



## Shifting from Conventional to Islamic Banking: Challenges and Barriers (a case study on Libya)

\*Abdelrahman M. Abudirbala · Mohamed M. Mukhtar

Department of Banking and Finance, Faculty of Commerce and Political Science, Sebha University, Libya

\*Corresponding author: [abde.abudirbala@sebhau.edu.ly](mailto:abde.abudirbala@sebhau.edu.ly)

**Abstract** Since the beginning of the 21st century, there have been a few steps towards the implementation of Islamic banking in the state. Nevertheless, in addition to the overall lack of research considering issues of Islamic banking in Libya, there has been no clear and practical path for banks transforming to an Islamic banking model. The purpose of this study is to identify the barriers and challenges that facing banks to converting into Islamic banking in Libya. In order to answer this question, a quantitative approach is followed. Questionnaires were adopted to collect data from staff of five Libyan banks namely Jumhouria bank, AL Waha Bank, Wahda bank, National Commercial Bank and North Africa Bank. The main obstacles that hinder the implementation of Islamic banking in Libya are a shortage of skills and experience which represented in the distinct lack of human capital trained for Islamic banking, and a lack of awareness which is represented in the absence of education and training institutions that provide the new entities with the required staff, and infrastructure issues which are represented in weakness in technical accounting system.

**Keywords:** Barriers, Challenges, Conventional Bank, Conversion Process, Islamic banking, Libya.

### التحول من الخدمات المصرفية التقليدية إلى المصرفية الإسلامية: التحديات والحوار (دراسة حالة عن ليبيا)

\*عبدالرحمن موسى احمد ابودرباله و محمد مختار بشير مختار

قسم التمويل والمصارف - كلية التجارة والعلوم السياسية - جامعة سبها، ليبيا

\*المراسلة: [abde.abudirbala@sebhau.edu.ly](mailto:abde.abudirbala@sebhau.edu.ly)

**المخلص** الأعمال المصرفية الإسلامية في ليبيا لا تزال في مهدها، منذ بداية القرن الحادي والعشرين، الا انه كانت هناك خطوات قليلة نحو تطبيق الأعمال المصرفية الإسلامية في ليبيا. ومع ذلك، كان هناك نقص في الأبحاث التي تتناول قضايا المصرفية الإسلامية فيها ولم يكن هناك مسار واضح وعملي بالنسبة للبنوك التي تحولت او تتحول إلى النموذج المصرفي الإسلامي. لذلك كان الغرض من هذه الدراسة هو تحديد الحواجز والتحديات التي تواجه البنوك الليبية للتحويل إلى المصرفية الإسلامية. وللإجابة على هذا السؤال، تم اتباع المنهج الكمي. وتم اعتماد استبيانات لجمع البيانات من موظفين من خمسة بنوك ليبية هي بنك الجمهورية، بنك الواحة، بنك الوحدة، البنك الأهلي التجاري وبنك شمال أفريقيا. اظهرت النتائج الي ان اهم العقبات الرئيسية التي تعوق تنفيذ الأعمال المصرفية الإسلامية في ليبيا تتمثل في: نقص المهارات والخبرات التي تتمثل في الافتقار الواضح لرأس المال البشري المدربين على الخدمات المصرفية الإسلامية، ونقص الوعي الذي يتم تمثله في غياب مؤسسات التعليم والتدريب التي تزويد المؤسسات الجديدة بالموظفين المطلوبين ومسائل البنية التحتية التي تتمثل في ضعف نظام المحاسبي الفني.

**الكلمات المفتاحية:** التحول، التحديات والعوائق، الخدمات المصرفية التقليدية، المصرفية الإسلامية، ليبيا.

#### Background to the Research:

The banking law of 2005 gives permission to establish new commercial, specialised, financial, and investment banks; opening up ways to introduce the idea of Islamic banking. However, for some of the barriers and challenges that this work investigates, the Islamic banking system was not fully operated despite the changing legislations over time. The 2005 laws were twice amended in 2012, by Law No. 1 and followed with another important amendment by the National Transitional Council represented in Law No. 46 which contains definitions of an Islamic Bank, Islamic Banking, the Central Sharia Advisory Board in the Central Bank, the Sharia Advisory Board for Islamic Bank, Sharia, Auditing administration, Islamic banking branches, and Islamic banking windows as well the

fact that as all banks must be fully operate with Sharia law by the close of 2015. That law, moreover, distinguished between permitted and prohibited activities for newly established Islamic banks or conventional banks introducing Islamic banking services and products

Over the last few decades, there has been a substantial growth of Islamic banking in both developing and developed countries. Besides establishing fully Islamic banks, many conventional banks in both Muslim and non-Muslim countries have been launching Islamic banking divisions and opening Islamic windows. Moreover, many banks, e.g. the International Kuwait bank in Kuwait in 2003 and Aljaseera bank in Saudi Arabia in 1998, have adopted Islamic

banking systems. However, converting from conventional into Islamic banking is not as easy as it is thought to be. It involves converting from a debt-based system into an equity-based system [37]. Furthermore, globalization and the revolution in information technology have resulted in dramatic changes in global trade and placed pressure on businesses, particularly the banking sector, and forced banks to change their strategies to accommodate those changes. For example, those nations, which have joined the agreement have been encouraged by the World Trade Organisation (WTO) to allow all investors into their economies. This agreement has a great impact across the banking sector as Islamic banks face competition with conventional global banks who appreciate the opportunities presented by the Islamic banking system. Hence, it is not surprising to find several conventional large banks such as the US Citibank, UK Barclays and HSBC providing Islamic services.

#### **The Research Context:**

Libya is an Arabic country with totally Muslim population that holds an attractive geographic location in the heart of North Africa, long considered the gateway to Africa, Asia and Europe. Thus, this is what distinct Libya from several of its neighbors (Algeria, Niger, Sudan, Tunisia, Egypt, and Chad). Libya is an oil-producing country with a comparatively small population and a relatively large land area. The combination of these factors makes Libya a significant economically and commercially Centre in the region. As discussed earlier, after independence period, there has been some application of the principles of Sharia in the state, but mostly not relating to financial matters. Nevertheless, Libya is not as other Muslim and Arab neighboring countries in North Africa and the GCC region that implementing fully or partly Islamic Banking, Libyan banking practices are still massively conventional.

