

**The Barriers to, and Incidence of, Islamic Banking and Finance in
Canada**

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ABSTRACT

The non-interest and profit-loss sharing schemes of Islamic finance (IF) are attracting increasing global attention. Despite exposure to the similar opportunities as other Western countries that have adopted the financial business model there is little evidence of Islamic finance windows operating in the conventional institutions in Canada. This thesis takes a qualitative approach to bring the issue forward in Canadian social science literature by exploring the perceived challenges to, and the potential of, the development of IF offerings with a focus on factors affecting the supply and management decisions in the industry.

The study used an inductive approach with archival data and critical survey of literature to arrive at the hypotheses surrounding the challenges. These were tested deductively by semi-structured interviews and panel discussions both in Canada and the US on a sample of senior officials involved in both IF and conventional financial institutions. Using a thematic analysis the study arrived at findings supporting the hypotheses related to awareness, regulation, management intent and internal resources. In the external environment, factors affecting strategic decision on offering IF services are mainly due to regulation, lack of awareness, even among Muslim communities, or misgivings about Sha'riah authenticity. Internally, highly customized IT infrastructures, lack of funds and foreign investment make it unfeasible. Management interest when proposed with the concept is high but not in a top-down manner and there is an overall uncertainty avoidance culture and little proactivity with market research. Access to specific Sha'riah knowledge is not considered a hurdle anymore. It is apparent that investments in Sha'riah compliant stocks would be easiest to set up. Mortgage structures can be affected by the capital market structure, even if not tax structures. Knowledge on this can have implications for banks seeking to expand their investment portfolios and aid government policies.

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1. Introduction

1.1 Introduction and research question

The objective of this study is to explore the scene of Islamic banking and financial (IBF) services within the current Canadian landscape with a focus on its potential to increase the portfolio of financial offerings and subsequently, Canada's chances of participating with a more active role in the network of countries absorbing this alternative financial business model alongside the conventional one. While many western countries are seeking to leverage this new financial business model, Canada has been relatively quiet in this area. This thesis addresses the questions of why it is not a common practice, how it can be brought within the activities of mainstream financial institutions and which instruments have the most potential for market demand from a management perspective.

A system with its roots in the Sha'riah (Islamic common law), Islamic finance (IF) has been recently attracting much attention around the globe, and increasingly so in western economies as a new and innovative mode of finance. Financial systems play an active role in the development of world. The financial services sector is a significant contributor to Canada's economic growth representing over 3.4 per cent of Canada's gross domestic product and contributes approximately \$10 billion in taxes to government (Canadian Bankers Association, 2012). The much recent financial crisis had been leading academics, managers, and politicians alike to consider the effectiveness of the current system and bring into consideration other modes of finance. One interesting aspect of the issue is that Islamic financing is not just for an ethnic group, but rather it is a viable system that is open to the same larger market as the conventional banking system. Growth and innovation within the industry is gearing more conventional products within Sha'riah compliance.

Activities of Islamic financial institutions differ from those of standard commercial depository corporations in that predetermined interest on financial transactions, which lies at the core of the latter is prohibited (OECD, 2008). The basic technique used to avoid the

prohibition is the profit-loss sharing technique through partnerships. The backbone of the Islamic financial system involves values such as mutual trust, commitment to economic and social equity, and individual responsibility leading to the embedded practice of what we more commonly known as ethical or corporate social responsibility. There have no doubt been challenges in bringing this theory and practice together. Despite this, since its inception into practice in the 1960s, Islamic finance and banking now operates in over sixty countries (Zaher and Hassan, 2007). It has moved from commercial banking to investment banking and has introduced an array of innovations in competition to conventional mortgages, insurance and equities. The Islamic banking and financing (IBF) industry has been growing at a rate of over 15-20 per cent and has managed to maintain this growth even during the sub-prime debacle of the late 2000s. The current size of the industry is estimated at \$700 million. The United Kingdom has caught on to become the Western hub of Islamic finance albeit its being a nation with a strong institutionalized conventional system. It is no longer a niche market but is already on its way for a global financial industry. The system has not been able to catch on in Canada in comparison to several other western developed economies also employing the conventional system as its mainstream financial and banking practice.

1.2 Importance in relation to the Canadian economy

On one hand Islamic finance and banking is seeking to expand its boundaries, and on the other hand Canada holds room for expanding its economy and one way of doing this is by creating a larger portfolio of financial instruments and leveraging a new way of carrying out transactions and business ventures. There is much room to converge the diverse knowledge and ideas into practicable means to benefit the economy. With increasing globalization, the financial industry can be used to bridge cultures together. It must be noted that this system, albeit having roots grounded in the religious rulings of Islam, is one that can be practiced by everyone and also, it is one that can exist side by side in an economy with the convention banking and financial services.

Canada is a country that prides in her multiculturalism and diverse demographics. Not only does this practice provide an innovative stance on a business landscape, it also contributes to this multiculturalism which is important for communities. Immigrants to Canada make up a crucial proportion of the expanding economy. Among these, Muslims make up a strong presence in major cities such as Toronto, Ottawa, Montreal, and Calgary. It was projected by Statistics Canada that the Muslim Population would amount to 1 million by 2011, which is almost a double of the population from 2001 (Belanger & Malefant, 2005; Statistics Canada, 2001). This comprises of many 2nd and 3rd generation Canadians, new immigrants and a few indigenous Muslims. These people bring with them experience and skills that can enhance the infrastructure of the economy.

