# Obstacles and Motivation behind Conversion of Conventional Banks to Islamic Banks: An Overview

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***Abstract***

*Converting from conventional to Islamic banking involves significant changes due to the different nature of conventional and Islamic banks. Actually, Conventional banks are facing several obstacles due to non-existence of comprehensive framework for the conversion process. Some prominent obstacles are shari'ah compliance, resistance of conversion, human resources, Islamic financial products, and regulations and legislations. In this paper, the researchers provide a comprehensive review of the literature on the conversion process into Islamic banking system. This paper discusses the concept of the conversion process and highlights the challenges and obstacles facing the conversion process into Islamic banking. Therefore, this paper shed a light on some major factors that may hinder the success of conversion process. To investigate key obstacle factors, this research sketched the issues from literature (research articles, existing survey findings, concepts) involved with conversion process, and the motivations were prompted the conventional banks to convert to Islamic banks. However, the main objective of this study is to investigate the factors that influence the success of conversion process from conventional banks to the Islamic banks and the motivations for this process. The study suggests that the conversion process should be looked at as a comprehensive process of all components of the economic and financial system. Conventional banks which that to convert to Islamic banks should follow the format for financial statements suggested by AAOIFI in general and shari'ah standard number 6 (conversion standard) in particular. More research is needed to determine the most important factors that influence the conversion process into Islamic banking. This paper is the first of its kind that provides a comprehensive and integrative critical literature review that can serve as a useful checklist for Islamic banking researchers and leaders in their quest of evaluating the conversion process from conventional banks to Islamic banking.*

***Key Words:*** *Conventional Banking, Conversion Process, Motivations of Conversion, Islamic Banking.*

## Introduction

The start of the conversion trend of conventional banks (CBs) to the Islamic banking system has been attracting the interest of the banking industries in Muslim countries, particularly in member-countries of the

Gulf Cooperation Council (GCC) (Jaffer, Islamic Retail Banking and Finance: Global Challenges and Opportunities , 2005). This interest is reflected in the opening of Islamic windows/units as the first step toward conversion and full-fledged conversions. Conventional banks are facing several obstacles due to the non-existence of comprehensive framework for the conversion process. However, some prominent obstacles are shari'ah compliance, a resistance of conversion, human resources, Islamic financial products, and regulations and legislations. Converting from conventional to Islamic banking involves significant changes due to the different nature of conventional and Islamic banks. In addition, The Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI) responded to the importance of conversion by introducing Shari'ah Standard No. 6, entitled "Converting from conventional bank to Islamic bank" (AAOIFI, 2010). The main purpose of this standard is to explain the required procedures, mechanisms, and treatments in bank conversion.

Actually, there are several motivations that prompted the conventional banks to convert to Islamic banking systems. Some studies such as Alani & Yaacob (2012); Al-Atya (2007); Mamun (2007); Mustafa (2006) highlighted that religious beliefs of Muslim customers prompt the administrations of CBs to either convert fully to the Islamic banking system or offer Islamic financial products (Al-Atya, 2007). This factor is observed in most Muslim countries. Other studies have also reported that several CBs were inspired to convert to the Islamic banking model by factors such as the increased profitability of Islamic banking products, the maintenance of existing customers, and the attraction of new customers (citations).

In view of the information presented above, this paper addresses the factors that influence the success of conversion by reviewing previous literature on this topic and by providing recommendations to overcome these obstacles. The study does not consider the activities of Islamic windows or departments or units in conventional banks within the conversion process. Furthermore, this study follows the principles and rules certified by the Shari'ah Board of Accounting and Auditing Organization for Islamic Financial institutions (AAOIFI) in 2010, namely, Standard No. 6. The rest of the paper is organized in the following way; Section Two provides the literature review, Section Three explains the Conversion Trends in Some Countries, Section Four contains the limitation of the study, and finally section five recommendations and the summary of the paper.

## Literature Review

### Motivations for Conversion

Previous studies discussed the motivations that prompted the conventional banks to convert to Islamic banking systems. According to these studies, the motivations of conversion are varied from bank to bank and from country to country. However, according to Al-Atyat (2007), the main motivation for the conversion of banks in Jordan is the desire to maximize profitability and comply with Shari'ah rules. Mustafa (2006) investigated the phenomenon of bank conversion in Saudi Arabia and indicated that 82% of conventional banks in this country have converted full-fledged to the Islamic banking model to maintain existing customers. Among these conventional banks, 47% were motivated to comply with Shari'ah principles and to attract new customers, whereas 24% were motivated by the high rate of return on investments and the desire to comply with Shari'ah law (unlike the rate of return in conventional banking). In fact, Al-Atyat (2007) also indicated that the primary motivation of almost 60% of conventional banks around the world to convert is to comply with shari'ah principles.

Mamun (2011) investigated the prospects, problems, and growth potentials of Islamic banking in Bangladesh as perceived by Islamic and conventional bankers. The survey results indicate a high demand for interest-free banking services among a segment of people in this area who strongly desire to abide by the rules and principles set by shari'ah law. In Kuwait, Alani and Yaacob (2012) examined the factors that motivate the conventional banks in Kuwait to convert to the Islamic model. Specifically, they investigated this phenomenon through four axes, namely, (a) the law, (b) risk and profit rates, (c) customer needs for

Islamic products, and (d) lessons from successful conversions in the region. They selected two banks in this region: one had already converted from a conventional bank into an Islamic bank (International Bank), and the other (National Bank) was a conventional bank that opened an Islamic window. The study concluded that the trend toward conversion to Islamic banking is statistically significantly related to the low-risk nature of the high-profit levels that characterize Islamic banks. In addition, Islam as a religion is an influential factor in this conversion.

In Libya, for example, Kumati (2008) studied the potential for Islamic banking in Libya. The results show that interviewees believe there is no objection to adopting Islamic banking systems in Libya. Moreover, 98% of respondents mention that they would transfer all their bank accounts and transactions to the interest-free banks once this system is opened in the country. These findings show that the religion is the primary and most significant factor which influences the choice of Libyan people.

