of the respondents with a resulting mean of 4.32 and a standard deviation of 0.475.
### Table 4.5 Islamic Banking Guidelines

<table>
<thead>
<tr>
<th></th>
<th>SD</th>
<th>D</th>
<th>N</th>
<th>A</th>
<th>SA</th>
<th>Mean</th>
<th>Std Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Our bank has been put under the</td>
<td>0</td>
<td>0</td>
<td>25.8</td>
<td>54.8</td>
<td>19.4</td>
<td>3.94</td>
<td>.680</td>
</tr>
<tr>
<td>supervision of the Central Bank of</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Kenya and we are treated the same as</td>
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<tr>
<td>other conventional banks</td>
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<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>0</td>
<td>0</td>
<td>25.8</td>
<td>19.4</td>
<td>54.8</td>
<td>4.29</td>
<td>.864</td>
</tr>
<tr>
<td>Our bank has established its own</td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>separate Shari’ah Board that</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>supervises and offers guidance to our</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>operating systems</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Our board has the appropriate</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>74.2</td>
<td>25.8</td>
<td>4.26</td>
<td>.445</td>
</tr>
<tr>
<td>experience, competency and that puts</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>in practice professionalism and</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>personal integrity</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Our board has the appropriate number</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>25.8</td>
<td>74.2</td>
<td>4.74</td>
<td>.445</td>
</tr>
<tr>
<td>of directors that is commensurate with</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>the bank size and scope of operations</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Our guidelines have comprehensive</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>67.7</td>
<td>32.3</td>
<td>4.32</td>
<td>.475</td>
</tr>
<tr>
<td>provisions about consumer protection</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>and consumer relations</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### 4.4.2 Correlations for Islamic Banking Guidelines

A Pearson correlation test for the Islamic banking guidelines was carried out to determine their significance with the threshold set for any factor that was <0.05. The results were as shown in Table 4.6.

Table 4.6 shows that the banks being put under the supervision of the Central Bank of Kenya and being treated the same as other conventional banks was significant ($r=0.493, p<0.05$). The banks establishing their own separate Shari’ah Board that supervised and offered guidance to their operating systems was insignificant ($r=-0.137, p>0.05$). The banks’ board
having the appropriate experience, competency, and puts in practice professionalism and personal integrity was insignificant (r=-0.274, p>0.05). The banks’ board having the appropriate number of directors that were commensurate with the bank size and scope of operations was insignificant (r=-0.277, p>0.05). The banks’ guidelines having comprehensive provisions about consumer protection and consumer relations was insignificant (r=-0.037, p>0.05).

Table 4.6 Correlations for Islamic Banking Guidelines

<table>
<thead>
<tr>
<th></th>
<th>Correlations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Our bank has been put under the supervision of the Central Bank of Kenya and we are treated the same as other conventional banks</td>
<td>.493** .005</td>
</tr>
<tr>
<td>Our bank has established its own separate Shari’ah Board that supervises and offers guidance to our operating systems</td>
<td>-.137 .461</td>
</tr>
<tr>
<td>Our board has the appropriate experience, competency and that puts in practice professionalism and personal integrity</td>
<td>-.274 .136</td>
</tr>
<tr>
<td>Our board has the appropriate number of directors that is commensurate with the bank size and scope of operations</td>
<td>-.277 .131</td>
</tr>
<tr>
<td>Our guidelines have comprehensive provisions about consumer protection and consumer relations</td>
<td>-.037 .845</td>
</tr>
</tbody>
</table>

** Correlation is significant at the 0.01 level  
* Correlation is significant at the 0.05 level

4.4.3 Islamic Banking Regulations

The respondents were asked to rate the various Islamic banking regulations that affected their banks using the scale (SD=Strongly Disagree, D=Disagree, N=Neutral, A=Agree, SA=Strongly Agree). The resulting mean of >3.0 shows that the two banks were impacted by the regulations, and the standard deviation of <1.5 shows that the difference of the responses given was insignificant (almost similar).
Table 4.7 Islamic Banking Regulations

<table>
<thead>
<tr>
<th>Statement</th>
<th>SD</th>
<th>D</th>
<th>N</th>
<th>A</th>
<th>SA</th>
<th>Mean</th>
<th>Std Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Our main challenge is the ambiguity in respect to tax treatment</td>
<td>25.8</td>
<td>16.1</td>
<td>9.7</td>
<td>25.8</td>
<td>22.6</td>
<td>3.03</td>
<td>1.560</td>
</tr>
<tr>
<td>The depth of outreach remains a serious problem for our bank</td>
<td>0</td>
<td>22.6</td>
<td>16.1</td>
<td>58.1</td>
<td>3.2</td>
<td>3.42</td>
<td>.886</td>
</tr>
<tr>
<td>Our freedom of enterprise and financial decisions are made based on the guidelines provided by Islam</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>74.2</td>
<td>25.8</td>
<td>4.26</td>
<td>.445</td>
</tr>
<tr>
<td>As a bank, we have developed products and services which are not contradictory to the Islamic law and services adopted from conventional banks are normally tailored to fit the <em>Sharia</em></td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>67.7</td>
<td>32.3</td>
<td>4.32</td>
<td>.475</td>
</tr>
<tr>
<td>Our bank has refreshed Islamic banking and finance practices based on the proper understanding and implementation of the <em>maqasid</em> of <em>Sharia</em></td>
<td>0</td>
<td>0</td>
<td>22.6</td>
<td>58.1</td>
<td>19.4</td>
<td>3.97</td>
<td>.657</td>
</tr>
</tbody>
</table>

Table 4.7 shows that the main challenge for the banks was the ambiguity in respect to tax treatment as agreed to by 48.4% of the respondents. A significant number of respondents 41.9% also disagreed with the statement resulting to a mean of 3.03 and a standard deviation of 1.560. The depth of outreach remained a serious problem for the banks as agreed to by 61.3% of the respondents with a resulting mean of 3.42 and a standard deviation of 0.886. The bank’s freedom of enterprise and financial decisions were made based on the guidelines provided by Islam as agreed to by 100% of the respondents with a resulting mean of 4.26 and
a standard deviation of 0.445. The banks had developed products and services which were not contradictory to the Islamic law and services adopted from conventional banks as agreed to by 100% of the respondents with a resulting mean of 4.32 and a standard deviation of 0.475. The banks had refreshed Islamic banking and finance practices based on the proper understanding and implementation of the *maqasid* of *Sharia* as agreed to by 77.4% of the respondents with a resulting mean of 3.97 and a standard deviation of 0.657.