In light of adhering to faith, many of them may be deterred from up taking projects such as a new small business venture, a home purchase or even a regular loan due to the implications of dealing with fixed interest. An opportunity to overcome this obstacle can potentially lead to rising number investments such as small businesses and home loans. This links to benefits such as more employment, more flow of money in the economy and subsequently benefits to the financial and economic infrastructure of Canada.

Banking in Canada is considered as one of the most efficient and safe banking systems all over the world. With its grand scale of customer services and use of cutting edge technology it can be said to be one of the world's most advanced banking systems. A new mode of banking like IF can help add to the portfolio of services offered by Canadian banks and financial institution. Hence knowledge on this can have implications for banks seeking to expand their investment portfolios, help determine the challenges or drawbacks attached to up taking the practices and aid government policies in regard to regulation. Despite these opportunities, the main conventional banking and financial institutions in Canada do not operate any Islamic finance window and there are only a few independent institutions, the performance of which still warrants research. To address the questions of why this is so and what potentials lie ahead, chapter 2 will first provide an outline of Islamic business and finance and present a critical survey of extant literature. Chapter 3 will advance the framework to develop hypotheses about its development in a Western

setting and the associated challenges. Chapter 4 describes the methodology proposed to test these hypotheses followed by the findings presented in Chapter 5.

2. Literature Review

Academic literature on the field of Islamic banking and finance, especially with regards to the west is still an evolving arena. Warde (2000) and Bianchi (2007) point out the inherently interdisciplinary nature of the topic. So far the studies have been covered by theology, law and finance. However, studies of Islamic economics and finance have been focused more on the Arab or Persian world, and most classifications are derived from political as opposed to economic factors leading many analysts of Islamic finance to dismiss developments that have occurred outside the Arab Middle East. It must be noted that Arab, Turkish and Persian components of Islam together represent barely one-third of Muslims worldwide (Warde, 2000). In reality, significant innovation has occurred beyond the Middle East, and the practice is no longer limited to the religious sect. The following is a critical review of extant academic publications encompassing issues of Islamic finance such as its contemporary applications and the opportunities and challenges experienced or foreseen in the Western setting. The publications encompass journals on fields of economic studies, social studies, financial product taxation as well as law. Book publications, conferences and a few recent organizational reports have also been reviewed for insight on the applications of the literature findings. Following the need for an understanding of the social construction on the issue, most of this literature is found to be qualitative in nature. This analysis following the review study takes an empirical approach particularly from the strategic management or social science perspective.

This chapter is divided into two main sub categories: It begins with a background on Islamic finance, presenting the debates on the core constituents of the system, followed by an account on the current trend of the industry and its comparison with the conventional banking system. The second part puts forward the arguments on potential dynamics faced in the industry's expansion in the west with a look at the benefits of alternative modes of finance and the likely obstacles for growth. This part informs the next chapter of the study for the conceptual development of hypotheses in application to Canada.

2.1 Background on Islamic Banking and Finance

Although a term coined in the later 20th century, the system had been in use in the form of ‘interest- free’ or ‘profit sharing’ transactions from much earlier on (Zaher & Hasan, 2001). Islamic financial institutions are set apart from conventional counterparts based on the adherence to certain Islamic principles constituting the following:

Table 1. Fundamental principles of Islamic finance

Enjoinments	Prohibitions
Transparency of contracts	Issuance of pre-determined or unjustified increase(Riba)
Responsibility and trust	Dealing with uncertainty and excessive risk speculation
Physical asset backing	Speculative and gambling transactions creating wealth from chance instead of productive activity
Charity	Investment in unethical business and trade involving tobacco, alcohol or similar addictive substances, ammunitions, adult entertainment and non halal consumption such as pork.

The Sha’riah law is derived from primary and secondary sources; the primary source includes the Holy Quran¹ and the Sunnah². The interpretation of the laws is done with consensus of jurists and scholars of Islam which provide the secondary sources for rules governing Islamic finance. The ideology is a simple one that believes in a balance between materialism and spiritualism and the guidelines apply to all aspects of life including at the social, familial and economic levels. Like all religions, one of the main objectives of life is taken to be maintenance of good and peace for humanity and have strong belief in the universal ideologies of fairness and accountability, and following this is the maintenance and distribution of wealth for the common good. While capitalism considers wealth to be an individual right to property, in Islamic economics, wealth is considered to be a

¹ The last Testament following the old and new Testaments which were revealed by God, Lord of Abraham, Noah, Moses, Jesus and Muhammad, Peace be upon them all.

² The traditions of the last prophet Muhammad (Peace be upon him), through his actions and affirmations of the guidelines of the Quran.

responsibility. The recent literature on capitalism points at the divide between cultures focused on the maximization of self-and-company interest and those focused on greater social good (Davis, 2005. McKinsey Quarterly, #3, pp. 104-113). The Islamic economic system relies on individual responsibility, commitment to economic and social equity, and also reliance on market mechanisms making it different from the socialist system where the government takes the responsibility of distributing resources.