Also, we cannot ignore the profit factor; previous studies such as Siraj & Pillai (2012); Al-Tamimi (2010); and Mustafa (2006) indicated that Islamic banks are more profitable than conventional banks. Thus, a number of conventional banks have converted to Islamic banks to achieve maximization of their profit. In turn, Mustafa (2006) and Al-Atyat (2007) summarized that there are more motivations attracting conventional banks to converting toward the Islamic banking mode, such as meeting the customer's needs, keeping their customers, and attracting new customers to compete with Islamic banks. However, as mentioned earlier, the motivations are varied from bank to bank and from country to country depending on the country's situation. In general, almost previews studies reveal that the religion is the primary and most significant factor which influences CBs to convert to Islamic banking system.

**Obstacles to the Conversion of Conventional Banks to the Islamic Banking Model**

In the context of developed and developing nations, the notable developments of the Islamic banking system have led to its considerable expansion and acknowledgement all over the globe. This phenomenon has attracted the attention of several international conventional institutions including the Standard Chartered Bank, Citibank, HSBC, and Deutsche Bank to take advantage of the developments through the establishment of distinct windows/branches and the provision of Islamic financial services to whole customers (Haque & Tariq, 2012).

Added to this, the knowledge concerning Islamic banking and finance has been increasingly spreading and this had led to the significant demand for banking products that are shari'ah-based or compliant with shari'ah roles. This has urged banks to leverage this market opportunity by converting to a full-fledged Islamic bank or by providing distinct windows/branches to conduct shari'ah compliant transactions (Alani & Yaacob, 2012).

More recently, in the context of the banks in the Middle East and GCC countries, conversion from conventional banks to wholly Islamic banks has garnered ample attention. This process of conversion has been increasing in the Middle East region, where over a decade, several CBs have successfully converted to Islamic banks in Kuwait, Saudi Arabia and the UAE (Alani & Yaacob, 2012). Also, banks in this region have also successfully offered Islamic banking branches to work side by side with conventional banks. This phenomenon has also been noted in other Muslim countries around the globe.

In linguistics, the word 'convert' in the English language indicates the changing of something to a different form or to transform something or to turn an original state into another, or a particular use or purpose to another (Cambridge Dictionary, 2nd Edition, 2013). In turn, the Business Dictionary defined it as follows; in the context of an organization, a conversion process refers to a profound and radical change that directs the organization to a totally different level of effectiveness. In contrast to turnaround – a term that describes incremental development on one plane, transformation indicates a fundamental change in character with little or no similarity to the original configuration or form (Business Dictionary, 2013). While this study uses the term conversion, other studies prefer transformation and hence, conversion and transformation is considered to be synonymous in the present study.

Religion-wise, conversion means converting from a corrupt circumstance to a favorable one based on the religion (Rbaia, 1989) and in this case, converting means transforming or changing from a specific situation to another, with the latter being better than the former. In the context of banks, the corrupt position is the conventional banks' dealing in transactions that go against shari'ah principles (haram), in other words the corrupt transaction is dealing with interest (riba).

The term transformation has become a popular, overused and misconstrued term in the organizational environment, particularly in the 21st century (Daszko & Sheinberg, 2012). In the field of management and organization systems, transformation happens at the individual level, followed by at the organizational level. Daszko and Sheinberg (2012) referred to transformation as the creation and change of the whole past to the new form, function or structure. It is the creation of something new that could not be predicted and was not present in the past. It is a change in the mindset and is based on learning a novel system of knowledge and adopting actions that have their basis on knowledge and courage.

The authors further added that transformation happens when leaders create a vision for it and a new system to continuously challenge old extant beliefs, assumptions, patterns, habits and paradigms in order to develop and employ management theory through based on the profound knowledge system. It occurs when system management desirous of creating a new future that was not present before and is based on continuous learning supported by a completely new mindset and actions.

Literature has largely ignored the conversion/transformation phenomenon although it has evidenced its importance. As a consequence, only few conceptual studies have been carried out in the context of Arab nations. For instance, Al-Matran (1999) drew up a report concerning the conversion of the National Commercial Bank (NCB) in Saudi Arabia, within which the dual banking system exists. The report revealed that the NCB conversion was rife with several challenges and issues that can be divided into internal and external barriers. More specifically, NCB internal barriers were administration-related issues, relationship among departments, human resources, system and policies, Islamic products, and banking market issues. Added to these, other barriers are lack of knowledge among accountants and auditors concerning Islamic banking rules. On the basis of the NCB experience, the study recommends that a step-wise jurisprudence conversion is the best strategy of adoption to be adopted. In such a conversion, a versatile plan is drawn up for the conversion process, with the involvement of all the CBs employees.

In a related study, Abdalla et al. (2015) examined the validity of successful conversion model of conventional banks to Islamic banks in the context of Libya and the driving factors of the experience. They examined four independent variables namely the availability of qualified human resources in Islamic banks, the availability of the Islamic capital market, the inclination of employees to convert to Islamic banks, and the successful Islamic banking experience. They considered the successful experience of Libyan conversion into Islamic banks as the dependent variable. The authors used a quantitative method of data collection and found that the tested factors positively impacted the successful conversion of CBs in Libya into Islamic banks.

In a similar study, the conversion validity from the conventional banks to Islamic banks in Libya was examined by Abo-Homera and Aswaysy (2008) in their case study between Jumhouria Bank and the Bank of Commerce and Development. They made use of descriptive analysis for the questionnaire analysis. The study's main objective is to understand the attitude among banks customers regarding two CBs conversion into Islamic banks. Based on the findings, approximately 76% of the sample is agreed to the Libyan CBs conversion into Islamic banks and that 79% of them agreed that Libyan environment is the right environment for the conversion process in terms of its basic constituents. The findings also showed that

91% of the respondents were convinced that the religion factor is the major factor that urged the process of conversion.

In the context of the U.K., Ahmad (2008) examined the opportunities and challenges that Islamic banks face through data collection from nine in-depth interviews with different respondent groups (banking authorities, customers and non-customers of Islamic banking). The author highlighted great opportunities in the U.K. for the development of Islamic financial system. Added to this, the study also highlighted some challenges in the form of service network related to Muslims in the U.K. and the lack of Islamic banks and institutions that can wholly meet the requirements of the community. Moreover, Islamic U.K. banks face challenges in the form of harmonizing the accounting system, the lack of qualified team members knowledgeable in Islamic financial products, marketing, and sales.