### 4.4.4 Correlations for Islamic Banking Regulations

A Pearson correlation test for the Islamic banking regulations was carried out to determine their significance with the threshold set for any factor that was <0.05. The results were as shown in Table 4.8.

#### Table 4.8 Correlations for Islamic Banking Regulations

<table>
<thead>
<tr>
<th></th>
<th>Correlations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Our main challenge is the ambiguity in respect to tax treatment</td>
<td>.567** .001</td>
</tr>
<tr>
<td>The depth of outreach remains a serious problem for our bank</td>
<td>.569** .001</td>
</tr>
<tr>
<td>Our freedom of enterprise and financial decisions are made based on the guidelines provided by Islam</td>
<td>.280 .127</td>
</tr>
<tr>
<td>As a bank, we have developed products and services which are not contradictory to the Islamic law and services adopted from conventional banks are normally tailored to fit the <em>Sharia</em></td>
<td>.029 .876</td>
</tr>
<tr>
<td>Our bank has refreshed Islamic banking and finance practices based on the proper understanding and implementation of the <em>maqasid</em> of <em>Sharia</em></td>
<td>.294 .109</td>
</tr>
</tbody>
</table>

** Correlation is significant at the 0.01 level  
* Correlation is significant at the 0.05 level

Table 4.8 shows that the main challenge being ambiguity in respect to tax treatment was significant (r=0.567, p<0.05). The depth of outreach being a serious problem for the banks was significant (r=0.569, p<0.05). The freedom of enterprise and financial decisions being
made based on the guidelines provided by Islam was insignificant \((r=0.280, p>0.05)\). The banks developing products and services which were not contradictory to the Islamic law and services adopted from conventional banks was insignificant \((r=0.029, p>0.05)\). The banks having refreshed Islamic banking and finance practices based on the proper understanding and implementation of the *maqasid* of *Sharia* was insignificant \((r=0.294, p>0.05)\).

### 4.5 Enhancing Penetration of Islamic Finance Products in Kenya

#### 4.5.1 Factors enhancing Islamic Banking Development

The respondents were asked to rate the various factors that enhanced Islamic Banking development in their banks using the scale \((SD=\text{Strongly Disagree}, D=\text{Disagree}, N=\text{Neutral}, A=\text{Agree}, SA=\text{Strongly Agree})\). The resulting mean of >3.0 shows that the two banks were impacted by the development factors, and the standard deviation of <1.5 shows that the difference of the responses given was insignificant (almost similar).

Table 4.9 shows that the development in the Islamic Capital Market has encouraged the banks to issue *Sukuk* (Islamic bonds) as agreed to by 58.1% of the respondents with a resulting mean of 3.81 and a standard deviation of 1.078. Consumer education and awareness about Islamic banking was critical to the success and development of the banks as agreed to by 80.6% of the respondents with a resulting mean of 4.10 and a standard deviation of 0.700. The banks had non-Muslim customers who preferred them because they were a low risk alternative to the customers as agreed to by 77.4% of the respondents with a resulting mean of 4.26 and a standard deviation of 0.815. Culture affected the perception and standards of the consumers and it affected the consumers’ selection of the banks as agreed to by 61.3% of the respondents with a resulting mean of 3.19 and a standard deviation of 1.138. Economic benefits, financial position of the banks, interest paid on deposits, firm image and network reputation were factors that drove the banks’ customers towards conventional banks as agreed to by 87.1% of the respondents with a resulting mean of 4.06 and a standard deviation of 0.574. The continuous review and improvement of *Sharia* compliant products in the banks had led to a drastic development and marketing of the banks’ products as agreed to by 83.9% of the respondents with a resulting mean of 4.00 and a standard deviation of 0.577.
Table 4.9 Development Factors affecting Islamic Banking

<table>
<thead>
<tr>
<th></th>
<th>SD</th>
<th>D</th>
<th>N</th>
<th>A</th>
<th>SA</th>
<th>Mean</th>
<th>Std Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>The development in the Islamic Capital Market has encouraged our bank to issue <em>sukuk</em> (Islamic bonds)</td>
<td>0</td>
<td>12.9</td>
<td>29</td>
<td>22.6</td>
<td>35.5</td>
<td>3.81</td>
<td>1.078</td>
</tr>
<tr>
<td>Consumer education and awareness about Islamic banking is critical to our success and development</td>
<td>0</td>
<td>0</td>
<td>19.4</td>
<td>51.6</td>
<td>29</td>
<td>4.10</td>
<td>.700</td>
</tr>
<tr>
<td>We have non-Muslim customers who prefer us because we are a low risk alternative for them</td>
<td>0</td>
<td>0</td>
<td>22.6</td>
<td>29</td>
<td>48.4</td>
<td>4.26</td>
<td>.815</td>
</tr>
<tr>
<td>Culture affects the perception and standards of our consumers and affects their selection of banks</td>
<td>12.9</td>
<td>16.1</td>
<td>9.7</td>
<td>61.3</td>
<td>0</td>
<td>3.19</td>
<td>1.138</td>
</tr>
<tr>
<td>Economic benefits, financial position of our bank, interest paid on deposits, firm image and network reputation are factors that drive our customers towards conventional banks</td>
<td>0</td>
<td>0</td>
<td>12.9</td>
<td>67.7</td>
<td>19.4</td>
<td>4.06</td>
<td>.574</td>
</tr>
<tr>
<td>The continuous review and improvement of <em>Sharia</em> compliant products in our bank have led to a drastic development and marketing of our products</td>
<td>0</td>
<td>0</td>
<td>16.1</td>
<td>67.7</td>
<td>16.1</td>
<td>4.00</td>
<td>.577</td>
</tr>
</tbody>
</table>
4.5.2 Correlations for Factors enhancing Islamic Banking Development

A Pearson correlation test for the factors enhancing Islamic banking development was carried out to determine their significance with the threshold set for any factor that was <0.05. The results were as shown in Table 4.10.