Interest/Riba: From an economic perspective, the concept of interest can be related to what can be done with extra wealth that remains after one's necessities are paid for. We shall consider that to be the net wealth of an individual. In general there are three things one may use net wealth for: investment, saving and lending. The impetus for these activities lies in the return or reward to the lender of carrying out that activity which, under the common practice today, takes the form of interest. The conventional investment mechanism focuses on loans or deposits repaid with a fixed return of interest to the lender on a fixed and guaranteed basis irrespective of the productivity of the investment to the borrower, and so it is like 'selling money for money'. Money is taken to be measuring tool, not as an asset in itself, so income from money is taken to be usurious under the guidelines of the Abrahamic religions including Islam, Christianity and Judaism. Also, the risks may fall disproportionately on the borrower and this is seen as exploitative, socially unproductive and economically wasteful. The idea is that productivity cannot simply be measured in terms of monetary return to the lender, but there must be an effective outcome from the use of the lent/ invested money in the first place, which then may lead to further financial gain to the lender. The solution to this is taken in the form of the profit-loss sharing mechanism where the transaction must be backed with real economic activity. The modern debates concerning Riba have been presented in section 2.1.2.

With regards to saving, keeping resources idle and hoarding of large amounts of wealth is discouraged as the activity itself does not bring about any further productivity in the economy. This is not to say saving is forbidden. From a Keynesian point of view, excessive saving, i.e. saving beyond planned investment, is a serious problem, stimulating recession or even depression. Similarly, in the view of Islamic economics, savings don't bring benefit

if they are not used for a productive purpose. In terms of role of money Schumpeter (Poon, n.d) distinguished between a pure exchange economy and a capitalist economy. The pure exchange economy is essentially the classical economy, where money is only an instrument to facilitate trade, and is obtained in exchange for goods or services (Bertocco, 2006). In the capitalist economy it includes the entrepreneur and the sponsor (bank) in addition to a pure exchange economy, where money is created by the banks to initiate economic development (Bertocco, 2006). The diverging ideology in the Islamic economic system is that this money is created not by one side through interest but by a mutual participation by both entrepreneur and sponsor through profits. Fairness and equity lies at the heart of the concept. Regarding ethics Jackson (2000) points out that cultures vary in ethical response because they differ in their underlying Moral Philosophies (which in turn relate to the Ethical Conduct of Business but which aren't entirely distinguished by religious indoctrination). Analyzing the systems under the ethics of teleology, the theory of morality that derives duty or moral obligation from the consequence that is good or desirable, choices can be made in light of (a) which option produces the greatest good for his/her own self-interest (egoism), and (b) for the greater number of people (utilitarianism). The conventional system can be compared to the theory of egoism where the consequences of a decision are used to measure the moral worth of an action; the Islamic economic principle in contrast can be compared to the theory of Justice which establishes standard rules that are equity-based and transparent, and that apply to everyone. It's is more of a Utilitarian ethic focusing on the distribution of benefits and harms to all stakeholders with the view to doing the greatest good for the greatest number.

The profit loss mechanism seeks to balance the risks between both lender and borrower, not just one side. Islamic finance takes a conservative approach to risk, the value and pricing being backed by actual physical assets (Clarke, 2009). But this does not mean there is no risk management involved. Other highly risky practices are banned as speculative and short selling and the lower risk makes it a more stable mechanism. It is a complementary system rather than an alternative system to mainstream financing as it is used within the same framework and may appeal to those who want a moral approach to money about promoting interest of everyone involved. It functions like western equity

financing. It is the prospects of the project, not soundness of entrepreneur's credit history, which determines screening of potential investments (Zaher & Hasan, 2001). Relation of the investor to the institution is that of partners, whereas in conventional banking it is creditor-investor. The following table shows the basic differences between the two modes of finance.

Table 2. Basic comparison between conventional and Islamic banking and finance

Fundamental Differences	Conventional Finance	Islamic Finance
Interest	Interest at the heart of the system	No fixed interest is acceptable
Returns	Lender gets back principle plus a markup. Loss is not shared by lender/institution.	Both debtor and lender share gains and losses.
Mode	Loan based	Equity and partnership modes
Impact	Looks for financial returns to the lender only	Looks for returns that impact the society as a whole
Audience	Does not suit those wanting to avoid interest, e.g. devout Muslims, Christians and Jews.	Feasible for everyone irrespective of religious or ethnic affiliations
Money	An asset	A measuring tool

2.1.1 Evolution and current trend

The pioneering effort of IF started in Egypt in the village of Mit Ghamr in 1963 (Siddiqui 2011; Karasik et al., 2007) in the form of a profit sharing bank which moved from equity based investments to replication of conventional instruments. In 1970, Organization of the Islamic Conference (OIC) was formed. The Islamic Development Bank, established in 1975, gave institutional recognition to the developing industry since which several Islamic banks arose in the Middle East in the form of commercial banks serving retail customers, investment banks and insurance companies. The impetus can be identified to be mainly:

- Increasing wealth in Muslim countries, along with rising oil prices (Karasik, et al., 2007)

- Senior managers of IF banks believe they must compete on commercial grounds
- Religious awareness