Moreover, in Jordan, the transformation of CBs in Islamic banks and their adoption of Islamic banking systems to follow the Shari'ah principles were examined by Al-Atyat (2007). The study's primary objective was to shed light on legislation that covers the process of conversion. The study includes several factors, which are; clarity of Islamic rules in relation to CBs actions, the inclination of CB management to provide the terms of Islamic shari'ah, the expectation to acknowledge additional profitability from the conversion in the future, the conversion laws and regulations available, the qualified human resources available, the financial instruments that are aligned with Islamic shari'ah law available, and lastly, the successful experience of the conversion. The study concentrated on the enactment of shari'ah laws among private banks with the sample constituting the leaders and executive managers of CBs in Jordan. Data was collected through a questionnaire survey distributed to 154 managers and employees in the head CBs offices. The study results showed that the major factors that influence successful transformation included availability of qualified human resources, availability of financial markets that are compatible with shari'ah principles, and successful experience of Islamic banks.

In the context of Saudi Arabia, the factors motivating the conversion of CBs into Islamic banks was determined by Mustafa (2006), in his study involving a sample of 17 participants working in Saudi private banks. Added to this, he also conducted interviews with five Saudi regulators in the banks. He highlighted six categories of obstacles and descriptively tested them – they are administrative, human resource, technical, product development and market development issues and lastly, legitimate control. The study evidenced the existence of the obstacles and explained the lack of a distinct entry point for Saudi CBs, where each CB chose a step-wise or gradual jurisprudence conversion according to motivation and nature of the conversion, and the individual bank's circumstances. The study also showed the multiple positive impact of the conversion including the development of Islamic banking products, enriching knowledge concerning the Islamic banking sector among employees, customers and the society. The study suggested a step-wise conversion method for CBs.

In a similar line of study, Karbhari et al. (2004) examined the issues and challenges that Islamic banks face in the U.K. with data collected from focused interviews of six participants (chief executives, deputy executives, and senior managers), who are experienced and working in four organizations in London. The study revealed that the top challenge that U.K. Islamic banks face is the clients'(present and potential) heterogeneity, regulatory issues, CBs competitiveness, and the lack of qualified and experienced personnel. The study highlighted opportunities including e-banking – that may influence the future of Islamic banking in the country.

In Bangladesh, the barriers faced by Islamic banks were examined by Sarker (2014). He found the major obstacles to include; the creation of an interest-free mechanism for the short-term funds placement and the high risk in profit-sharing. He also found that approximately 60-70% of bank investments are presently made on a mark-up basis, in the form of Murabaha and Bai-Muajjal and the short-term trade investments in Islamic banks are concentrated. Another major barrier is the lack of complete legal Islamic banking framework, and the limited trained and efficient human resource that are committed to Islamic banking, and lastly, the under-developed shari'ah compliant regulatory and supervisory standards. He recommended that SMEs should be prioritized when it comes to investment decisions made by Islamic banks and further improvements in such banks can be achieved through the upgrading of manpower quality.

In relation to the above studies dedicated to Islamic banking in different countries, Islamic banking and finance have their basis on the Shari'ah principles and rules and the Islamic jurisprudence (fatwa) issues by qualified Muslim scholars. It is evident from the reviewed literature that the major challenge that is faced in the conversion of CBs to Islamic banks is the compliance to Islamic principle sand guidelines. According to Al-Atyat (2007), CBs seeking to convert to Islamic banks and to adhere to the Shari'ah law should be able to resolve several questions; 1) How will the bank handle receivables and liabilities that are received or paid before conversion? 2) How will the bank tackle prohibited assets in the bank's possession before its conversion?, and 3) What are the suitable disposal methods?

In sum, the primary factors that are highlighted by the present study to influence successful conversion of CBs into Islamic banks are as follows;

**Shari'ah Compliance**

The distinguishing factor that differentiates Islamic banks from CBs is the shari'ah compliance rules and principles and this factor is what boosts the confidence of customers into patronizing banks. Mohd. Zamil (2014) revealed that the setting up of Islamic banking and finance is wholly governed by the shari'ah principles, and it is expected that the whole operations of Islamic banks adhere to shari'ah rules with the ultimate aim of contributing to shari'ah objectives (maqasid al-Shar'ih). This aspect is demanded and expected by strict believers of Islam who are desirous of performing banking transactions that comply with the shari'ah principles. This is supported by Kahf (2004) who stated that the primary difference between Islamic banks and CBs is the former's adherence to the Islamic principles.

Moreover, the shari'ah principle has its basis on four sources namely the Quran, the Hadith and Sunnah (the Prophet's (SAW) sayings and actions during his lifetime), Ijma' (Muslim scholars consensus), and lastly, Qiyas (analogical deductions from the first three sources to tackle contemporary issues). Hence, it is important for financial Islamic institutions to provide products and services that adhere to the Shari'ah rules and principles (Ab.Aziz, 2013; Khir et al., 2008). Ab. Rahman et al. (2013) stated that based on Islam, every Islamic institute should comply with the rules and principles of Islam and this should be reflected in every aspect of the working environment.

Prior studies that addressed the challenges Islamic banks are facing showed that the Islamic banking system operating based on a dual-banking system faces challenges involving the regulatory and financial infrastructure that is based on CB. Owing to the fact that such Islamic banks are based on conventional economic system, they are not fully supportive of a fully-compliant shari'ah-based bank and this may prevent the development and innovation of Islamic banking products and services as evidenced in studies (Al-Oqool, 2011; Al-Sarhi, 2010; Al-Atyat, 2007; Al-Martan, 2005; Al-Omar & Iqbal, 1999; al-Rbaia, 1989).