Table 4.10 Correlations for Development Factors affecting Islamic Banking

<table>
<thead>
<tr>
<th></th>
<th>Correlations</th>
</tr>
</thead>
<tbody>
<tr>
<td>The development in the Islamic Capital Market has encouraged our bank to issue <em>Sukuk</em> (Islamic bonds)</td>
<td>0.771**</td>
</tr>
<tr>
<td>Consumer education and awareness about Islamic banking is critical to our success and development</td>
<td>-0.328</td>
</tr>
<tr>
<td>We have non-Muslim customers who prefer us because we are a low risk alternative for them</td>
<td>0.514**</td>
</tr>
<tr>
<td>Culture affects the perception and standards of our consumers and affects their selection of banks</td>
<td>0.793**</td>
</tr>
<tr>
<td>Economic benefits, financial position of our bank, interest paid on deposits, firm image and network reputation are factors that drive our customers towards conventional banks</td>
<td>0.614**</td>
</tr>
<tr>
<td>The continuous review and improvement of <em>Sharia</em> compliant products in our bank have led to a drastic development and marketing of our products</td>
<td>0.536**</td>
</tr>
</tbody>
</table>

** Correlation is significant at the 0.01 level
* Correlation is significant at the 0.05 level

Table 4.10 shows that development in the Islamic Capital Market encouraging the banks to issue *Sukuk* (Islamic bonds) was significant (r=0.771, p<0.05). Consumer education and awareness about Islamic banking being critical to the success and development of the banks was insignificant (r=-0.328, p>0.05). The banks having non-Muslim customers who prefer them because of their ability in being low risk alternatives for them was significant (r=0.514, p<0.05). Culture affecting the perception and standards of the banks’ consumers and affecting their selection of banks was significant (r=0.793, p<0.05). Economic benefits,
financial position of the banks, interest paid on deposits, firm image and network reputation being factors that drove customers towards conventional banks was significant ($r=0.614$, $p<0.05$). The continuous review and improvement of Sharia compliant products in the banks leading to a drastic development and marketing of the banks’ products was significant ($r=0.536$, $p<0.05$).

4.5.3 Influence of Laws and Training on Islamic Banking Development

The respondents were asked to rate the level of influence by laws and employee training on the development of Islamic Banking in their banks using the scale (SD=Strongly Disagree, D=Disagree, N=Neutral, A=Agree, SA=Strongly Agree). The resulting mean of >3.0 shows that the two banks were impacted by the available laws and employee training, and the standard deviation of <1.5 shows that the difference of the responses given was insignificant (almost similar).

Table 4.11 shows that amendments to the existing banking legislation is necessary in allowing conventional banks to undertake trade-related activities and other multi-faceted functions of Islamic banking as agreed to by 90.3% of the respondents with a resulting mean of 4.19 and a standard deviation of 0.601. Provision of infrastructure programs and regulations aimed at establishing Islamic banking institutions and it being used to attract the huge assets available within the Islamic banking sector as agreed to by 90.3% of the respondents with a resulting mean of 4.32 and a standard deviation of 0.653. Conventional banks have the right to offer Shari’ah compliant banking products subject to statutory and prudential requirements as agreed to by 64.5% of the respondents with a resulting mean of 3.45 and a standard deviation of 1.234. There are viable and attractive products being used to attract the players in the market towards Islamic banking as agreed to by 74.2% of the respondents with a resulting mean of 4.10 and a standard deviation of 0.790. A framework that facilitates Islamic banking expertise and uniformity is essential in the development of Islamic banking in the country banking as agreed to by 83.9% of the respondents with a resulting mean of 4.10 and a standard deviation of 0.651. Employee training on both general and Islamic banking principles and the Shariah may be effective in the adoption and spread
of Islamic banking as agreed to by 90.3% of the respondents with a resulting mean of 4.48 and a standard deviation of 0.677.

Table 4.11 Influence of Law and Employee Training on Islamic Banking

<table>
<thead>
<tr>
<th>SD %</th>
<th>D %</th>
<th>N %</th>
<th>A %</th>
<th>SA %</th>
<th>Mean</th>
<th>Std Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amendments to the existing banking legislation is necessary in allowing conventional banks to undertake trade-related activities and other multi-faceted functions of Islamic banking</td>
<td>0</td>
<td>0</td>
<td>9.7</td>
<td>61.3</td>
<td>29</td>
<td>4.19</td>
</tr>
<tr>
<td>Provision of infrastructure programs and regulations aimed at establishing Islamic banking institutions may be used to attract the huge assets available within the Islamic banking sector</td>
<td>0</td>
<td>0</td>
<td>9.7</td>
<td>48.4</td>
<td>41.9</td>
<td>4.32</td>
</tr>
<tr>
<td>Conventional banks have the right to offer Shari'ah compliant banking products subject to statutory and prudential requirements</td>
<td>9.7</td>
<td>16.1</td>
<td>9.7</td>
<td>48.4</td>
<td>16.1</td>
<td>3.45</td>
</tr>
<tr>
<td>Availability of viable and attractive products are used to attract the players in the market towards Islamic banking</td>
<td>0</td>
<td>0</td>
<td>25.8</td>
<td>38.7</td>
<td>35.5</td>
<td>4.10</td>
</tr>
<tr>
<td>A framework that facilitates Islamic banking expertise and uniformity is essential in the development of Islamic banking in the country</td>
<td>0</td>
<td>0</td>
<td>16.1</td>
<td>58.1</td>
<td>25.8</td>
<td>4.10</td>
</tr>
<tr>
<td>Employee training on both general and Islamic banking principles and the Shariah will be effective in the adoption and spread of Islamic banking</td>
<td>0</td>
<td>0</td>
<td>9.7</td>
<td>32.3</td>
<td>58.1</td>
<td>4.48</td>
</tr>
</tbody>
</table>