Clear and meaningful figures have been difficult to identify due to the fragmented nature of this new market which resides within the same infrastructure of the conventional market. It is a fast growing infant industry and the key to forecasting its presence and effect in the coming periods is to comprehend where it stands today. Warde (2000) states that 'the new world of finance, characterized by the blurring of distinctions between commercial banking and other areas of finance, the downgrading of interest income, and financial innovation, has been rife with opportunities for Islamic financial institutions.' KPMG is one of the first accountancy organizations to establish a global Islamic finance division on the basis that Islamic banks will account for 40 to 50 per cent of the total savings of the world's Muslim population within a decade (Vahed & Vawda, 2008). In 2003 a consortium of Gulf banks and a British business man bought Aston Martin for £250 million being financed by a *Murabaha* transaction. This is the very first of its kind in the West and shows that the prospects of wholesale Islamic banking are a lot more prosperous than initially assumed in the UK (Kabir & Lewis, 2007). Many conventional banks are now offering products that are also aimed at non-Muslims through Islamic financing windows by HSBC, Citigroup, Standard Chartered Barclays capital, Deutsch bank BNP Paribas (Karasik et al., 2007; Zaher & Hasan, 2001). The US has developed a Dow Jones Islamic Market Index have listed 1937 companies eligible for investment as of 2006 (from inside and outside the Muslim world) whose products and services do not violate Islamic law.

There are now over 280 IF institutions in over 60 countries (Zaher & Hassan, 2007) with some mainstream banks also operating IF windows. The 1.5 billion Muslims account for around 21 percent of total world population. The Islamic finance industry has a recorded growth rate of over 15 -20 per cent per annum (Clarke, 2009; Imam & Kpodar, 2010; Malik et al, 2011; Jessop, 2009). Its assets are valued up to almost US \$ 60 billion (de Belder and Khan, 1993; Ernst and Young report). Some sources say funds are valued up to \$ 300 billion. The IFB industry assets have increased more than fortyfold since 1982 to exceed \$200 billion (Warde, 2000). Similarly, countries like India, the Kyrgyz Republic, and

Syria have recently granted, or are considering granting, licenses for Islamic banking activities (Solé, 2007).

Several studies have focused on the more common regions where IFB is present (Bahrain, Pakistan, Iran and Sudan, the latter three of which have fully integrated IFB into their financial system (Zaman & Movassaghi, 2002; de Belder & Khan, 1993) but authors such as Lewis (2008); Zaher & Hasan(2001), Karasik (2007) are of the view that the rest of the world is increasingly seeking to have it as a commercially sound option alongside the mainstream system. The more common model is where traditional and Islamic finance co-exists and competes with or complements one another.

The literature in this review shows studies done so far on the following regions.

The United Kingdom:

With five full-fledged Islamic banks and 17 conventional banks offering Islamic financial services through an Islamic window, the UK is currently the biggest market for Islamic retail banking and wholesale banking in Europe (Volk and Pudelko, 2010). 18 billion pounds of UK's annual income is said to be attributed to the Islamic finance industry, London has undoubtedly emerged as the hub of Islamic finance in the west (Karasik, et al., 2007; Volk & Pudelko, 2010). Malik et al (2011) have identified factors contributing to this as a fast growing Muslim population, wealth from the Middle East, a shift from investing in US to UK due to political after effects of 9-11 event, and strong government support through accommodation of regulations for the practice of IBF. The first bank, Al Baraka Investment which acquired Hargrave Securities in 1982 failed due to limited capacity and resources but the British bankers became experts in Sha'riah principles when they responded to liquidity management needs of Muslim clients in the Gulf with overnight deposit facilities. Bank of London started accepting deposits with a short term trade on the London Metal Exchange (Malik et al, 2011). In 1976 the Institute of Islamic Banking and Insurance was established. The Islamic Bank of Britain was set up in 2004. Government made changes such as the Finance Acts of 2003, 2005 and 2006 as well as the abolishment of double stamp duty which solved the hurdles for *Murabaha*, *Ijara* and diminishing *Musharaka* (Ayub, 2007; Umer, 2007) [*Appendix 1 displays these instruments in detail*].

HSBC Amanah and Lloyds TSB offered IBF products. These British institutions have also been strategic in their choice of location- placed in the two areas of the UK with the highest density of Muslim population, to achieve the exposure they required so. They are attempting to attract the petrodollars of Arab sheikhs so they can appeal to them to invest their money into Sha'riah compliant investments. But this may go against the idea of social equity. David Hunt, of HSBC Amanah, stated that the volume of business HSBC Amanah sold grew 82 per cent in 2008. However it must be noted that in light of the bank's recent money laundering charges, HSBC has scaled down its overall operations which also included the IF windows in several countries. The decision, according to Failaka Advisors, a research and advisory firm that monitors advances in the field of Islamic investment funds, will not help the bank restore its reputation, especially in countries where they have exited and this will make it very difficult for the bank to return there in the future (Failaka.com, 2013).

France with the largest Muslim population in Western Europe also has large financial institutions like BNP Paribas and Société Générale. However, the supply of Sha'riah-compliant financial services is still very limited. Currently, three Spanish banks, Bancorreo, Santander and La Caixa, offer interest free current accounts and Islamic mortgages (Volk & Pudelko, 2010). In Germany: unlike France, the government has not made much legal modifications to facilitate IRB (Volk & Pudelko, 2010).