Despite obstacles have been holding the country back from implementing the Sharia in its banking system, the first several years of the 21st century have witnessed movements toward the widespread acceptance of Islamic banking. Especially in 2011 was a significant movement in the legitimization of Islamic banking such as the laws and legislation discussed above. Despite these promising developments, there have been several of challenges and barriers facing Libyan bank to establish new or existing banks transforming to Islamic banking.

#### **Study Purpose and Objectives:**

The purpose of the study is to attempt to examine the conversion process into Islamic banking and to investigate the obstacles that may face this process. A large number of Libyan banks lack effective strategies to provide Islamic banking services. Therefore, the main aim of this study is to investigate the challenges and barriers involved in shifting into Islamic banking. This aim can be realised by:

- Examining the requirements for converting from conventional banks into Islamic ones.
- Identifying the challenges and barriers that face conventional banks when they are converted into Islamic ones.

- Defining the reasons for the delay of Islamic banking in Libya.

The research question for this study is that;

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The research question will be answered by investigating the issues below:

- Are conventional banks' employees aware of the legislative and legal requirements of the shifting process?
- What are the reasons for the delay in shifting into Islamic banking in Libya?
- What are the obstacles and barriers that prevent Islamic banking services from flourishing in Libya?

#### **Background on Islamic Banking and Finance:**

[27] states that Islamic finance is a financial system based on interest free which has been applied principally in order to comply with Islamic Sharia law. In fact, Islamic banking is not an insignificant phenomenon, neither is it just a temporary one. Islamic banks are constructed to remain and to prosper; there are signs that they are healthy and promising. Islamic banking that has been defined in a number of ways is an innovative idea that adds variety to the existing financial institutions. An Islamic bank is defined by the General Secretariat of the Organization of the Islamic Conference (OIC) as a financial institution whose standing, rules and procedures confirm its adherence to the Islamic Sharia principles and to the prohibition of receiving and paying of interest on any of its financial operations [23].

#### **Theory of Islamic Banking:**

Islamic banking theory essentially is based on the premise that interest is totally forbidden in Islam, but the business and trade is allowed. Islamic banking system is standing the fundamental teachings from the holy Quran and Sunna of the Prophet P.B.U.H. Thus Islamic banking concepts and principles are useful financial transactions that are accepted by both Muslim and non-Muslim society. However, according to the fundamental teachings of the Sharia what is not acceptable is the use of interest "riba" mechanism as a part of the process of banks financial intermediation [46]. The conventional theory believes that interest "riba" is very important method in order to achieve economic growth and sustainable development of the financial industry. However, classical and contemporary Islamic scholars has started to provide answer to this dilemma, Islamic scholars suggested that it is possible to run and achieve economic growth without interest "riba" the invention of interest-free banking system was the outcome to replace the interest based banking system.

The concepts on the theory of Islamic banking which derived from the fundamental teachings of Islam or principle of Sharia has proceeded to become the backbone of Islamic finance and banking system. The profit and loss sharing concept (PLS) was used to be the key alternative of interest-based products, the two forms of profit and loss sharing which were mostly in use at the pre-Islamic period as well as the contemporary time are

mudarabah (Speculation) and musharakah (joint venture). Muslim jurists are unanimously agreed that these two type financial mechanisms are fully compatible with the ethos and philosophy of the value system of Islam. Islamic scholars believe that in order to achieve equitable income, to attain the Islamic socioeconomic adjectives as well as to maximize the employment opportunities these two forms of Islamic financial arrangements must be use [46].

#### **Background of Libyan Islamic Finance**

Libya is the fourth largest country in Africa, half the size of Europe but with a population of only five million, majority of whom are Muslims. Libya has one of the largest proven oil reserves in the world and is a member of the Organisation of the Petroleum Exporting Countries (OPEC) making the country largely dependent on oil production. [26] stated that, in 2012, Libya officially introduced Islamic banking via Law No 46 of 2012, with the bold aim of exporting its entire banking and financial system onto a completely Sharia compliant platform by 2015, following the footsteps of countries such as Iran and Sudan. In tandem with its goal, in January 2013, the country passed Decree No 1 of 2013 prohibiting the charging on loans to individuals (and corporate was to follow in 2015). The illegalisation of loan interest had stalled the financing activities of banks as they withheld extending loans that were no longer permitted, although it did compel banks to introduce Sharia compliant alternatives. However, there has not yet any full transformation of Libya's banking system. Although Libya has been highlighted as a market with significant Islamic banking potential, there has yet to be real progress on that front [17]. Sharia compliant banking products continue to be provided through Islamic banking windows in Libyan banks. Although, in 2013 the central bank announced plans to issue three Islamic banking licenses and evaluate five more in the following year, this has yet to happen.

Obtaining medium-term financing, whether for regular Libyan customers, or small or medium enterprises, is problematic; this is due to the lack of clarity regarding the implementation of the reforms to loan regulations. In November 2013, an agreement was signed between the Islamic Corporation for the Development of the Private Sector (ICD), itself a member of the Islamic Development Bank (IDB), and the Libyan Ministry of Economy. This was to structure several Sharia compliant finance mechanisms that will address the issues faced by small and medium enterprises. No details regarding these finance mechanisms have been released, but the government has stated that their implementation will assist in the economic development of the country, and generate employment as well as improve opportunities for business [22].

The change to the banking regulations to introduce Islamic banking caused a lot of initial confusion in its implementation, with conventional banks freezing the issuance of loans, and a slow start to the provision of Islamic products to fill the gap in the market [22]. This is slowly resolving itself, as the government introduces more regulation to ease

the transition toward non-Sharia compliant banking being completely phased out, supposed have happened.

[20] stated that many Islamic finance experts concede that diverse opportunities are available for training corporations, consultants, and banks which specialize in Islamic banking activities in a country that embraces tens of billions of dollars in offshore assets and that has gigantic oil wealth. The Libyan Investment Authority, the country's prime state fund is valued as estimated US\$65 to \$70 billion. The country local banks have already taken the necessary measures to meet the increase in the demand for Islamic finance. For instance, the Jumhouria Bank (Libya's largest commercial bank) opened branches in the period after 2013 provided through their Islamic window that delivers Sharia-compliant products; moreover, it also intends to offer its clients novel Islamic products.

#### **The Concept of Conversion Process**

The process of changing from conventional banking into Islamic banking varies from one conventional bank to another in accordance with the different incentives. Therefore, it is essential to define the vital incentives that prompt conventional banks to convert themselves into Islamic banking.