4.5.3 Correlations for the Influence of Law and Training on Islamic Banking

A Pearson correlation test for the influence of laws and employee training on development of Islamic banking was carried out to determine their significance with the threshold set for any factor that was <0.05. The results were as shown in Table 4.12.
Table 4.12 Correlations for Law and Employee Training on Islamic Banking

<table>
<thead>
<tr>
<th></th>
<th>Correlations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amendments to the existing banking legislation is necessary in allowing conventional banks to undertake trade-related activities and other multi-faceted functions of Islamic banking</td>
<td>.824**</td>
</tr>
<tr>
<td>Provision of infrastructure programs and regulations aimed at establishing Islamic banking institutions may be used to attract the huge assets available within the Islamic banking sector</td>
<td>.515**</td>
</tr>
<tr>
<td>Conventional banks have the right to offer <em>Shari’ah</em> compliant banking products subject to statutory and prudential requirements</td>
<td>.373*</td>
</tr>
<tr>
<td>Availability of viable and attractive products are used to attract the players in the market towards Islamic banking</td>
<td>.521**</td>
</tr>
<tr>
<td>A framework that facilitates Islamic banking expertise and uniformity is essential in the development of Islamic banking in the country</td>
<td>.377*</td>
</tr>
<tr>
<td>Employee training on both general and Islamic banking principles and the <em>Shariah</em> will be effective in the adoption and spread of Islamic banking</td>
<td>.418*</td>
</tr>
</tbody>
</table>

** Correlation is significant at the 0.01 level  
* Correlation is significant at the 0.05 level

Table 4.12 shows that amendments to the existing banking legislation being necessary in allowing conventional banks to undertake trade-related activities and other multi-faceted functions of Islamic banking was significant (r=0.824, p<0.05). Provision of infrastructure programs and regulations aimed at establishing Islamic banking institutions and being used to attract the huge assets available within the Islamic banking sector was significant (r=0.515, p<0.05). Conventional banks having the right to offer *Shari’ah* compliant banking products subject to statutory and prudential requirements was significant (r=0.373, p<0.05). Availability of viable and attractive products being used to attract the players in the market towards Islamic banking was significant (r=0.521, p<0.05). A framework that facilitates Islamic banking expertise and uniformity being essential in the development of Islamic banking.
banking in the country was significant ($r=0.377, p<0.05$). Employee training on both general and Islamic banking principles and the *Shariah* being effective in the adoption and spread of Islamic banking was significant ($r=0.418, p<0.05$).

### 4.6 Chapter Summary

The chapter has presented the study findings using that were obtained from the questionnaires. The analysis has been done using descriptive statistics of means and percentages to explain the findings and a Pearson correlation analysis was used to determine the significance of the various study factors and a p value of $<0.05$ was the base for a significant relationship. Presentations have been made using tables and figures.
CHAPTER FIVE
5.0 SUMMARY, DISCUSSIONS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction
This chapter is divided in various sections. Section 5.1 introduces the chapter, section 5.2 gives the summary of study findings, section 5.3 gives the study discussions, section 5.4 gives the study conclusions, and section 5.5 offers the study recommendations.

5.2 Summary of Findings
The purpose of this study was to establish the main Islamic products on offer in Kenya, the main requirements for provision of Islamic financial products and what could done to enhance their penetration Kenyan banking industry. The study sought to answer the following research questions: What are the main Islamic banking products on offer in Kenya?, What are the main requirements to provide Islamic financial products in Kenya?, and What can be done to enhance penetration of Islamic finance products in Kenya?

This study adopted descriptive and explanatory research design. The population is the entire group of individuals, events, or objects having a common observable characteristic. The population for the study was all employees of Gulf African Bank (GAB) and First Community Bank (FCB), the population represents the total number of Branches countrywide which is estimated at 20 for FCB and 15 for GAB, a total of 35 branches. The sampling frame used in this study was a list of the Branch managers in Nairobi of both Gulf African Bank and First Community Bank provided by their respective head office managers. Simple random sampling is applicable when population is homogeneous and readily available. The sample elements consisted of 32 Branch managers within Nairobi including the Head office.

The study used both primary and secondary data. The primary data was collected using a structured questionnaire and the respondents targeted were Branch managers of the two Islamic banks sampled. A pilot test of the questionnaire was done using 10 branch managers of GAB and FCB chosen at random to respond to the questionnaire. The questionnaires were given to the Head Office Managers who handed them over to the branch managers over a
period of 10 days. The study used quantitative data analysis. A Statistical Package for the Social Sciences (SPSS) tool was used to carry out a quantitative analysis. Descriptive statistics of means and percentages was used to compare the study variables numerically and make interpretation easier. Pearson correlation analysis was used to determine the significance of the various study factors and a p value of <0.05 was the base for a significant relationship and presentations were made using tables and figures.

The study showed that the banks offering debt-like financing structured as sales (Murabahah) was significant (r=0.637, p<0.05). The banks offering purchases with deferred delivery of the products (Salam and Istisna) was insignificant (r=0.316, p>0.05). The banks offering lease (Ijārah) with different options to buy was significant (r=0.698, p<0.05). The banks providing profit-sharing and loss-bearing (Mudarabah) products to customers was significant (r=0.542, p<0.05). The banks providing pure profit-and-loss-sharing (Musharakah) products to customers was significant (r=-0.467, p<0.05). The banks providing services of safe-keeping contracts (Wadi’ah) for current deposit for customers was insignificant (r=0.222, p>0.05). The banks providing safe-keeping contracts (Wakalah) for agency contracts was insignificant (r=0.275, p>0.05).

The study showed that the banks being put under the supervision of the Central Bank of Kenya and being treated the same as other conventional banks was significant (r=0.493, p<0.05). The banks establishing their own separate Shari’ah Board that supervised and offered guidance to their operating systems was insignificant (r=-0.137, p>0.05). The banks’ board having the appropriate experience, competency, and puts in practice professionalism and personal integrity was insignificant (r=-0.274, p>0.05). The banks’ board having the appropriate number of directors that were commensurate with the bank size and scope of operations was insignificant (r=-0.277, p>0.05). The banks’ guidelines having comprehensive provisions about consumer protection and consumer relations was insignificant (r=-0.037, p>0.05).