Ahmad and Hassan (2009) have examined the regulations of IF in Australia. They do not try to empirically evaluate the efficiency or profitability of IFs in Australia but find that there is huge potential for Australia, being geographically near Muslim majority nations like Indonesia, Malaysia. With introduction in 1989 of MCCA limited, although not a big player, authors are hopeful of cooperation from regulatory authorities in Australia.

South Africa is another economy where Muslims form a minority, around 2 per cent in 2001, but there has been increasing interest in IF Institutions with the Al Baraka bank established in 1989. Vahed & Vawda (2008) study Muslims clients in SA, 75 per cent of whom claimed they feel that IF institutions can be a viable alternative option to conventional financial institutions in general, they also find that many Muslims simply

don't challenge the dominant capitalist system and hence there has been a move away from the ideal PLS system. Ackermann and Jacobs (2008) find from 72 Muslim corporate clients that even though that they mostly want Sha'riah compliant products for religious reason, the products costs need to be aligned with client expectation, and they seek trusted relationships and a brand name.

Jusic and Ismail (2012) explores the Western Balkans where in spite of the presence of large Muslim population in Bosnia and Herzegovina, Albania, Turkey, Montenegro, Kosovo, Macedonia and Serbia Islamic financial and retail investment has only recently emerged as a player in region's financial markets. He finds the main challenges to be inherent in the implementation, as well as due to lack of legal personnel who are sufficiently educated in both Islamic financial law and European financial regulations.

China inaugurated its first Islamic investment fund that attracted \$1.2 billion dollars and that targeted infrastructure projects, real estate and industrial property markets. Imam & Kpodar's (2010) empirical regressions on 117 countries' averaged data from 1992 to 2006 found probability of IFBs to be higher where there are higher Muslim populations, income per capita, and whether it is a net exporter of oil trading with the Middle East and economic stability also help the diffusion. Having a British colonial heritage favors the development in a positive way as well where regulatory systems are built on a solid foundation as well as proximity to IF hubs such as Middle East and Malaysia.

Malaysia has been a more central focus for practitioners and academics alike; despite being the eastern epitome of success of IFIs, it has emerged as a successful dual system with Islamic and conventional markets operating in parallel, a large portion of clients being non-Muslims. (Krasika & Nowak, 2012). They have in place a financial system that includes best practices in legal and regulatory infrastructure, institutions to promote the skills and diversity of market players.

2.1.2 The debate on interest free and profit-loss sharing (PLS) schemes of finance

Profit-Loss Sharing (PLS) Scheme: According to (Hull, 2002) business organizations are formed for the purpose of making profit. Although charity is a huge concept in Islamic economy, with every self-dependent Muslim obliged to give at least 2.5 per cent of their net annual wealth to charitable causes, the whole concept is not simply that. It is also profit oriented. Broadly, profit-loss sharing is a contractual arrangement between two or more transacting parties, which allows them to pool their resources to invest in a project to share in profit and loss (Humayun & Preseley 1998). Losses are based on initial investment only, and are based on the contractual agreement, while the profit depends on the gains throughout the duration of the business venture. The PLS concept has emerged as a response to the interest based banking debate, not solely for religious purposes (Zaher and Hassan, 2007).

One of the seminal works on interest free banking was by M.N. Siddiqui in the late 1960s through his book '*Banking without interest*' (Nienhaus, 1983). This publication was not based on the Islamic financing and banking per say, but presented method of creating and running an interest free economy where he presents the idea of the profit loss sharing system much applied by Islamic financing. However, his discussion assumed this PLS system to reside in a closed economy, without any international trade or affiliation and assumes that the PLS system is the only one used in the economy. That is a study of the normative with regards to interest free banking rather than the reality, which must take into account the presence of the conventional banks that exist in competition and this would, in turn, affect the role of entrepreneurs, investor and borrowers and will also be affected by existing regulatory frameworks and policies. This point is of particular salience in the case of implementing the Islamic or PLS mode in the West. Through PLS, IFB encourages financial relationship between financiers and entrepreneurs (borrowers) where lender and borrowers share investment risks in businesses and assets (Shamshed, 2008; Zaher & Hasan, 2001; Lewis, 2008). It also encourages risk sharing, honoring of contractual obligations, transparent transactions, facilitate good relations in community through partnerships and cooperation and promotion of entrepreneurial activity by

helping allocation of resources to potential ventures, not just creditworthy borrowers (The lack of interest also means increases in production do not necessarily lead to increased money supply and hence inflation).

Interest based schemes: Lewis (2008) points out that prohibition of interest is the *raison de etre* of the Islamic financial system and 'one of the far reaching and controversial aspects of Islamic finance with regards to the Western perspective'. Several authors have put forward debates on what constitutes 'riba'. There has also been debate even among the Islamic communities as to the effectiveness of the system (Zaher & Hasan, 2001).