#### **The conversion Requirements**

The process of transforming from conventional to Islamic banking involves diverse administrative, legitimacy, legal and general requirements. Numerous researchers, who investigated the transformation into Islamic banking, indicate certain requirements that ought to be fulfilled to attain the successful conversion; the following are the most relevant:

1. Scientific Planning, [6].
2. Sharia Supervisory Board.
3. Management commitment: [32].
4. Compliance with the AAOIFI Standards [6] and [45].
5. Considering the criteria for Evaluating the Efficiency and performance of the employees: [12] and [4].
6. Teaching, training, research and development [32], [31] and [40].
7. Administrative independence [10].

#### **The success of the Conversion Process**

In the conversion process, the main challenge involves the complexity of implementing a strategic plan for transformation, and for tackling the obstacles that may arise before, during and after the conversion process. The conventional banking authorities, regulators and leaders are called upon to resolve difficulties. Only a few studies have been conducted to investigate the barriers and obstacles that face banks in the process of converting from conventional to the Islamic system. According to [44]; [8]; [4]; [33] and [6], few challenges and obstacles are highlighted as seen in Figure 1.

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**Figure 1:** The potential obstacles facing the shifting process

### Research Methodology

This research is conducted in Libya; it involves the senior, junior and managers staff of the banks who are part of the shifting process in five Libyan banks namely Jumhouria bank, Al Waha Bank, Wahda Bank, National Commercial Bank, and North Africa Bank. The selected participants are from different age groups and both genders.

Then followed by eight sections that are starting with **background Information** about respondents as normal survey. This represents the information and demographic factors of respondents.

Then, the **Second section is knowledge of Islamic banking**. This section represents the main aspects of Islamic banking and hence asking respondents about their level of awareness and understanding of these aspects.

The **Third section** is stage of **the shifting process** to Islamic banking and this section asking respondents whether progressing in the shifting into Islamic banking or not as well as which the main obstacles and challenges facing.

The **Fourth section is legal issues**, which represents the extent of legal, regulations and legislations have hampered shifting into Islamic banking.

The **Fifth section is sharia issues**, and this section represents the issues with regard to Sharia framework as well as whether the Sharia board members within their banks were qualified and being able to support banks during the shifting phases.

The **Sixth section is talent issues**. This section is presents issues with regard to the human resources issues and if they are qualified and trained as well as if banking sector face shortage supply of talents in Islamic finance industry or not.

The **seventh section is infrastructure issues**. In this section was asking whether Libyan banks infrastructure such as technical accounting system

being able to facilitate shifting into Islamic banking.

The **final section is personal views** and this section is asking respondents about their view and perspective towards conversion into Islamic baking as well as open ended question to add anything they say is not covered in the questionnaire. Due to the different language of the respondents, the survey has been officially translated according to their language. Than an online survey was prepared and reviewed in order to ease the response process and get higher responses.

### Data collection Method

There are two types of data that are usually used in any research projects, that is primary and secondary data. In this research, data were obtained from the primary data.

### Research Design

In light of the research objective, a quantitative design has been adopted. This involves the statistical analysis of survey questionnaire which is used in data collection to achieve the research objectives. However, there is an open-ended question, which is one of the requirements of qualitative research at the end of the survey. It is interpretative in the sense that it examines the individuals' activities and perceptions; it aims to provide a deeper insight into the individuals' cognitive patterns. Furthermore, it relies on words rather than on numbers. It comprises questionnaires that have open-ended questions.

### Data Analysis

In order to analysis the data, which has been collected, it entered into Statistical Package for Social Science (SPSS) software. Due to its capacity and ability for analysing large amount of data, SPSS has been used as well as it will enable the researcher to analyse the data in depth. Thus, will be easy to calculate and develop reliability, frequencies and means in graphs and tables.

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### Pilot Study

In this study, a pilot study has been executed after the development of questionnaires. The purpose of this pilot study was to pre-test the adequacy of the instrument and to assess whether respondents were able to understand the questions before the actual set of questionnaires were distributed. It will involve a group of respondents that have similar characteristic with the actual respondent. According to [38] the implementation of the pilot study is to correct any inadequacies in the instruments prior to data collection and also identify the difficulties in wording and translation in the questionnaires. In this research, a pilot study, prior to the formal research, was conducted among the bankers who are part the shift from conventional to Islamic banking, yet had knowledge in Islamic banking. This was to iron out potential mistakes and issues which might arise in

the formal research such as issues with technical language.

**Reliability**

[39] describe reliability as representing the internal consistency demonstrating the homogeneity of an item measuring the variables. The reliability analysis procedure provides information about the relationship between individual items in the scale and their internal consistency and examines the properties of a measurement scale and the questions that make it [35]; [39]. The reliability analysis of the factors was tested using Cronbach's Alpha in order to test the internal consistency reliability of the scales. For the purposes of the research, any Alpha value that is 0.6 or less generally indicates unsatisfactory internal consistency reliability, those exceeding 0.7, indicate acceptable reliability, and those over 0.8 are considered good [38]. Thus, the higher the Alpha value or the closer reliability coefficient is to 1.0, the higher reliability of the measurement items will be [39].

**Table 1: Response rate** Source: SPSS, Questionnaire findings

Items	Distributed	Returned	percentage %
Jumhouria Bank	10	8	80%
AL Waha Bank	10	4	40%
Wahda bank	10	7	70%
National Commercial Bank	10	6	60%
North Africa Bank	10	4	40%
Invalid	-	4	-
Total	50	33	66%
Total Valid	50	29	58%

The table above presents the number of sent and received questionnaire and the percentage of questionnaire returned. In total 33 out of 50 questionnaires has been return, 29 out of 50 questionnaires were returned and successfully completed, this means that 58.00% of the questionnaire were successfully filled. While, due to mistakes and missing information, 4 of the questionnaire were invalid. In order to analyse data, the 58.00% considered as an acceptable and reasonable when we factor in the political and security issues in Libya in 2017 which have a negative effect on the banking sector in particular and the economy as whole in general.

**Demographic Characteristics of Respondents**

The demographic characteristics of the participants answered the questionnaire (Figure 1) indicates that the majority of respondents were males with 72.4%, while 27.6% were female. According to World Bank (2015), there is higher number of male working in banking industry, so, the percentage was expected.