The study showed that development in the Islamic Capital Market encouraging the banks to issue Sukuk (Islamic bonds) was significant (r=0.771, p<0.05). Consumer education and
awareness about Islamic banking being critical to the success and development of the banks was insignificant ($r=-0.328$, $p>0.05$). The banks having non-Muslim customers who preferred them because of their ability in being low risk alternatives for them was significant ($r=0.514$, $p<0.05$). Culture affecting the perception and standards of the banks’ consumers and affecting their selection of banks was significant ($r=0.793$, $p<0.05$). Economic benefits, financial position of the banks, interest paid on deposits, firm image and network reputation being factors that drove customers towards conventional banks was significant ($r=0.614$, $p<0.05$). The continuous review and improvement of Sharia compliant products in the banks leading to a drastic development and marketing of the banks’ products was significant ($r=0.536$, $p<0.05$).

5.3 Discussions
5.3.1 Main Islamic Banking Products
The study showed that the banks offered debt-like financing structured as sales ($Murabahah$). According to Hussain, Shahmoradi and Turk (2015), Islamic finance products are contract-based and may be classified into three broad categories: Debt-like financing structured as sales, which could be sales with mark up and deferred payments ($Murabahah$).

The study showed that the banks offered purchases with deferred delivery of the products ($Salam and Istisna$). According to Hussain, Shahmoradi and Turk (2015), Islamic finance products include purchases with deferred delivery of the products ($Salam$ for basic products and $Istisna’$ for manufactured products).

The study showed that the banks offered lease ($Ijārah$) with different options to buy. According to Hussain, Shahmoradi and Turk (2015), Islamic finance products include lease ($Ijārah$) that comes with different options to buy.

The study revealed that the banks provided profit-sharing and loss-bearing ($Mudarabah$) products to their customers. According to Amin et al. (2011), profit-sharing and loss-bearing ($Mudarabah$) is provided by banks whereby the financier (investor, bank) provides capital and the beneficiary provides labor and skills (profits are shared, but losses would be borne by
the financier who does not have the right to interfere in the management of the financed operation, unless negligence, misconduct, or breach of contract can be proven).

The study showed that the banks provided pure profit-and-loss-sharing (Musharakah) products to their customers as well as Wadi’ah and Wakalah. Amin et al. (2011) also states that, pure profit-and-loss-sharing (Musharakah) is provided by Islamic banks, where the two parties have equity-like financing of the project and would share profits and losses; and services, such as safe-keeping contracts (Wadi’ah) as for current deposits, or agency contracts (Wakalah), which are also increasingly used for money market transactions.

The study showed that the banks provided customers with mudharabah (trust financing). According to Hussain, Shahmoradi and Turk (2015), Mudarabah is similar to the concept of silent partnership in which financial capital is provided by one or more partner(s) (rabul mal) and the work is carried out by the other partner(s) mudarib.

The study showed that the banks did not face a serious problem with their mudaraba loans because their borrowers did not prefer the conventional banks. These results defer with Idries et al. (2013) who examined Mudaraba loans and an inverse relationship for Islamic banks who worked in countries with Hybrid banking systems. They state that, such banks face a serious problem with Mudaraba loans because their borrowers prefer to transact with conventional banks when they expect high return for their project while they prefer Islamic banks when they expect low return for their project.

The study showed that profit-and-loss sharing features were marginally practiced in the banks. These results concur with Dar, Azeem and Masood (2013) who argue that, PLS features marginally in the practice of Islamic banking and finance and that Islamic banks, they have so far failed in adopting PLS-based modes of financing in their businesses.

The study revealed that the banks employed the use of Sukuk to provide funds to customers and bolster their activities. These results are in tandem with Aggarwal and Yousef (2010), who note that, Islamic banks issue Sukuk as a mechanism to mobilize savings, and their
issuance can be diversified and expanded to benefit from the opportunities existing for these financial market instruments.

5.3.2 Main Requirements for the Provision of Islamic Financial Products

The study showed that the banks had been put under the supervision of the Central Bank of Kenya and were treated the same as other conventional banks. These results concur with Wako, Kamaria and Kimani (2014), Islamic banks in most countries are put under the supervision of the central bank of the country and are given the same treatment given to conventional banks.

The study revealed that the banks had established their own separate Shariah Board that supervised and offered guidance to their operating systems. These results are in tandem with Kinyanjui (2013) who notes that, in part, all banks offering Islamic banking have established their own separate Shariah Board to supervise and offer guidance to their respective banks on Islamic banking system.

The study showed that the banks had boards that had the appropriate experience, competency and that put in practice professionalism and personal integrity. According to KBA (2013), the Prudential Guidelines significantly cover most aspects of governance and internal controls of banks in Kenya and provides that the board should possess, both as individual board members and collectively, appropriate experience, competencies and personal qualities, including professionalism and personal integrity.

The study revealed that the banks’ board had the appropriate number of directors that were commensurate with the bank size and scope of operations. These results concur with KBA (2013) which states that, Prudential Guidelines further provide that the board must have an appropriate number of directors that is commensurate with an institution’s complexity, size, scope and operations.

The study showed that the banks’ guidelines had comprehensive provisions about consumer protection and consumer relations. These results concur with KBA (2013) which states that,
Prudential Guidelines also introduce comprehensive provisions on consumer protection which did not exist under the previous guidelines.

The study showed that the main challenge for the banks was the ambiguity in respect to tax treatment. These results concur with Beck et al. (2010) who states that apart from the lack of a proper legal framework, there is ambiguity in respect of the tax treatment of Shariah-compliant financial instruments.

The study revealed that the depth of outreach remained a serious problem for the banks. These results concur with Beck, Demirguc-Kunt and Merrouche (2013) who state that the depth of outreach remains a serious problem for the Kenyan Islamic financial sector where the best positioned banks to maintain or extend outreach are government-owned banks that are also in most need of efficiency improvement.