Riba is of two forms- *Riba an-nasiyah* which is the predetermined fixing of a positive return on a loan as a reward for abstaining from consumption (Quran), and *Riba al fadhli*- encountered in hand to hand purchases regarding exploitation through unfair exchanges (Sunnah). To maintain authenticity, the design of instruments must be in accordance to the Sha'riah law, and involvement of advisors knowledgeable and certified in the field are required. Most scholars of Islamic economics are unanimous on the inclusion of interest within the definition of riba. This common understanding of riba is what guides the subsequent product designs that are today already established in the Islamic financial market worldwide. So, for the purpose of this study, the most widely accepted interpretation as given by the learned scholars and jurists will be taken. Nevertheless the arguments regarding *riba* interpretation will be highlighted to present the role of the profit loss sharing scheme.

Interest is a predetermined payment on loan. In the conventional system, no one wants to lend out wealth without ensuring its return. Lewis (2008) cites Razi (1938) explaining the difference as profit in the business being uncertain, while the excess amount received by the creditor is guaranteed- this clearly brings up an element of injustice but there must be equal treatment of all parties. Furthermore, if the borrower's investment is unsuccessful through no fault of his or her own, it is unfair for the lender to demand extra payment over the principle amount. Hence fairness is practiced by giving the lender the rights to reward, depending on risk and effort involved and governed by the returns/profits received from

the projects, instead of a predetermined return to the lender only. The profit sharing model has laid the foundation for the design of Sha'riah compliant products in the financial market.

Zaman & Movassaghi (2002), argue that the Islamic banks are not significantly different from conventional ones. Their claim is not based on performance metrics but on the opinion that 'interest' does not count as riba and they state that 'not all conventional products are usurious'. Although the latter is true, what needs to be considered is that *some, if not all*, conventional products do include interest and hence are considered usurious. It is understood that the purpose of Islamic banking is not to replace all conventional products, but rather provide an alternate for those products which *are* usurious, i.e. involves interest. The authors justify their opinion by stating that the Quran does not define riba and also that, while the Quran refers to riba on debt, the Sunnah does not (it refers to sales). Citing similar arguments by Suhail (1936), and Afzal (1996), they claim that there is no historical evidence the riba practiced in the pre-Islamic period were similar to modern interest on loans. They also emphasize that, based on the Quranic guideline that the lender is entitled to the return of his/her principle, the question of loss sharing by the lender should not even arise. Some critical reasoning using the basic understanding of the distinction between direct loan and 'investment' can be used to refute these points. Under IF, money can be lent out in two modes: 1. The type of permissible loan given solely on goodwill- Qard e Hassan (*good loan*) whereby lender does not charge interest but is entitled to receive back the principle, and in case it is not feasible for the borrower to pay back loan forgiveness is encouraged (Quran, 2:280) This was what the Riba-al-nasiyahn the Quran referred to. Riba-al-nasiyah is the prohibition on an increase from mere use of money with no measurable real economic increase (Zaher & Hassan, 2001). The lender is however, entitled to the return of the principle amount lent. Here the lender neither shares loss nor profit. In other words, this is not the PLS scheme. The second type of lending is through the PLS which offers a solution to the interest problem and was seen in practice by the Prophet through trade transactions himself. Other verses have specified that 'trade' is not the same as usury (Quran 2:275). This has also been explained in terms of property rights by Lewis (2008). There are two types of property rights:

property that results from creative labor and natural resources, and property the title of which has been transferred through exchange, remittance, inheritance or gifts. Lending money as loan (Qard) is a transfer of the right (of that principle amount) and all that can be claimed in return is the equivalent only. On the other hand, when the resources/ money lent is used in partnership, the lender's right of the property is still his own therefore making him a co-owner of the venture, this gives him a legitimate claim to a share in the wealth generated from the use of that borrowed resource (PLS). Islamic banking systems around the world use usually three main type of deposits; *current accounts, saving accounts and investment accounts*. On current and saving deposit the bank guarantees the depositor the nominal value that he has deposits but gives no guaranty on return; and the investment deposits are operated fully under the concept of profit and loss sharing (PLS) model (Ariff, 1988).

Another claim made by Zaman & Movassaghi (2002) make is that money is no longer a medium of exchange unlike the 'earlier centuries of Islam' and money can be traded like other commodities. It must be noted that term 'earlier centuries of Islam' is not applicable; one of the purposes of clients seeking to practice IF may be for the religious context of adhering to the religious rules which, despite the eras gone by don't change. Hence it would be wise to recognize that as the larger number of clients, who may demand these products may not want to risk such interpretations of faith, so they stick to the more commonly accepted interpretation of riba. Money cannot be traded as a commodity, money can be saved and invested, but this is not encouraged without productivity (Lewis, 2008). The views of benefits from an interest free system can be upheld from conventional economic analysis. Seminal writers on the issue of interest or PLS (not Islamic Finance per say) have questioned the view that interest is a reward for abstinence; Austrian economist Eugene von Boehm-Bawerk (1922) as cited by Lewis (2008) is of the view that there is no sacrifice in abstaining from consumption since the utility of the goods in productivity should have been the main concern. Abstinence would be 'justified' if it were being used for further productive investments creating wealth and capital (Lewis, 2008; Zaher & Hassan, 2002). As for the argument that interest enables adjustment between values of capital goods over time, it may be more reasonable to allow the next period's economic condition to

determine the extent of reward instead of predetermining it as interest (Zaher & Hassan, 2002).