They show that the majority of the participants are within the age range of 26 to 45 years (69%), similar to the global average (Bureau of Labor Statistics, 2016). Participants between 46 to 59 years accounted for 17.2% with 13.8% between 18 to 25 years.

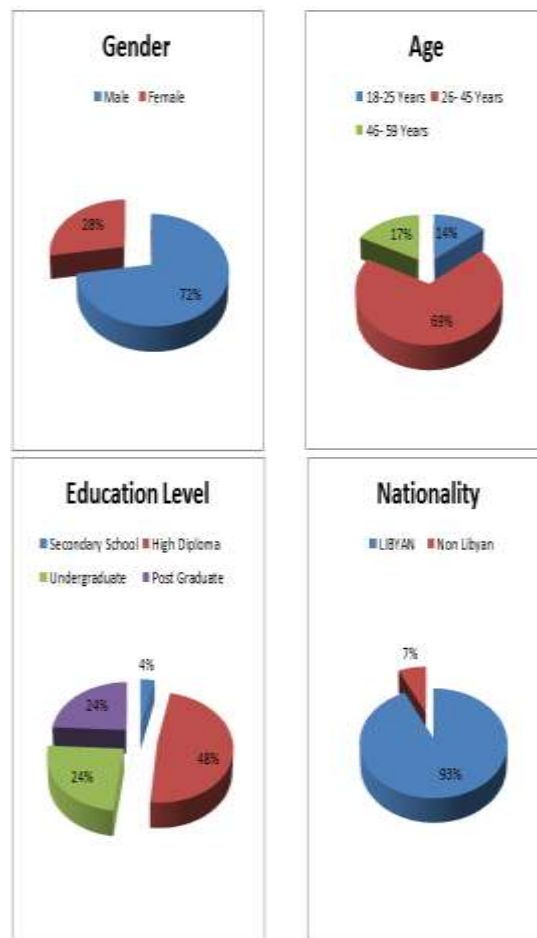
The majority of the participants had high diploma education level with 48.3%, post graduate and undergraduate level were 24.1% each, only 3.4% had a secondary school education.

The vast majority of respondents were Libyan at 93.1%, while 6.9% were non-Libyan.

**Ethical Considerations**

[14] pointed out that all aspects of research grant high to range of ethical matters about anonymity, privacy, confidentiality, informed consent as well as the desirability of the study. The researcher has taken his effort in order to ensure such of these matters not happen. [21] mentions that in order to encourage participations, ethical aspects must be in considerations as a main motivation. In this study, overt study has been adopted in order to make participants comfortable and totally aware of the research as well as the expected results of the research. consequence of this, in the cover letter of the questionnaire, a full information and details has provided such as who is doing this study and for, and for will be used as well as assurance has been granted such as all the data will be treated confidentially [15].

In total, 50 online questionnaires have been equally distributed to Libyan bankers across the five chosen banks for this study. Table 1 below presents a summary of the rate of response.



**Figure 1:** Respondents demographics (Source: Questionnaire finding, own work)

Regarding the type of banks, the vast majority of respondents work at Jumhouria Bank (27.6%), the biggest bank in term of its assets, also the largest employer, accounting for 38.8% of the total Libyan commercial banking assets and 42.7% of total banking deposits [30]. The Whada Bank is a Libyan share-holding company and fourth Libyan Bank where almost a quarter of respondent's work. 20.7% work for National Commercial Bank the second Libyan bank, 13.8% were from both Al Waha Bank and North Africa Bank.

Moreover, 31% been working in the banking sector for 10 to 15 years. Therefore, they are most likely to have greater amount of knowledge about banking sectors in general and the conversion process in particular. More than half of them have

always worked for the same bank, therefore they may have detailed knowledge of their own banks procedures but lack broad knowledge of the sector in general. While almost a quarter of the respondents worked between 15- 25 years only a minority of them changed from their bank to a different one during that time with 17.2% of the participants have worked in banking sector for 5 - 10; but, almost a quarter of them worked in the same bank. Likewise, 10.3% worked in the sector less than 5 years which is still working in same bank whereas 6.9% of bankers have worked more than 25 years they are the most likely to have acquired information and training concerning the shifting process, though they have lack of practical experience of it.

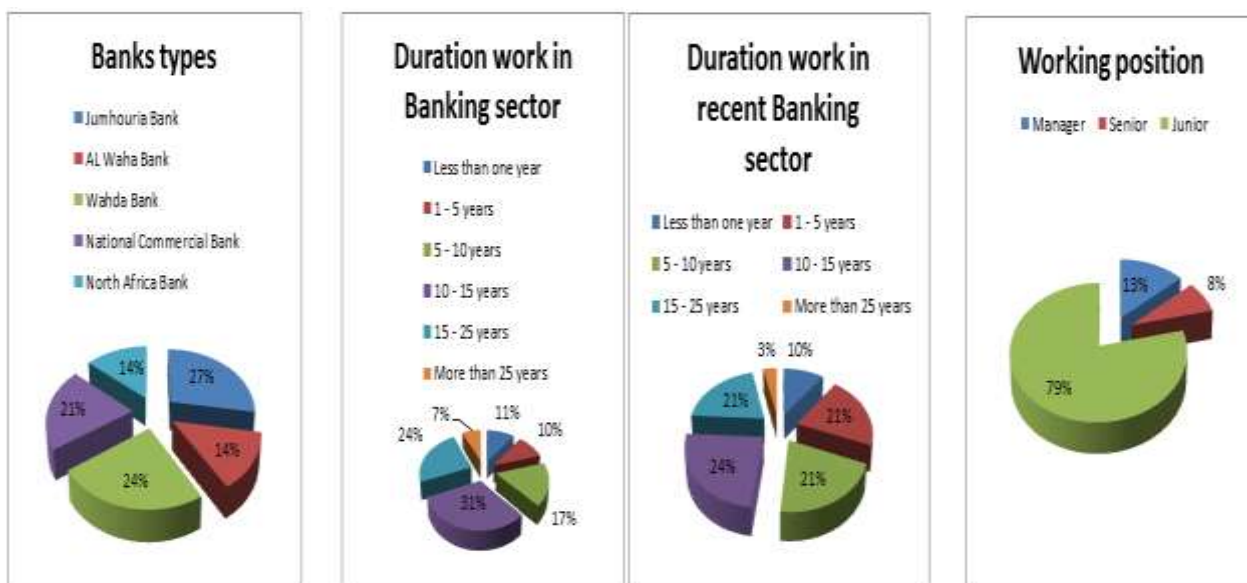


Figure 2: Respondents demographics (Source: Questionnaire finding, own work)

**Knowledge of Islamic Banking**

To determine the rate of conversion from conventional to Islamic banking, Participants were asked whether their banks provide Islamic products. 89.7% of the participants said yes their banks are providing Islamic products while 10.3% of the respondents said that their banks did not provide Islamic products yet. This confirms that the Islamic banking system is being successfully phased into the conventional system.