The study showed that the banks’ freedom of enterprise and financial decisions were made based on the guidelines provided by Islam. These results are in tandem with Nazim (2013) observation that, in Islamic Financial System, freedom of enterprise as well as financial decisions made either by individuals or corporations should be on the basis of guidelines provided by Islam which do not prohibit profit making as the target, as long as the interest of society and the nation as a whole are protected and preserved meaning that profitable undertaking is permissible under Sharia.

The study showed that the banks had developed products and services which were not contradictory to the Islamic law. These concurs with Siddiqi and Nejatuallah (2012), who state that, Islamic financial institutions have had to develop products and services which are not contradictory with the Islamic law and that, products and services that are offered by conventional banks are always tailored to fit the Sharia.

The study revealed that the banks had refreshed Islamic banking and finance practices based on the proper understanding and implementation of the maqasid of Sharia. These results concur with Dusuki and Abozaid (2012) who call for the revitalization of Islamic banking
and finance practices based on a proper understanding and implementation of the maqasid of Sharia, and Siddiqi and Nejatuallah (2012) note that, Islamic banks are business entities that strive to meet religious obligations, need to compete with other banks to win customers.

5.3.3 Enhancing Penetration of Islamic Finance Products in Kenya

The study showed that the development in the Islamic Capital Market had encouraged the banks to issue Sukuk (Islamic bonds). According to Demir, Mustafa and Toprak (2014), the creation of Islamic money market and capital market has facilitated the smooth flow of funds in the IFS and that the development in the Islamic Capital Market (ICM) has encouraged major Islamic banks to issue Sukuk (Islamic bonds).

The study revealed that consumer education and awareness about Islamic banking was critical to the success and development of the banks. These results are in tandem with Dusuki and Abdullah (2012) who state that, consumer education and awareness about Islamic banking is critical to its success and future development. A consumer education program needs to be developed to enhance public awareness of the features of Islamic banking products and services.

The study showed that the banks had non-Muslim customers who preferred them because they were a low risk alternative to the customers. These results concur with Sumiyu (2013) who states that, non-Muslim investors have also begun to look for less risky alternatives since the onset of the global credit crisis over a year ago cast doubt on many Western risk management practices.

The study revealed that, culture affected the perception and standards of the consumers and it affected the consumers’ selection of the banks. The study agrees with Mabrouk and Mamogli (2010) who identified that culture was also an important factor that affected the consumer standards for selection of a financial institution.

The study showed that continuous review and improvement of Shariah-compliant products in the banks had led to a drastic development and marketing of the banks’ products. According
to Ndung’u (2011), Islamic banking was driven by religious compliance and customers’ needs being met and also revealed that, continuous review and improvement of Shariah-compliant products together with diversifying market niche may lead to drastic development and marketing of Islamic banking products.

The study showed that amendments to the existing banking legislation was necessary in allowing conventional banks to undertake trade-related activities and other multi-faceted functions of Islamic banking. These results concur with Salman (2010), who notes that, for conventional banks offering Islamic banking products, there needs to be amendments to the existing banking legislation to allow such banks to undertake trade-related activities.

The study revealed that provision of infrastructure programs and regulations was aimed at establishing Islamic banking institutions and to attract huge assets available within the Islamic banking. These results concur with Beck et al. (2010), who states that, both Islamic and non-Islamic, are putting ambitious infrastructure programs and regulations aimed at establishing Islamic banking institutions hence attracting part of the huge assets available in the sector.

The study revealed that conventional banks have the right to offer Shariah-compliant banking products subject to statutory and prudential requirements. These results are in tandem with Oundo (2009) who states that, all banks can offer Shariah-compliant banking products subject to statutory and prudential requirements.

The study revealed that there were viable and attractive products being used to attract the players in the market towards Islamic banking. Demir, Mustafa and Toprak (2014) states that, the growth of Islamic financial industry cannot be achieved without having viable and attractive product to attract the players in the market.

The study showed that a framework that facilitates Islamic banking expertise and uniformity was essential in the development of Islamic banking within the country. According to Laldin
Islamic banking is a very fast industry that does not lack capital but expertise and uniformity.

The study revealed that employee training on both general and Islamic banking principles and the Shariah may be effective in the adoption and spread of Islamic banking. These results are in tandem with Vogel and Hayes (2009) who states that, as the Islamic Banking sector continues to grow, it is becoming increasingly important for banks to ensure that their employees receive the training and resources to follow both Sharia principles and traditional compliance laws.

5.4 Conclusions

5.4.1 Main Islamic Banking Products
The study concludes that the Islamic banks in Kenya were on the right track although there is a lot that needs to be done. The banks provided majority of the products that are provided by Islamic banks like debt-like financing structured as sales (Murabahah), purchases with deferred delivery of the products (Salam and Istisna), lease (Ijārah) with different options to buy, profit-sharing and loss-bearing (Mudarabah) products, profit-and-loss-sharing (Musharakah) products among others. These indicates that Kenyan Muslims have the opportunity to enjoy banking experiences like their counterparts in other areas where Islamic banking is mainstream. From the study, it can be concluded that GAB and FCB did not have a serious problem with their mudaraba and that, profit-and-loss sharing features in their banks were still being marginally practiced.

5.4.2 Main Requirements for the Provision of Islamic Financial Products
The study concludes that Islamic banks in the country like all over the world have been put under the supervision of the Central Bank and in this case the Central Bank of Kenya. The banks, however, have an established Shariah Board that is separate from the CBK that supervises and offers guidance to the banks’ operating systems. These different boards have the appropriate experience, competency and number of directors that put in practice professionalism and personal integrity. The study concludes that GAB and FCB have comprehensive guidelines that provide consumer protection and dictate consumer relations.
These guidelines also ensure that all the products and services provided by the banks are in tandem with the requirements of the Shariah. For these banks, their main challenge is the ambiguity of tax treatment and their outreach depth within the country.