In the context of Muslim demographic consumers, their attitude concerning products and services are, more often than not, influenced by their religion, Islam. In other words, in banking, the products and services they patronize have to be offered by Islamic financial institutes. To this end, a shari'ah compliance dimension for Islamic bank service quality was introduced by Othman and Owen (2001), where they include several items under the dimension that are related to Islamic laws and principles. Muslims have to adhere to Islamic rules, particularly when it comes to banking, and thus, Islamic banking was welcomed by the Islamic world, particularly in Libya, where Muslims constitute a major proportion of the population. The aim of this dimension is to define the ability of the company to meet Islamic laws and requirements in order operate according to Islamic banking and economic principles.

Islamic banks are obligated to adhere to the shari'ah rules in ever operational aspect in order to meet the first objective of the establishment of an Islamic banking institution. Several advantages have been noted for the adherence to such rules and principles as evidenced by the holistic Islamic view, where shari'ah is considered to be a complete and integrate life code that encompasses the whole life of the individual. It reflects the individual's commitment and organization to the principles of justice, brotherhood and social welfare (Dusuki & Abdullah, 2007).

On the contrary, disregarding shari'ah rules will lead to the breaching the main objectives of shari'ah and the operational goals of protecting the societal welfare. It will also lead to a banking system that is characterized by unfairness and lack of sustainability. This will ultimately result in the stakeholders' loss of confidence on the Islamic bank and their detachment from it, and ultimately, the Islamic banking system will lose its popularity (Ginena, 2014). On the basis of a related study by Iqbal and Mirakhor (1999), lack of compliance to the rules established by shari'ah would expose Islamic banks to shari'ah risks, which are of two types. The first type stems from the non-standard practices in terms of various contracts in various jurisdictions, and the second one stems from the failure to adhere to the shari'ah rules.

Several studies have been dedicated to examining the perspectives of shari'ah rules compliance of Islamic financial institutes. To begin with, Mohd. Zamil (2014) conducted a study to look into both theoretical and practice aspects of issues and challenges that Islamic banking and finance face in Malaysia in light of four issues namely, legal and regulatory framework, shari'ah compliance, management, and accounting. The study utilized a semi-structured interview to obtain data from different respondent groups who had a hand in the operations of the Islamic banking and finance. The respondents comprised of shari'ah committee members, shari'ah officers, and chief executive officers (CEO). The process of data collection involved 31 interviewees and the findings showed that the major challenges faced include the influence from the dual-banking environment, lack of regulatory framework support for products and services, shari'ah non-compliance, operation and management, lack of human capital expertise, lack of accountability, and lack of influence of accounting practices and auditing.

Also, in Malaysia, Bin Mohd. Dali (2014) examined the satisfaction of Islamic credit card users in his comparative study between Malaysia and the GCC countries. The main objective of his study was to examine if the Islamic banking in the countries was perceived by customers are shari'ah compliant, if religion had a significant impact on such perception, and if their perception of Islamic bank's compliance had an impact on their satisfaction. He made use of a mixed-method design to achieve the study objectives. His empirical findings showed that shari'ah compliance will only influence satisfaction for Islamic products and not for conventional banking products. The findings are aligned with those reported by Sadek et al. (2010) who revealed that adherence to shari'ah principles was significant for users of Islamic banks, indicating that banks have to leverage the major antecedents of customer satisfaction, which covers compliance with shari'ah and ethical dimensions.

In Nigeria, Adara et al. (2013) investigated the direct effect of service quality dimensions on customer satisfaction and customer loyalty in an Islamic bank. They conducted the data analysis with the help of SEM using AMOS 16. The study findings showed responsiveness to be a significant predictor of customer satisfaction, while assurance significantly predicted customer loyalty. This shows that customer satisfaction can be achieved only when the bank staff is responsible and they provide timely banking services. Added to this, customer loyalty to Islamic banks requires the customers' assurance of the compliance of the bank to the shari'ah principles.

In the context of Bangladesh, 17 private commercial banks were included in Ahmed and Khatun's (2013) study to examine their shari'ah compliance level. The banks operated with shari'ah governance system, in particular AAOIFI – the study aimed to shed light on the shari'ah non compliance risk management status of the banks. The authors found that none of the Bangladeshi banks included in the study were fully adhering to the shari'ah governance system of AAOIFI as none of them had audit and governance committee at the board level. On the basis of the findings, the average of shari'ah compliance levels of the full-fledged Islamic banks was the highest, with the medium and low compliance operating in Islamic banking through Islamic bank branches and Islamic windows in this order. This indicates that the need to increase the shari'ah compliance levels in all the banks. The authors recommended that the increasing the levels would assist in mitigating the shari'ah non-compliance risk and support the efficiency growth of the Islamic banks in the country.

Meanwhile, in the case of Kenya, Tuitoek (2012) explored the effect of the provision of shari'ah compliant products on the performance of Kenyan commercial banks. The banks achieve high performance by maximizing their profits and making decisions to invest their excel cash in a range of portfolios that involve the investment amount and the portfolio investment type. The study also considered the financial exclusion that affects the Muslim population in the country who prefer shari'ah compliant financial products – therefore, the possibility of shari'ah compliant financial services is expected to contribute significantly to the mitigation of Kenya's unbanked population. This motivated the introduction of shari'ah compliant products in Kenyan banking industry. In their study, the authors employed a descriptive survey applied on 43 Kenyan commercial banks. The study findings showed that offering new shari'ah compliant products positively impacts the financial performance of the commercial banks, and extends the investment opportunities in the Kenyan banking sector.

In a related study using the CARTER model, Amin and Isa (2008) revealed that service quality positively impacts customer satisfaction, with the entire six dimensions examined significant and shari'ah compliance positively impacted service quality. Their findings were consistent with those of Parasuraman et al.'s (1988) where the dimension of reliability had the greatest impact on service quality. The authors also made use of SERPERF as opposed to SERVQUAL in their study method.

In a similar case with other Muslim countries examined, Libya is country where religion is the major factor that is considered by the Libyan population as evidenced by Kumati (2008) as the population is highly inclined to stressing on the Islamic societal identity. His study showed that most of the respondents and interviewees had positive attitudes towards Islamic banking. More specifically, 77% of the respondents were ready to acknowledge any return or no return as long as the banks adhere to the Islamic principles and conduct their banking transactions based on the principles of Shari'ah.