Referring back to [28], he suggested that the banks failed to exploit the knowledge of their management. When the respondents were asked about their knowledge of Islamic banking, 93.1% of the participants have known how Islamic banking works. Further to this question, they were asked to classify the aspects of Islamic banking, including the legal, regulatory framework, products, Sharia law, Technical and accounting aspects and management aspects, Overall, the level of knowledge ranges between average and good in general. This indicates that confidence has grown since the work of Kridan (ibid) possibly indicating a level of success with training and awareness programs.

Comparing with the research conducted by [34], Murabaha and Islamic Structured Products and

derivatives have continued to gain in importance, yet the other services have as well. Likely, this is because it is practical and is easy to authorise on an individual basis where most customers wish to use it to buy car, white goods or appliances. After which, Islamic Structured Products and Derivatives, Musharakah and Qard Hassan, which is given in exceptional circumstances in order to alleviate costumers' financial hardship. However, according to the other services are being practised now, but to a low level (approx. 20%) possibly because regulation has changed and they are being offered. Possibly because interest in them has grown. In contrast with [13], Istisnaa, Ijarah and Bai Salam are now being practiced, though at a low rate (10%) indicating a change in government regulation, yet a lack of awareness of these products. The availability of these products may indicate an effort of the by the banking system to expand the range of products available.



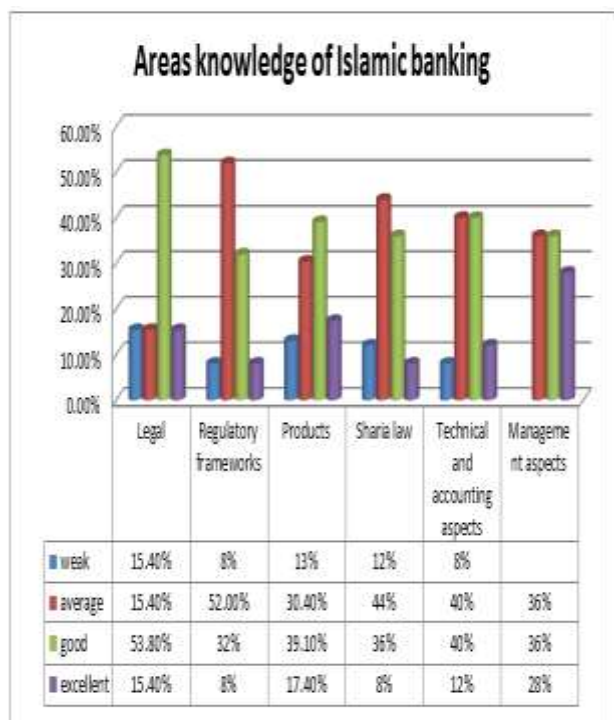


Figure 3: Knowledge of Islamic banking (Source: Questionnaire finding, own work)

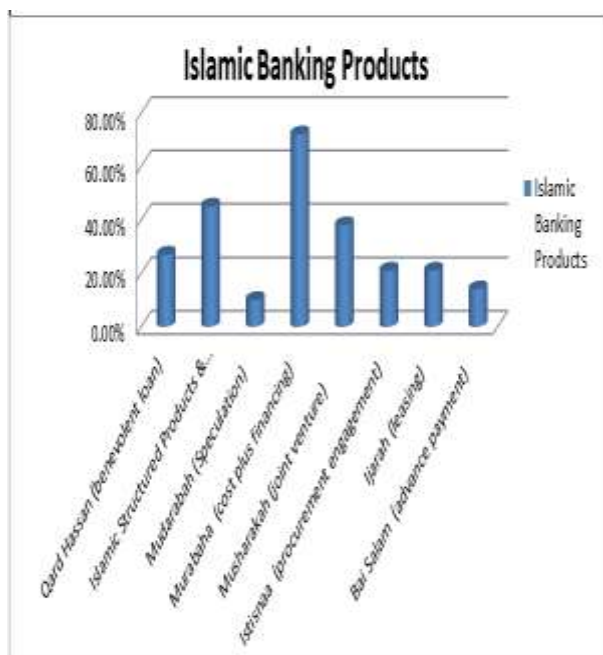


Figure 4: Knowledge of Islamic banking (Source: Questionnaire finding, own work)

**Stage of the Shifting Process to Islamic Banking**

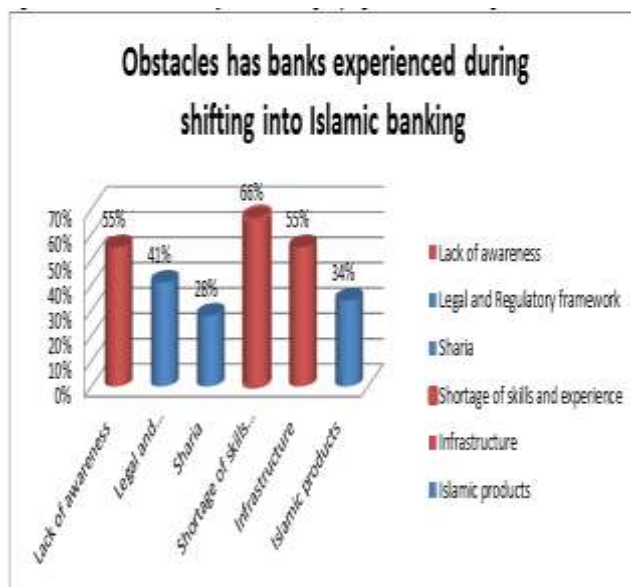
This section investigates whether the shifting process is on the right track or not, as well as the barriers that are facing the shifting process.