5.4.3 Enhancing Penetration of Islamic Finance Products in Kenya

From the study, it can be concluded that the development in the Islamic Capital Market has encouraged the Kenyan Islamic banks to issue Sukuk (Islamic bonds), and that there is a need for consumer education and awareness about Islamic banking that is critical for the success of the banks. There is a continuous review and improvement of Shariah-compliant products in the Islamic banks in Kenya that requires amendments to the existing banking legislation that will also allow conventional banks to undertake Islamic trade-related activities as guided by the Sharia. It can be concluded that the conventional banks in Kenya have the right to offer Shariah-compliant banking products subject to statutory and prudential requirements and that there are viable and attractive products being used to attract the players in the market towards Islamic banking. The study concludes that a huge gap exists in terms of the framework that facilitates Islamic banking expertise and uniformity and thus there is a need for employee and population training on both general and Islamic banking principles and the Shariah for an effective adoption and spread of Islamic banking as well as facilitate the existence of professionals in Islamic banking.

5.5 Recommendations

5.5.1 Recommendations for Improvement

5.5.1.2 Main Islamic Banking Products

Specific measures should be taken to promote a healthy competitive culture among the Islamic banking players in Kenya to create sufficient market depth to build distinct competitive advantage in a dynamic financial environment. Among the initiatives in this direction entail the issuance of new Islamic banking licenses to other interested players willing to join the market as well as the stimulation of Islamic financial engineering in product development and risk management. The emergence of the Islamic Capital and Financial Market is expected to play a complementary role in spurring the development of
the domestic Islamic financial market by facilitating cross border access to global markets, players and expertise.

5.5.1.2 Main Requirements for the Provision of Islamic Financial Products
Concerted efforts should be directed to creating a separate and viable platform for Islamic banking to function effectively in parallel with conventional banking. The legal, regulatory and Kenyan framework of Islamic banking should strengthened further through the review of the existing laws and guidelines governing the industry. Code of ethics should among the core determinants in disciplining the industry with less emphasis on Central Bank’s intervention.

5.5.1.3 Enhancing Penetration of Islamic Finance Products in Kenya
Strategic steps should be taken to prepare the Islamic banking and the industry players to be among the best managed institutions, capable of capitalizing on the unique features of Islamic banking to achieve significant competitive edge. The study recommends the government, GAB and FCB to ensure that the scarcity of skilled manpower in Islamic banking are adequately addressed through the formulation of training. In addition, the banks should ensure that there is development of management teams that focus on continuous application of Sharia laws through benchmarking to elevate the performance level of the banks.

5.5.2 Recommendations for Further Studies
Suggested areas of study should be on the examination of the permissibility of credit creation by banks from the Shariah point of view. Further studies should also include ways of introducing negotiable papers in the Islamic financial market. The risk and expectation characteristics of households, firms and banks in an interest free economy. A further study can also be done on the other Islamic financial instruments in use and confirm if findings of this study hold true and whether they are also being offered in the banks. Other Islamic financial instruments would be qard al-hassan (welfare loan), bay’ bi al-thaman al-ajil (deferred payment financing), and Murabaha (Cost plus) which is the sale of goods at a price which includes a profit margin agreed by both parties.
REFERENCES


APPENDICES
APPENDIX I: LETTER OF AUTHORIZATION

To:
Managing Director
Name of the Bank…………………………....
P.O. Box …………………………………..…
NAIROBI
Date: ………………………………

Dear Sir,

RE: RESEARCH DATA ON MAIN REQUIREMENTS FOR PROVISION OF
ISLAMIC FINANCIAL PRODUCTS AND THEIR ENHANCEMENT IN THE
KENYAN BANKING INDUSTRY

I am a student at United States International University pursuing a Degree in Master of
Business Administration - Finance Option I am required to undertake a research project as
partial fulfilment for the award of this degree.

The purpose of this letter is therefore to request you to grant permission to collect relevant
data from your organization from selected respondents among your management staff on the
stated topic above. The information collected will be treated with utmost confidentiality and
will be used for the purpose of enabling the researcher accomplish an academic requirement.

Yours Sincerely,

Ahmed Rashid Mohamed.
Student Reg No. 624448
Dear Sir/Madam,

**RE: COLLECTION OF RESEARCH DATA**

My name is Ahmed Rashid, an MBA student in Business Administration – Finance option at United States International University. Currently, I am carrying out a research on the “*Main Requirements for Provision of Islamic Financial Products and Their Enhancement in the Kenyan Banking Industry*”. I am in the process of gathering relevant data for this study. You have been identified as one of the respondents in this study and kindly request for your assistance towards making this study a success.

I therefore kindly request you to take some time to respond to the attached questionnaire. I wish to assure you that your response will be treated with confidentiality and will be used solely for the purpose of this study.

I thank you in advance for your time and responses. It will be appreciated if you can fill the questionnaire within the next 5 days to enable early finalization of the study.

Yours Sincerely,

Ahmed Rashid Mohamed.
Student Reg No. 624448
APPENDIX III: QUESTIONNAIRE

Please respond to each question by putting a tick (√) against the checkbox.

PART 1: General Information

1. What is your highest level of education?
   - Secondary □
   - College □
   - University □
   - Post Graduate □

2. How many years do you have in current employment?
   - <1 Year □
   - 2-4 Years □
   - 5-7 Years □
   - 8+ Years □

3. For how long has your bank been providing Islamic Banking?
   - 1-4 Years □
   - 5-8 Years □
   - 9-12 Years □

4. What type of financial system does your bank have?
   - Conventional Financial System Only □
   - Islamic Financial System Only □
   - Both Islamic and Conventional Systems □

5. If the answer is “Both Islamic and Conventional Systems”, please indicate the level of Islamic Finance being applied at your bank? (If it is Islamic Only, kindly skip the question)
   - Limited Use □
   - Developing Rapidly □
   - Predominantly Used □

PART 2: Main Islamic Banking Products

6. How would you agree and rate the following statements concerning the Islamic products that are offered in your bank using the scale (SD=Strongly Disagree, D=Disagree, N=Neutral, A=Agree, SA=Strongly Agree)?