In relation to this, shari'ah rules form the core of the Islamic banking system and serve as its main driver. Shari'ah principles form the basis of the Islamic financial system and the guidance and framework for long-term performance of the industry. It is important for Islamic banks to meet the shari'ah requirements in order to solidify relationships among major players – banks, stakeholders, top level management, suppliers, customers and employees. Hence, based on this argument, Libya's ability to convert CBs into IBs is a considerable challenge to undertake and in this context, it is important for the converted bank to adhere to the shari'ah rules to maintain customers' confidence and to transform the stereotype of what they were before (CBs).

**Human Resources (HR)**

According to Beekun (1997, cited in Ab. Rahman et al., 2013), Islamic HR are valuable servants as opposed to mere servants and as such, they should be deemed as a powerful and dynamic workforce asset. This claim is supported by Oqool (2011) who stressed on the significance of HR on successful economic institution and El-Seoudi et al. (2012) who stated that HR forms the core of any successful business organization based on its activities. In relation to this, because the Islamic banks developments concerns stem from its operational issues (e.g., lack of qualified staff, lack of HR policies, and lack of planning and training to expedite shari'ah business development), it is crucial to touch upon HR.

Moreover, in Islamic banks, if HR has limited understanding of the way to carry out transactions from the Islamic perspective and knowledge concerning shari'ah rules, staff will face difficulties in dealing with customers concerning the bank's offerings (Tahir et al., 2004; Kahf, 2002; Wilson, 2002). Hence, a CB desirous of converting into IB should use suitable legitimate and experienced staff to achieve the conversion goals and objectives of Islamic banking. According to Al-Matran (1999), owing to the difference between IB and CB in nature, HR should be prepared to meet and adapt to the new banking situation and this process have to take top priority in leaders and managers of CBs. The lack of qualified and experienced staff is a top concern for Islamic financial institutions as this may pressure CBs to use staff form non-Islamic institutions. Aside from the training and hiring concerns, it is also pertinent for IBs to educate and train Islamic bank staff by offering them opportunities and good remuneration packages (Noor Khan, 2015).

Furthermore, it is crucial to determine the nature of the Islamic bank staff as it is in contrast to that of the CBs staff – where in the former, Islamic is the legitimate factor that controls and governs the whole banking aspects and special controls are required for the staff in IBs to perfect their knowledge of the business. CBs are primarily based on the legal aspect of organizing business without stressing on what is halal (legal) or haram (illegal) (Al-Gharbi, 2008).

In a similar line of study, El-Seoudi et al. (2012) found that HR is crucial to successful process of conversion and Al-Gharbi (2008) underlined Islamic banks requirements of highly-qualified, quality and trained banking and legal employees to achieve the developmental objectives, to evaluate investments and to be ready to conduct Islamic banking transactions.

Similar to the above recommendations, Al-Gharbi (2008) related that it is pertinent for CBs to launch specialized training initiatives before converting into IBs several Islamic financing aspects are overlooked in the transformation. Thus, it is important to note that Islamic banks differ from conventional banks in many respects – in concepts, controls, procedures, and risks and interest-based loans. CBs employees should be trained for Islamic banking operations in light of the following; 1) attracting investors and depositors through effective relationships, 2) provision of shari'ah requirements, and 3) determining suitable opportunities for investment. Such opportunities should be examined in light of the feasibility of their implementation and they should be supported through the shari'ah framework.

Generally speaking, lack of trained staff adds to the detriment of innovation in products/instruments in IBs (Iqbal et al., 1997) and lack of affects relationships with central banks arise from their lack of clarification and explanation of different issues (Kahf, 1999, cited in Karbhari et al., 2004).

In relation to the above, owing to the distinction of IBs from CBs in nature, there are many studies that examined HR's role in the transformation from different perspectives; for instance, Bariah et al. (2015) developed and proposed a model of Islamic Banking HR to carry out an analysis of the IBs HR performance through its determinants. The authors adopted a case study approach to examine Bank Syariah Mandiri (BSM) in Indonesia by employing a sample of 248 respondents culled through purposive sampling. Gathered data was then analyzed through confirmatory factor analysis (CFA) in SEM to determine confirm Islamic performance indicators. The findings confirmed that HR of Bank Syariah Mandiri lacked the fundamental basis of Islamic economics and finance, or extensive knowledge for that matter. What they had was a non-formal education of Islamic financial knowledge that was geared towards economics and general management and not holistic Islamic financial knowledge (e.g., Fiqh Muamalat).

In the context of Pakistan, the perception of bankers towards Islamic products and services and the training and experience obtained from Islamic banking were investigated by a study carried out by Arshad et al. (2011) and the results showed that Islamic bankers hold positive perceptions on the above mentioned aspects with a few them holding a relevant academic background or experience in Islamic banking prior to immersing themselves in an Islamic finance career. Contrastingly, their counterparts providing Islamic windows face challenges in comprehending Islamic banking concepts and principles as they primarily work in CBs. Hence, lack of well-trained and skilled workers is a significant issue that needs addressing by the government, the industry entities and educationists in order for Islamic banking to develop in the country. The authors suggested that the management of banks should adopt initiatives to provide workers with appropriate and sufficient knowledge and expose them to the shari'ah rules and principles when it comes to Islamic banking. This ensures that workers are knowledgeable enough to address customers' requirements and concerns and to conduct their tasks and responsibilities.

In the Libyan context, the potential of Islamic banking from progressing was examined by Kumati (2008) through data collected with the use of questionnaire and interviews. The findings showed that lack of knowledge and understanding of Islamic banking exists and the author attributed this to the closure of Islamic education institutions and the lack of Islamic research and publications. He highlighted that there are limited people who are qualified to serve in the shari'ah board and who are specialized in fiqh-muamalat in Libya.

Similar findings were revealed in Zainol et al.'s (2008) study, where the authors found that bankers holding suitable academic background and experience in Islamic banking are few and far between and they had even less knowledge prior to working in IBs. Moreover, the factors that influence the transformation of CBs into IBs were investigated by Al-Atyat (2007) in his study and he found that one of the top factors is HR. He revealed that HR did not significantly and negatively affected the transformation ability of the banks into IBs, indicating that human resources available were capable of conducting tasks after the transformation process of banks in Jordan.