89.7% of respondents said that their bank is a part of the shifting process, while 10.3% said theirs was not; as all banks are required to be part of the system, it seems this is error on the part of the respondents, possibly not understanding the shifting process, banks are not part of the process. 58.6% of respondents think that the shifting is progressing in accordance with the plan to convert

all banks to providing Islamic banking services, with third of them answered that shifting has not been progressing according to the plan. However, a few of them said that banks are unable to progress in accordance with plan. (Why not, should include a qualitative question as to why not in accordance-Future recommendations) Furthermore, almost three quarter of banks have separate department/division, which focuses on the shifting process to Islamic rate. These departments can provide expertise and technical knowledge, may be about to monitor and regulate the shift in accordance with government requirements.

Shortage of skills and experience were classified by [28], [16] and [19] as the most significant challenge when shifting into Islamic banking, while this research identified two other important challenges (those being infrastructure and lack of awareness. (See Fig. 8 below) The skills shortage is due to a lack of trainers available, a lack of people familiar with Sharia law, a lack of practical experience in Libya. The lack of trainers is also an infrastructure issue since the lack of technical and telecommunication systems for banking in Libya limits the contact between banks, effective coordination and planning and monitoring of the situation. The lack of awareness stems from the government's failure to propagate the issue and use its influence to encourage conversion, as does the aforementioned technical limitations

The findings of a workshop of the Central bank of Libya titled; 'Evaluating the Transitional role of Islamic Banking in the Libyan Banking Sector (Reality and prospects)' state that the expectation for transformation was considered to be rapid; but, unfortunately, some obstacles and barriers prevented this from being fully accomplished. Therefore, seeking coordination with the competent authorities internationally and gaining knowledge from the experience of the Libyan banks was required. Sharing this local experience and expertise between banks required identifying several factors: the transformation requirements for each bank, the efforts required for the success of the transformation as well as well identifying the difficulties facing the process of transformation [16]. Additionally, the Head of the Advisory Committee of Islamic Banking, confirmed in his speech the efforts that have been made for the transformation process, according to Banking Law No. (1) for 2005 and under Law No. (46) for 2012. The committee have been working on forming a strategy for Islamic Banking in Libya in cooperation with a team of experts from the World Bank confirmed the obstacles were still facing banks including shortage of skills and experience, Infrastructure and Lack of awareness, more recently, [19] have also support the results, they pointed out that Libyan banks are lacking of information technology for modern systems of Islamic Banking. This, in turn, formed a barrier and big challenge to the shifting into Islamic banking.



**Figure 5:** Obstacles has banks experienced during shifting into Islamic banking

Source: Questionnaire finding, own work

### Legal issues

Participants were asked whether legal, regulation and legislation issues facilitate or obstruct shifting into Islamic banking. 37.9% pointed out that the legal, regulation and legislation are available but do not cover all aspects that banks needed. However, 27.6% stated that legal, regulation and legislation are obvious, available and understandable, the same percentage selected 'available but ambiguous'. A tiny minority of respondents stated legal, regulation and legislation as unavailable at all.

Participants were asked if the legal issues generate a barrier to the conversion process; 69% said yes. Expanding on this question, they were asked to choose the biggest legal issues facing adopting Islamic banking. Over the third of the participants suggested absence of Islamic banking laws, 25% indicated the process does not have sufficient legal support. The fifth of the responses pointed to the lack of an efficient regulatory and supervisory framework, while, a lack of standard Islamic financial contracts and products amounted to 16.7%.

Table 8 reveals there are different perspectives among bankers, but the vast majority of them confirmed the availability of legal structures, regulation and legislation though limited to differing degrees. However, the variance between respondents is only about its perceptions of legal support remains unknown, unfortunately, only one answer was provided to the open-ended question. This represents a need for more qualitative data.

A third of respondents cited a lack of Islamic banking laws bringing attention to the further issue. Again, no comments were left by the managers in the open-ended section. One speculative answer is that the application of Islamic banking requires banking to be interest free; but, making interest illegal would make it very

challenging for Libya to bring its banking system in line with the rest of the world, nor would it allow Libyan banks to compete globally. However, the Libyan General National Congress went a step further than most lenders expected: passing a law that not only introduced Islamic banking but banned interest on financial transactions on January 6, 2013, as it explained above in first chapter. The move is popular with Libya's Muslim majority but for the nation's lenders the law is problematic, giving them just two years to become fully Sharia compliant. Top banking executives are concerned about the changeover with \$1.4 billion in interest-bearing loans on the books; how could an alternative for this money be found. They argue that the law was drafted without any proper study of how the banking sector was going to be affected. Aman Bank is planning to lobby against the new law, which it says will further isolate Libya's economy at a time when it needs to become more integrated with the outside world [18].

### Sharia Issues

[8] noted that financial infrastructure was based on conventional banking, as such, [10], [4], [5], [7] and [9] confirmed that converting to Sharia law will be the principle challenge in the conversion. Tackling this issue, respondents were asked about the status of Sharia governance framework as well as the availability of Sharia scholars and experts. The vast majority of the respondents stated that Libya has Sharia governance framework for Islamic banking and that there are different classifications of the status of Sharia framework. Almost half of them highlighted that the current Sharia framework is enough but need further enhancement while 28.6% found it unclear and does not cover all the areas banks need. Only, 17.9% of participants outlined that it is effective enough and that it covers all aspects that banks need during and after shifting. 10.7% said that it is clear but there is lack of sub-committees for control and supervision.

Almost two third of participants stated that there are boards of Sharia scholars and Sharia experts within their banks, while approximately one third of the participants emphasized their banks do not have them. (See Table 9 below) 65% highlighted that board members are qualified in jurisprudence and able to Issue Fatwa (religious rulings) on financial transactions. However, three quarters of participants stated that the Sharia boards do not have a high level of autonomy and independence to protect them from commercial pressures which undermine the main principle of Sharia law. While three quarter of participants stated that the board of Sharia scholars comply with AAOIFI Standards. With respect to whether Sharia-compliant banking products, which are supposed to be fully operated under Sharia principles, 31% of respondents thought that they are not actually fully operational under sharia principles due to two reasons; 52.9% of them suggested that there is deficiency in the transactions application, while 41.2% said that there are lack of knowledge and experience of Sharia Supervisory Boards.