Islamic banks must therefore develop products to achieve the goals of Sha'riah, and at the same time meet the economic needs of society. Other critics of the concept of Islamic finance claim that even if difference exists it is artificial in nature (Hafeth, 2006; Al Yasseen, 2007; Zaman & Movassaghi, 2002). This can be a serious dilemma since there have been mismatch in theory and practice (Warde, 2000). It is noted that there is a widespread use of securitization, Murabaha deals, etc in the market which don't conform to the design principles. Another challenge is whether the scholars involved in the design are biased.

2.1.3 Product structure under IF

Other than using money for the loan on goodwill (Qard e Hassana), for deposit and saving accounts, there are four basic contracts which make modes of investments:

1. Murabaha (buying and selling)
2. Ijara (leasing)
3. Mudharaba (PLS)
4. Musharaka (PLS).

The principle of "risk-sharing" is a critical component. There are two principle financing arrangements offered to borrowers: Murabaha (installment sale) and Ijara (redeemable lease). With the Murabaha, the bank can buy the asset (e.g. equipment) and then resell it to the customer at a higher price while the customer still uses it with an installment plan. Under Ijara the customer would use the asset over a number of years and at the end of the agreement pay cash to own it outright. When it comes to deposit accounts, Islamic banks have a similar philosophy to credit unions. They will both share in the profits of the organization, however the profits that will be distributed are at a rate agreed to when the account is initially opened. In case of no profit made, the depositor will not receive any payment. This is an example of the risk-sharing principle outlined earlier. Mudharaba and Musharaka are the profit-loss share modes; in essence, the Islamic bank becomes a

business partner with the customer for an investment. The common product structures are tabulated in Appendix A-1.

Over the last two decades, several financial instruments have been developed and are considered innovations in Islamic finance. As conventional investors worldwide are playing larger active roles in the IF markets (Thomson Reuters, 2008), this also represents a form of business model innovation through its 'window model' where conventional banks simultaneously carry out conventional and Islamic finance activities, but assure clients segregated accounting and operations of the two types of activities. This would count as an organizational innovation which refers to a new organizational method in business practices, workplace organization or external relations (<http://www.oecd.org>).

Several authors have discussed financial product design. Based on these fundamental designs several newer products have been derived. Derivatives refer to financial products whose value is 'derived' from an underlying asset. On the positive side, derivatives can play an important role in risk management. Adopting reverse engineering (Iqbal, 2006) and hybrid Islamic products structured by blending two to three Islamic products that suit the financing requirements of businesses (Shamshed, 2008) a number of offerings have been designed as conventional product equivalents. Reverse engineering is the process of discovering the technological principles of a device, object, or system through analysis of its structure, function, and operation (^{wikipedia}). Objectionable features can then be removed from a product. A bond issue, for example, can be divided into 'interest-only' or 'principal-only' components. The 'principal only' component, just like zero-coupon bonds, can satisfy clients who do not want to deal directly with interest. A certain deal could involve a combination of the above, making the deals complex in some cases, as required by the clients. Appendix A gives an overview of some of the most common IF products.

Based on the PLS, the two primary investment vehicles which form the underlying design of most innovations of financial products: the *Musharaka* and *Mudharaba*. Jusic and Ismail (2012) propose that *Murabaha*, alternative to the standard debt contract, have been over emphasized in practice and it is the equity based transactions such as *Musharaka* which should be more actively in practice. In 2005, the website vernimmen.net gave a

distribution of the Islamic Banking businesses by product type: 59% in *Murabaha* and 17% in *musharaka-mudaraba* contracts. The first problem with the *Murabaha* contract is that it is pegged to the interest rate in terms of the calculation of the re-payment rate, so that the periodic payment is calculated in accordance with the LIBOR index (in UK) or a related interest rate. Second, the *Murabaha* contract involves higher transaction costs than the standard debt contract, raising fundamental questions about the extent to which the *Murabaha* contract is actually Sha'riah-compliant and whether it is welfare-improving. Authenticity demands that industry continues its efforts to innovate. To facilitate this, there is need for IF industry and regulators to now consider a change in mind set accompanied by enhancement of the legal, regulatory and supervisory infrastructure backed by proper governance framework to allow banks to transact in equity based transactions. Consistent with IF provisions, one concrete way forward is to focus efforts to develop right framework and applications for PLS-Sha'riah compliance (Shamshed, 2008).

2.1.4 Comparison in Performance

According to (Ariss, 2010) profitability of Islamic banks has significantly increased but not as much as compared to conventional banks. Khan (1989) mathematically compares interest based technique with fixed return scheme vs. non interest based technique on variable return scheme to find that the Islamic financial system is superior to a non-Islamic system due to the risk-spreading characteristic of the Islamic scheme. Under conditions of asymmetric information, however, the debt contract emerges as the most cost efficient. According to recent IMF study (Hasan & Dridi, 2010) Islamic banking performs better than convention banking in terms of profitability, credit and asset growth. The failure during the subprime debacle is due to the poor working of the institutions which have granted loans while underestimating the risks associated with such investments (Shafique et al., 2012). A study for the World Bank by Beck, Asli, Kent, & Quarda (2010) on a sample 20 countries that have both the conventional and Islamic financial structures, found that Islamic banks are better capitalized with liquidity reserves but are less cost efficient during recent financial crisis. Despite being small and less in number, Iqbal (2008) states that no study

has been able to prove the inefficiencies of Islamic banks. The study discusses the performance of IFIs in comparison to conventional banks and states that the former, despite being smaller, is not necessarily less efficient but accurate results are difficult to come to due to various factors such as information disclosure of IFIs, or limitation of studies being limited to geographical samples.