In a different take on CBs transformation in Bangladesh, Hassan and Ahmed (2002) highlighted that customers and employees of the Islamic bank in Dhaka were not interested in transacting with the bank as they are convinced that the name of the bank might have changed but it is still based on CB principles, where interest is still practiced. Also, the Islamic bank's staff lacked the necessary knowledge to tackle the fundamental Islamic banking transactions. Majority of them did not have clue of the objectives of IBs, where religion is the top characteristic as opposed to profitability. The researchers showed that customers and employees' knowledge of Islamic banking concepts and practices is still ambiguous and to rectify such ambiguity, sufficient training has to be provided to both.

Lastly, HR is considered to be a crucial factor for successful Islamic banking industry. It is evident from the literature reviewed that qualified workers in conventional financial institutions and their training take top importance if such institutions are to gain success and sustainability of business (El-Seoudi et al., 2012).

**Regulations and Legislation**

Similar to the general CB industry, Islamic banking and finance has its regulations and rules but its operations are distinct in this aspect – rather than being regulated by national law alone, it is also regulated by shari'ah law. In relation to this, the CB system can be traced back to a long history necessitating the establishment of effective regulatory and supervisory entities, comparing to IBs that still lack regulatory and supervisory techniques. To compound the issue further, the conventional banking and company laws in majority of Islamic nations are based on the Western banking pattern (Al-Omar & Iqbal, 1999) and as a result, one of the top issues that are faced by IBs in their development is the present legal structure in terms of lack of understanding, lack of regulation, and the tension that arose from Islamic banks and regulators owing to the first two reasons (Kahrbhari et al., 2004).

Specifically, the supervisory authorities responsible for overseeing the Islamic banking industry are faced with considerable regulatory issues and challenges that needs addressing to facilitate a more favorable IB system (Rafay & Sadiq, 2015). The authors noted that the legal definitions of banking and financial services in most countries do not recognize Islamic financial transactions owing to their nature as vessels of trade and investments and to this end, several issues are expected to crop up if the general laws of the country are to be directly applied to transactions of Islamic finance in nature. This would lead to conflicts and negative legal effects. It is notable that Islamic financial institutions are not purely running based on shari'ah jurisdictions but also in Western legal systems that deviate from Islamic principles. Therefore, the adjustment and management of clashes between Western and Islamic legal principles constitute a huge predicament (Ahmad & Hassan, 2007).

Similar to other business entities, Islamic banks are influenced by its external environment, where the top factor noted in Kenyan IBs environment is lack of legal support (Kinyanjui, 2013). Coupled with this is the lack of suitable laws for IB and financial transactions implementation – a case in point, Islamic banking transactions are considered as buying and selling properties and are thus, taxed twice. Additionally, the provisions in commercial banking and company laws provide a narrow definition and thus, the Islamic banking activities scope is prohibited within such narrow confines.

To reiterate, commercial banking and company laws in majority of Islamic nations are based on the Western laws pattern – laws that provide a narrow scope for the activities of Islamic banking to be carried out. Parties are enabled to structure their agreements based on Islamic contract, but the enforcements of such agreements incur high costs. These issues, among others, call for special laws to introduce and practice Islamic banking (Iqbal et al., 1998), where a necessity exists to enact laws for facilitating the mixed system operation. More specifically, an important policy issue is how dividends are treated for the purpose of tax liability determination. Based on the convention system, corporations pay interest as tax-deductible expense and the same law applied to dividends paid out of any financial institution.

According to Iqbal et al. (1998), there are three major reasons behind the importance of regulations, legislation and supervision of the banking industry and they are; to increase information access to investors, to guarantee sound financial system, and to enhance oversight of the monetary policy. In addition to these three, in Islamic banks, the supervision of shari'ah principles is also a reason.

Several studies have been dedicated to addressing the importance of regulations and legislation in different contexts; to begin with, Sarker (1999) dedicated his study to examining Islamic banking in Bangladesh in light of their performance, issues and opportunities. He stated that Islamic banks have to potential to provide efficient banking services in the country if there exist efficient banking regulations and legislation to support them. These will facilitate banks willing to introduce Islamic banking products and services that are conducive to economic development. The author indicated that Islamic banks will fail to reach their efficiency level if they operate under CB framework in which case they will lose their efficiency in various dimensions. He recommended that authorities in Bangladesh conduct modifications to extend the operational scope of Islamic banking operations and establish rules and regulations that are suitable for Islamic banks to operate with.

In an extensive study involving 11 Muslim nations, Abdul Majid and Ghazal (2012) pin pointed gaps in major areas of legislation, regulation and supervision, along with setting of standards of shari'ah compliance and the areas that require improvement to facilitate the stability of the Islamic banking and finance sector. Their comparative analysis study concentrated on Muslim countries including Malaysia, Iran, Bahrain, Saudi Arabia, Pakistan, Turkey, Indonesia, Sudan, Kuwait, the UAE and Jordan, and two non-Muslim countries namely Singapore and the U.K. According to their study's findings, the legislation provided for Islamic financial institutions in majority of the countries in the sample is developed based on conventional banking, with some of them lacking efficient legal framework, and others lack effective Islamic banking law (e.g., Saudi Arabia), or only have a few laws dedicated to their corporate governance (e.g., Iran, Bahrain, Kuwait and the UAE). In this regard, majority of the countries adopt the regulations of their domicile coupled with International Accounting Standards (IAS). They recommended that harmonization of Islamic banking practices, and the facilitation of the cluster or regional convergence in the sector.

Also in this line of study, Ahmad and Hassan (2007) explored the present legal and regulatory issues faced by the Islamic banking sector in Bangladesh and found the top issue to be the lack of an efficient regulatory and supervisory framework for Islamic banks to function consistently with the shari'ah principles. Along with this challenge are the lack of inter-bank Islamic money market, policy and guidelines for Islamic and conventional banking by the Bangladesh bank, the discriminatory legal reserve requirement for IBs and CBs, the confined environment in the capital market, and the lack of legal support and protection to steer clear of related risks among Islamic banks. According to the researchers, it is crucial for the Bangladeshi Islamic banks to possess independent banking act to control, guide and supervise bank functions and to support their legally. Also, in Bangladesh, a specific Islamic banking act, law or independent regulations are still absent and therefore the functions of Islamic banks are not property regulated, controlled, guided and supervised.