<table>
<thead>
<tr>
<th>Statement</th>
<th>SD</th>
<th>D</th>
<th>N</th>
<th>A</th>
<th>SA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Our bank offers debt-like financing structured as sales</td>
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</tbody>
</table>
Our bank offers purchases with deferred delivery of the products (Salam and Istisna’)

Our bank offers lease (Ijārah) with different options to buy

As a bank, we provide profit-sharing and loss-bearing (Mudarabah) products to our customers

As a bank, we provide pure profit-and-loss-sharing (Musharakah) products to our customers

As a bank, we provide services of safe-keeping contracts (Wadi’ah) for current deposit for our customers

As a bank, we provide safe-keeping contracts (Wakalah) for agency contracts

7. How would you agree and rate the following statements concerning the Islamic financing products and services that are offered in your bank using the scale (SD=Strongly Disagree, D=Disagree, N=Neutral, A=Agree, SA=Strongly Agree)?

<table>
<thead>
<tr>
<th>Statement</th>
<th>SD</th>
<th>D</th>
<th>N</th>
<th>A</th>
<th>SA</th>
</tr>
</thead>
<tbody>
<tr>
<td>As a financial institution, we provide our customers with musharakah (partnership financing)</td>
<td></td>
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<tr>
<td>As a financial institution, we provide our customers with mudharabah (trust financing)</td>
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<tr>
<td>As a financial institution, we provide our customers with murabahah/ baimuajjal (deffered payment sales) and financing</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>As a financial institution, we provide our customers salam/istisna (purchase order) financing</td>
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<tr>
<td>As a financial institution, we provide our customers ijarah (leasing)</td>
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<tr>
<td>As a bank, we face a serious problem with our mudaraba loans because our borrowers prefer the conventional banks</td>
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<tr>
<td>The profit-and-loss sharing features are marginally practiced in our bank</td>
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</tbody>
</table>
Our organization employs the use of Sukuk to provide funds to our customers and bolster the activities in our banks.

PART 3: Main Requirements for the Provision of Islamic Financial Products

8. How would you agree and rate the following statements concerning the guidelines that are presented for your bank using the scale (SD=Strongly Disagree, D=Disagree, N=Neutral, A=Agree, SA=Strongly Agree)?

<table>
<thead>
<tr>
<th></th>
<th>SD</th>
<th>D</th>
<th>N</th>
<th>A</th>
<th>SA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Our bank has been put under the supervision of the Central Bank of Kenya and we are treated the same as other conventional banks</td>
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<tr>
<td>Our bank has established its own separate Shari’ah Board that supervises and offers guidance to our operating systems</td>
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<tr>
<td>Our board has the appropriate experience, competency and that puts in practice professionalism and personal integrity</td>
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</tr>
<tr>
<td>Our board has the appropriate number of directors that is commensurate with the bank size and scope of operations</td>
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<tr>
<td>Our guidelines have comprehensive provisions about consumer protection and consumer relations</td>
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</table>

9. How would you agree and rate the following statements concerning the regulations that have been provided for Islamic Banks in the country using the scale (SD=Strongly Disagree, D=Disagree, N=Neutral, A=Agree, SA=Strongly Agree)?

<table>
<thead>
<tr>
<th></th>
<th>SD</th>
<th>D</th>
<th>N</th>
<th>A</th>
<th>SA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Our main challenge is the ambiguity in respect to tax treatment</td>
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<tr>
<td>The depth of outreach remains a serious problem for our bank</td>
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<tr>
<td>Our freedom of enterprise and financial decisions are made based on the guidelines provided by Islam</td>
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</tbody>
</table>
As a bank, we have developed products and services which are not contradictory to the Islamic law and services adopted from conventional banks are normally tailored to fit the *Sharia*. Our bank has refreshed Islamic banking and finance practices based on the proper understanding and implementation of the *maqasid of Sharia*.

**PART 4: Enhancing Penetration of Islamic Finance Products in Kenya**

10. How would you agree and rate the following statements concerning the development and attractiveness of Islamic banking in the country using the scale (SD=Strongly Disagree, D=Disagree, N=Neutral, A=Agree, SA=Strongly Agree)?

<table>
<thead>
<tr>
<th>Statement</th>
<th>SD</th>
<th>D</th>
<th>N</th>
<th>A</th>
<th>SA</th>
</tr>
</thead>
<tbody>
<tr>
<td>The development in the Islamic Capital Market has encouraged our bank to issue <em>sukuk</em> (Islamic bonds)</td>
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<tr>
<td>Consumer education and awareness about Islamic banking is critical to our success and development</td>
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<tr>
<td>We have non-Muslim customers who prefer us because we are a low risk alternative for them</td>
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<tr>
<td>Culture affects the perception and standards of our consumers and affects their selection of banks</td>
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</tr>
<tr>
<td>Economic benefits, financial position of our bank, interest paid on deposits, firm image and network reputation are factors that drive our customers towards conventional banks</td>
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</tr>
<tr>
<td>The continuous review and improvement of <em>Sharia</em> compliant products in our bank have led to a drastic development and marketing of our products</td>
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</tbody>
</table>

How would you agree and rate the following statements concerning the enactment of laws and training that would facilitate the adoption of Islamic banking in the country using the scale (SD=Strongly Disagree, D=Disagree, N=Neutral, A=Agree, SA=Strongly Agree)?
Amendments to the existing banking legislation is necessary in allowing conventional banks to undertake trade-related activities and other multi-faceted functions of Islamic banking.

Provision of infrastructure programs and regulations aimed at establishing Islamic banking institutions may be used to attract the huge assets available within the Islamic banking sector.

Conventional banks have the right to offer *Shari’ah* compliant banking products subject to statutory and prudential requirements.

Availability of viable and attractive products are used to attract the players in the market towards Islamic banking.

A framework that facilitates Islamic banking expertise and uniformity is essential in the development of Islamic banking in the country.

Employee training on both general and Islamic banking principles and the *Shariah* will be effective in the adoption and spread of Islamic banking.

**THANK YOU**