As stated in section earlier, Libyan banks have been facing several obstacles, but with different



levels of difficulty in implementation and severity of consequences. The majority of respondents confirmed the existence of a governance framework and the role it plays for Islamic banking in Libya. This is confirmed by [41] who proved that Sharia operates in numerous areas of banking. It participates in both establishing and approving policy. It also monitors the process towards objectives and confirms that each action is taken in accordance with the fundamental rules and principles of Sharia law. As mentioned earlier, the distinctive feature of Islamic banks has been the existence of a legitimate control body, a Sharia Supervisory Board, in addition to a board of directors. Thus, the main purpose of the Sharia board seems to be giving and enhancing the credibility of the operations of Islamic banks for clients. This can be done by authenticating their legitimacy [29].

With respect to the 31% of respondents who indicated the products are not fully operated under Sharia principles, two reasons were offered with the option for an open-ended reason given. The first reason is that bank transactions may not be in accordance with Sharia law; for example, under conventional law, money is loaned for the purchase of an item, however, under Sharia law the item must be first be owned by the bank as under Sharia law you may not sell something that you do not own. So, the bank cannot loan the money unless debt need to be paid, it must buy the item on behalf of the customer. This may be complicated if the customer initiates an application but changes their mind. Under Sharia law they may be entitled to do this, however, banks which have already purchased the item, are incentivised to force customers to continue to pay for the item, this is forbidden under Sharia law. Connected with the first reason, the other reason is lack of knowledge and experience of the Sharia Supervisory Board. The results of this question is inconsistent with [2] who did not foresee any difficulties integrating Sharia principles and banking products, but confirms [3] suggestion that a well-regulated framework is required to tackle issues like these.

#### **Talent Issues**

Respondents were asked about talents/human capital issues in Islamic finance industry, as well as the Libyan plans to develop them. There is agreement (93.1%) that there is a limited supply of talent and that Islamic finance professionals were the most affected. Furthermore, the vast majority of respondents agree that it is necessary to develop them. Moreover, there is also agreement between them (96.6%) that there are initiatives for training available. Participants were further asked to rank the three principles initiatives which are; tertiary education in Islamic finance, sponsorships to undertake Islamic finance studies (encouraging employers to sponsor staff to acquire knowledge on Islamic finance) and continuous training on Islamic finance such as seminars, training on Islamic finance, etc. Tertiary education in Islamic finance is the most common initiative pursued in Libya with mean value of 1.8929. Then, sponsorships to undertake Islamic finance studies, such as encouraging employers to sponsor staff to acquire

knowledge on Islamic finance is the second most initiative at a mean of 1.9286. While, continuous training on Islamic finance such as seminars, training on Islamic finance was the last initiative having a mean of 2.1429.

Additionally, participants were asked about Libya's immediate plans to develop talents on Islamic finance through training. 69% of respondents said that this can be done through establishing training institutions specialized in Islamic finance, while, 24.1% of respondents recommended sending staff for overseas training. However, a minority of respondents at 9.6% added other suggestion.

It can be seen that along with Infrastructure and lack of awareness, Libya also has shortage supply of talents in Islamic finance industry. This complements the finding in earlier section of the three greatest obstacles facing shifting to Islamic banking. Moreover, there was a greater shortage of Islamic finance professionals than of experts in Sharia laws. This is consistent with the findings of [31] and [40] who indicated there would be an issue finding appropriately trained human resources.

The findings determined that there is an active pursuit by employees of several initiatives which have been adopted with all three initiatives with relatively equivalent degrees of popularity. The first initiative is tertiary education in Islamic finance. Recently, several Libyan universities have begun to teach Islamic banking in both undergraduate and postgraduate levels, as compared to the past. Sponsorships to undertake Islamic finance studies has been classified as a second initiative and confirmed by respondents. Then the third initiative is continuous training on Islamic finance such as seminars and workshops on Islamic finance. The Libyan Association of Islamic Banking published several training courses in Islamic banking to staff and employees of Libyan banks as a part of its plans to improve talent (Libyan Association of Islamic Banking, 2017). This is also revealed by vast majority of participants, establishing training institutions specialized in Islamic finance as an immediate Libyan plans to develop talents on Islamic finance through training.

#### **Infrastructure issues**

Respondents were asked about the technical and accounting systems within their banks and whether they meet the requirements to ease the shift into Islamic banking. Additionally, they were asked about the types of support received to help promoting the shifting process and also who is responsible for non-support.

With respect to bank's technical and accounting systems, almost half of respondents stated that they are able to ease the conversion, while the other half stated that systems are not able to facilitate the conversion. However, 66.7% of the respondents who believe bank's technical and accounting systems are not helpful classified them as somewhat acceptable to meet the requirements of shifting, while, 33.3% of them classified bank's technical and accounting systems as poor to meet the requirements of shifting. Moreover, 41.4% of respondents proved that human resource departments are trained enough to work under

Islamic banking, while the rest disclosed that they are not trained enough. This is slightly inconsistent with the findings of [11] possibly indicating a recent improvement in cooperation and coordination between their own branches and branches of other banks.

Furthermore, participants were asked if the dual-banking system is efficient. 69% of them said yes, while 31% said it is not efficient. Others, however, totally ignore the differences between Islamic and conventional banks. They assume that the recent Libyan banking law (Law No. 1 of 2005) is able to supervise Islamic banking. They cite two reasons: first is that Islamic banks have an organisational set-up similar to that of the conventional banks. Second is that the present banking law is flexible and structured according to international standards and thus is able to supervise any kind of banking industry. For these reasons, Islamic banking can exist alongside conventional banking and offer a dual banking system. 41.4% of respondents pointed out that banks are receiving media support with regard to promoting the shifting process. However, 58.6% of them stated that banks are not receiving any media support. Thus, researcher asked them further question; who is responsible for non-support. 17.6% of participants said the government is responsible, and also with the same percentage outlined that Central bank is responsible, while, 11.8 % reveal that conventional banking management is responsible. However, 52.9% stated all of above which means that shared responsibility among them. Similarity, this confirms the situation established by for [29] that media is not playing a major role in the phases of shifting Islamic banking.

#### **General Perspective and Open-end Questions**

In this final section participants were asked general questions in order to know more deeply various perspectives. They also were asked whether they have any further comments or they would like to add or explain anything that has been missed from the questionnaire. Thus, participants were given some statements and they were asked to classify them as strongly disagree, disagree, agree or strongly disagree.