Furthermore, Karbhari et al. (2004) determined the issues and challenges that Islamic banks face in the U.K. They obtained data from interviewing the senior officials of major financial institutions in the U.K., who are experienced in Islamic banking. Their findings showed that the major issues faced by the U.K. Islamic banks include the heterogeneous clients and potential clients, the regulatory issues, conventional banks rivals, lack of standardization, particularly when it comes to interpretations of Islamic shari'ah principles based on different schools of thought, and tax discrimination that all contributes to the retardation of the progress made by Islamic banking in the U.K. context.

In the case of Middle Eastern countries, Bashir (2001) determined the determinants of performance among Islamic banks in eight Middle East nations from 1993 to 1998. Several internal and external banking features were examined as predictors of profitability and efficiency of banks. On the basis of his study's findings, foreign-owned banks were found to be more profitable compared to local banks. With everything being constant, both implicit and explicit taxes influence the performance of banks in a negative way. Generally, the performance of banks are influenced by external environment (e.g., tax system), where four sets of control variables are expected to influence such performance namely the macroeconomic environment, the financial market structure, the regulation indicators and the dummy variables.

In this regard, many countries apply the common law and this exposes firms using Islamic financial modes at a disadvantage. The combination of the two traditions is required in the context of Islamic banking and finance, and the harmonization could lead to the development of Islamic banking. To this end, Ahmad and Hassan (2007) attempted to minimize the gaps by suggesting that Islamic financial institutions concentrate on seven priorities namely 1) the design of a suitable legal framework for Islamic banks and Islamic financial institutions, 2) the review of current legislation and revision of relevant laws to combine to be consistent with the shari'ah principles, 3) creation of an effective, efficient a strong regulatory framework, 4) implementation of the AAOFI, IFSB, and Basel II legal and regulatory standards, 5) management and monitoring of risk-return structure of Islamic finance, 6) centralization of shari'ah board/committee, supervisor and verdicts, 7) guarantee of tax neutrality and exemptions for shari'ah compliant banking activities, and 8) establishment of a shari'ah compliant audit framework and initiative.

More importantly, Al-Matran (1999) revealed that majority of conventional banks that convert to IBs, fully or through windows/branches, were unaware of the insufficiency of the accounting system and the entities that regulate and supervise Islamic banks. The accounting system is primarily based on traditional methods and as such, a new one for Islamic banking has to be developed. It is notable that the conventional banking system has long established effective regulatory and supervisory entities but such system is not effective for Islamic banks. To compound the matter further, the central banks in majority of Islamic nations are ignorant of their role as an entity that initiates and tracks the development of primary, secondary and money markets that are shari'ah supervisory board (SBB) – approved. Added to this the banks lack innovation of new regulations and legislation and as a result, regulations and legislations remain based on profit-sharing and unfixed rates of interest (Karbhari et al., 2004).

Another major issue that is linked with the regulations and policies is the applicable tax system in majority of Muslim nations – wherein tax systems appear to be on the side of conventional banks as they allow interest to be tax-deductible because in the context of Islamic banking, profit is not an alternative to interest (Karbhari et al., 2004). This extra burden on Islamic banks calls for an effective regulation that is just and fair. To this end, Garas (2004) noted that central banks play an ineffective role as regulators of standards and practices for Islamic financial institutions in a way that the accounting practices within Islamic banks are not aligned with their financial statements, where the latter lacks transparency and disclosure.

It is evident from the above discussed literature that despite the fact that studies have tackled the effect of regulations and legislation on Islamic banks performance, more studies are needed to address this subject, particularly in terms of the influence of regulations and legislation on the CBs conversion into IBs.

**Islamic Financial Products**

Considering what is lacking in the Islamic banks, it is not surprising that financial products are noted to have slow development (Al Omar & Iqbal, 1999), which constitute as another issue in Islamic banks in terms of innovation of shari'ah-compliant products and services (Al-Salem, 2009). Generally speaking, the limitation of Islamic banking products is deemed to be a major challenge that Islamic banks are facing and by CBs who are desirous of converting into IBs or to offer IB products and services (Mustafa, 2006). Regardless of the considerable development made by shari'ah compliant banking products in the Islamic banking sectors all over the world, the system that is based on is still in the stage of infancy. In theory, the major products/services offered by Islamic banks are covered in profit and loss sharing (PLS) mode (e.g., Mudaraba and Musharaka). In practice, the adoption of these products is rare (Karbhari et al., 2004). On the basis of Kahfe's (1999) study, practically, it has been noted that 20% of the Islamic financing is conducted as profit and loss sharing and among the many issues linked to PLS mode is the long-term nature and the high rate of risk. In relation to this, Bahri (2009) related that the PLS principles appear to have no improvement although the contract is globally acknowledged and adopted. Another problem linked with PLS contracts is its susceptibility to agency problems (Presley, 1999, cited in Bahri, 2009).

Alternatively, several Islamic products are launched into the market through the adaptation and reengineering of their conventional counterparts (Mustafa, 2006; Iqbal et al., 1998). This is a popular trend as Islamic banking products are nothing but convention products modified to adhere to shari'ah laws as explained by Mustafa (2006). He added that this limitation confines the Islamic banks competitiveness against CBs. However, new ideas have to be eventually innovated and implemented on the basis of Islamic law because development and innovation of financial products/services in adherence with Islamic shari'ah principles is crucial for the development and survival of the Islamic financial sector and for the successful conversion process of CBs to IBs (Al-Salem, 2009).

In another take on the subject, Abdul Aris et al. (2013) suggested that Islamic products have to be launched as alternative convention products but eventually, most Islamic products customers realize that Islamic products are similar to convention products in CBs and therefore it is unrealistic to separate Islamic from non-Islamic banking activities (Al-Salem, 2009). In actuality, there is a dire need among Islamic banks to innovate and produce new products to remain competitive. The products introduced have to be attractive so that individual as well as business customers will be willing to take advantage of them. In addition, such products and services have to be introduced in a timely manner owing to the technology advancement and the financial markets evolution pace.

A related study examined the Islamic banking products in light of their related issues and challenges in the Malaysian case. In particular, Aris et al. (2013) showed that the launching of new Islamic products poses some challenges to practitioners, shari'ah council members and the whole society. As mentioned, most Islamic products are introduced as conventional products in alternative. However, due to the dynamic environment, it is high time for Islamic banks to innovate and produce new products to solidify their competitiveness in the market. Aris et al. (2013) added that product development has to comply with the guidelines and shari'ah principles before they can be introduced in the market. In other words, the internal shari'ah supervisory board has to endorse the Islamic banking products, with the products variations attributed to the different shari'ah advisors' interpretation.

In the case of Iran, the importance of Islamic banking was examined by Ashraf and Giashi (2011) in light of the challenges and progress. They traced the growth of Islamic banking and the expected future challenges. They found that one of the major problems is the profitability without facing risk so the risks are all imposed on the customers. However, some Islamic banks steer clear of adhering totally to the Islamic rules and regulations assuming that running a banking system that is Islamic-based would encounter some problems. This fear lacks basis as the issue lies in the fact that conventional banking systems dominate the market and are intent on running by their own rules – this should urge Islamic banks to innovate and be creative in introducing Islamic banking products/services in the market to create their niche.

Nevertheless, owing to its novelty, the Islamic banking system is limited in its reach (Ashraf & Giashi, 2011) compared to conventional banking system, and the amount of funding in them is less compared to conventional banks, which may well weaken the system of Islamic banking in the future. Despite this fact, the future of the global Islamic banking industry is still bright. Ashraf and Giashi's (2011) study revealed that Islamic banking in the context of Iran is characterized by sluggish growth, huge portfolio of non-performing assets and a limited range of products and services. They stressed on the need for product/instruments/service development and innovation in order to meet customer needs and achieve customer satisfaction.

Aligned with the purpose of the above discussed studies and their findings, Al-Salem (2009) also looked into financial product innovativeness among Islamic financial institutions adopting a qualitative method of study for his data collection and analysis. He noted varying assessments highlighting the issue of ambiguity on the subject. The findings showed that the rate of innovation of Islamic financial institutions are negligible and may be attributed to the fact that the Islamic finance development is still new. He added that although innovations and developments in Islamic instruments are ongoing, the demand for them is still low and they still face problems and issues concerning such instruments. The question that has yet to be addressed concerns the nature of Islamic financial products and their distinction from conventional products and services. A core issue in this respect is shari'ah compliance.

In reality, Islamic banks provide financial products that are fully shari'ah compliant like mudarabah, istisna and murabaha but in other products like musharaka forms that are trust-based they often fail owing to the difficulty of its achievement in practice. Added to this, the lack of method or instrument to determine the presence of such instruments challenges the Islamic banks in their provision (Al-Salem, 2009).

Because innovation and development of Islamic financial products/services is one of the many challenges that Islamic banks face in general, and CBs who are willing to convert in particular, it is crucial for CBs desirous of converting to comply with the rules of shari'ah while at the same time meeting customers' needs, offer Islamic financial products and services in order to satisfy customers and retain their confidence. This will all assist in changing the previous image related to the bank.

**The Value of this Paper**

The results obtained in this study would be invaluable to different stakeholder groups in the banking sector (e.g., regulators, policy makers, bankers, bank leaders and researchers). This paper is one of the pioneering works to address the phenomenon under study and thus, its results may contribute to the knowledge concerning the CBs conversion to IBs.

## Limitation and Future Studies

By now, it should be evident that the study examines the issues and challenges that are related to the conversion process of CBs to IBs and owing to the newness of the topic, several limitations are faced in conducting the study. First, there is limited number of studies dedicated to the conversion process, particularly in the English language, and in terms of Islamic banking. Majority of the studies dedicated to the topic are written in Arabic. It is recommended that future studies examine the factors influencing successful conversion through an empirical method. Added to this, this study also recommends that future studies concentrate on the leadership of conventional and Islamic banks and their major role in the conversion process, and in improving the Islamic banking system, primarily when it comes to tackling conversion resistance. For further exploration of the phenomenon, it is crucial to extend the understanding of the relevant factors influencing the conversion process from CBs to IBs with the help of in-depth interviews.

## Conclusion

This study's primary objective is to provide an extensive review of literature related to the CBs conversion into IBs. The process of review was directed by the research articles, extant findings in survey studies, and relevant concepts in prior studies. The researcher highlighted pertinent findings from the review, particularly the fact that the conversion process from CB to IB is a process riddled with complication as it entails one entire system's transformation to another system. The results also revealed that conventional banks are faced with issues relating to the lack of a comprehensive framework of conversion, with some of the issues being; shari'ah compliance, conversion resistance, human resources, Islamic financial products, regulations and legislations. The results showed that the recruitment of profession, knowledgeable and experienced staff is one of the major issues of conversion. Staff is expected to hold technical expertise in banking as well as knowledge in the fundamental principles of the Islamic banking system. Thus, it is pertinent for a CB that is willing to convert to IB to ensure that its staff has the required knowledge and training.

The review of literature also indicated that need for a conversion framework that would guide future studies to examine the issues faced during conversion. The researcher recommends that CBs adopt a gradual conversion process as this most appropriate, particularly in the case of Libyan CBs. This would entail top management of Libyan conventional banks adoption of training initiatives and development of accountants' knowledge concerning AAOIFI standards. It is crucial for the converted CB banks to follow the format of financial statements established by the AAOIFI in general and shari'ah standard number 6. It is also crucial to establish regulations and policies and legislation relating to taxes and commercial law that are aligned with the Islamic financial system. Additionally, mature markets should be created so as to absorb the work of Islamic banks, companies and Takaful insurance, securities markets and other financial entities. Legislations and regulations of the banking system have to take the full-fledged conversion process into consideration, and in this area, the experience of the Central Bank of Kuwait has to be noted.

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