55.2% of respondents believe and strongly agree that there is lack of feasible studies on the conversion process, while they agree that human resources are not sufficiently qualified to work under Islamic banking. Respectively, 55.2% and 41.4% agree and strongly agree that banks should establish independent Islamic banking rather than converting current banks. Approximately half of respondents agree that banks should establish window banks which provide Islamic products and services within conventional banks rather than converting.

Additionally, almost 48.3% of respondents agree that the conversion from conventional to Islamic banking has a positive effect on banks, employees and Libyan economy as a whole. 41.45 % agree that, in the present financial system, banks are able to convert into Islamic banking. Almost half of respondents agree that current laws and legislations, banks can shift into Islamic banking.

Almost over 50% of respondents support conversion into Islamic banking as whole.

In the last section of the questionnaire, in order to enable the respondents to explain and add any further comments, there was an open-ended question. With respect to the perspectives to the shifting into Islamic banking, this part briefly discusses some of the considerable points of view therein. The minority of participants who added comments believe that Libya is fertile land for Islamic banking and any delay in shifting into Islamic banking will create issues such as a delay in keeping pace with development and lose more chances for conversion. On the other hand, the delay is because of several of reasons; first is the difficult political circumstance which Libya is going through and still, second is the lack of awareness in Islamic banking at the all level, the third is lack of focus by the banking leaders. In addition to this delay in development in laws and regulations as well as development in the planning and schedules of many institutions.

#### **Summary of the Research Finding**

The findings and analysis of that data indicate that banks are facing several of challenges. With regard to shifting into Islamic banking, resulting in with different effects. Perceptions of this conversion might have a positive and significant impact on the current imbalance in the differences between how obstacles are faced when fully implementing Islamic banking in Libya. Put simply, if bank employees better understood the conversion and the reason for it, it would reduce the barriers to implementation. This research indicates that the top three barriers and challenges are the shortage of skills and experience, infrastructure and lack of awareness facing banking during this phasing in.

#### **Implications and Recommendations**

The study was intended to provide a number of important contributions to the literature. The contribution lies in highlighting new findings in the barriers and challenges facing the banking management in Libya by investigate several of issues and extracting some perspectives. Despite the fact that the small number of studies conducted in this field in Libya, some examples of the research has been employed in countries already implementing Islamic banking such as Iran and Sudan, and on developing Islamic banking markets such as in the GCC countries.

The current study will help to expand the current literature and increase awareness level and understand the Islamic finance topics as well as offers a method and grounding for future study. In particular, addressing the lack of research in this area and concerning Libya ensure its findings will add value to future research and be practiced in a broader perspective in the Libyan banking sectors. Of further importance is that some of contracts and products of Islamic banking were found to be inconsistent with Sharia principles. Therefore, it is important that legislation specialists clarify the legislation behind any financial issues in order to avoid and remove any ambiguities regarding the Islamic banking activities which could undermine the legitimacy of the system.

This work establishes the necessity for The Central Bank of Libya to conduct scientific research and feasibility studies that draws the map as well, as well as clarify and specify the transition period and also pass a new law that organizes the process of conversion from conventional banks to the Islamic banking system

The findings of the current study are useful for Libyan policy makers especially for those who have a keen interest in converting traditional conventional banks into Sharia-compliant banks as well as they clearly identify the barriers to conversion. They are useful for the human resources practitioners as it clarifies their role and importance in the conversion. Further confirming where conventional bank managements must enhance their efforts in order to enable their staff to overcome and manage the barriers and challenges. Conventional banks staff should be granted adequate opportunities to understand the process of change.

#### Research Methods

In order to achieve the research objectives, it was necessarily to apply a deductive approach due to the nature of this work filling gaps created by and adding to previous research. A positivist approach was selected as it was considered that the shift from one banking system to another represented one concrete reality and the data would be able to reach solid scientific conclusions. This is due, which has enabled researcher to deeply investigate cross accessing the various experiences, knowledge and opinions surrounding the barriers and challenges towards shifting into Islamic banking. In this research, quantitative method has been used based on questionnaire where 50 questionnaires were distributed to five different Libyan banks with open ended questions providing a window of qualitative data. Due to the lack of previous research and the constantly changing nature both of the phasing in of Islamic banking and of the Libyan political system, getting primary data was vital. Overall, 33 questionnaires were returned, which obtained 66% of rate responses. Moreover, (SPSS) software has been used in order to analysis data.

#### Limitations and Future Research

Limitations to the research emerged in the process of writing it. Concerning resources access and time, the resources that have been used a bit old as well as difficulties accessing them, some of the resources were written in Arabic language. Therefore, they took plenty of time to understand and translate. Moreover, the respondent's rate was, at 66%, slightly lower than hoped compared to the number of targeted banks. Although the current study used a survey of 50 participants from five established Libyan banks, the respondent's rate could be higher as could the number of distributed questionnaires.

Concerning sample size, findings may have been more useful and further enhanced whether a larger number of respondents and other domestic banks were taken. Thus, the results were less statistically significant, which may have led to biased outcome and this, in turn, might limits the generalisation of this study. Please note that the researcher was

seeking to get higher rate of respondents due to researcher's relationship with bankers, unfortunately, most of them failed to response.

With the focus only being placed on investigating the barriers and challenges of Islamic banking from employees' perspectives, the perceptions of Central Bank staff, legislatures or interested in Islamic banking aspects have not yet been tapped.

The researcher did not include all factors which ban and impact on conversion into Islamic Banking in Libya. Thus, future researchers are advised to investigate other factors and to see how obstacles and challenges effect on implementation of Islamic banking.

The final limitation to this study is that most of respondents were employees, whereas the researcher was seeking with hope to access to higher level such as managers and head of departments. Therefore, concentrate on managers and senior staff and managers will improve and enhance the outcome, and also will encourage further research.

Concerning legal support, a great variance was found in the responses making it impossible to find patterns in the quantitative data, indicating rich ground for further research. The lack of qualitative data provided by respondents through the open-ended questions limits any clear conclusions being drawn in this research, but might covered by more specialised research possibly by someone with a legal specialisation.

Another issue raised was identifying why 10.3% did not think their bank to be part of the mandatory shifting process. The suggestion that this was an error in understanding is merely supposition and does not explain how this error has occurred. It may be of great significance and deserving of research, possibly focussed on depth of knowledge and of understanding among employees concerning the shift, possibly examined from a human resources perspective.

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