2.2 Opportunities and Challenges for the industry in the global setting

The strategic choice of creating IFIs or Islamic Banking Windows is driven by various external and internal forces. The growth of IFIS around the world has been catalyzed by broad reforms in financial systems, their integrations, privatizations, introduction of the new Islamic banking products and freedom of capital movement. IF is seen as a competitive mode of financial intermediation with increasing participation from non-Muslims and Muslims alike. The spread of the new phenomena has been facilitated by several factors:

- Muslims are increasingly becoming aware of the possibilities of connecting their faith with practice and are willing to take advantage of the innovations in IF.
- Excess liquidity in GCC countries has been favored by the rapid rise of commodity price (De Belder & Khan, 1993). The majority of IFIs have excess liquidity but lack potential entrepreneurial opportunities to employ these funds in an Islamic and profitable nature, and this paved opportunities for western institutions to arrange IF transactions through contact with these IFIs. Commercial interests can pave the way for risk management as well as cooperation and harmonization even at the political and security level (Bianchi, 2007). The climate of uncertainty surrounding the traditional practices of financial markets has put the curiosity for IF services on the rise. It is seen as an intermediary of growth and a means to achieve liquidity in economies and conventional financial markets in the grip of the consequences of the subprime mortgage crisis since the summer 2007.

Modern financial markets have tended to emphasize too much on maximizing profits, as the traditional economic theory capitalism would advocate but this has paid too little

attention to 'risk'. Clarke (2009) from the OECD, reports that financial innovations that were intended to spread the risks in the market ended up having the reverse affect. As a financial system based on risk sharing and the conservative risk taking tendency where the value of the product must be backed by physical existing assets such as real estate, the IF system has ability of reducing the frequency or impact of the financial crisis (Ahmed, 2010; Joana, 2009; Thomson Reuter, 2008). Ahmed (2010) points out that many are unaware about the close links between socially responsible investing and Sha'riah compliant investing. However, Thomson Reuter report (2008) point out that the system is not immune to monetary crisis at large. Certain instruments such as Murabaha financing still depends on LIBOR (London Interbank Offered Rates) rates. Hence the global interest rates can still affect this unless a new index is created.

- Resources are being dedicated for incubation of IF skills. European universities are opening graduate programs and research centers devoted to Islamic finance. Examples include the French Centre for Islamic Finance (Jusic and Ismail, 2012), the Institute of Islamic Banking (Malik, et al. 2011), and the Academy for International Modern Studies (AIMS) in UK. All offer certification courses, while several universities such as University of Durham and University of Bangor offer degrees at the Bachelor and Masters level. In USA the University of New Orleans as well as the Harvard law and Harvard Business School also jointly focus projects on Islamic finance.
 - A challenge to the growth of IFIs is the size of the assets compared to those of CFIs. On the performance of IFIS, Iqbal (2008) argues that IFIs can benefit through consolidation by expanding scale and scope and also through diversification and careful governance. Diversification can improve its economies of scales and hence help in the form of cost economies and organizational efficiencies and also enhance risk management. We can use the same concept and take this to be an opportunity from the Canadian financial market to grow as well. Financial services industries in developed countries have experienced a trend towards consolidation in the last two decades (Iqbal, 2008). In case of Canada however, it is seen that in the two periods 1990 to 1995 and 1996 to 2001, the number of banks changed from 52 to 112, and non-bank financial institutions from 85 to 167. We see a rise in the number of banks largely due to the

entry of foreign banks and an augmentation of the system, going towards a more cosmopolitan financial system. This can be assumed to be an opportunity for Canada to be part of the global Islamic finance industry.

- Small business financing-There is also room for microcredit to be adapted to Islamic financial practices through Musharaka and Mudharaba (Karasik, et al., 2007) this can be helpful mainly for low to middle income Muslim societies. The commercial banks need to see this as an opportunity to reach an attractive niche.
- Several international bodies have been established for regulating the IF industry. The establishment of international regulatory bodies (Appendix C) has enabled the international expansion of the business model.

Since the complete IF system is still evolving, many challenges related to the instruments, markets and regulations remain. This review has identified the following main themes related to challenges from the literature:

- Constraints in the macro economy- Thriving within the same market as conventional finance may expose it to similar problems. Despite the potential for reduction of adverse risk outcomes, the instruments are not completely immune to the problems of volatility in currency and commodity markets and interest rate since some of them still rely on the standard rates such as LIBOR (Zaher and Hasan, 2001; Thomson Reuter, 2008).
- *Skills and education:* In order to grow in this industry and keep up in the race for knowledge and skills in the international community, industry specific knowledge is indispensable. A study in Grant MacEwan University pointed out that Islamic finance was not being taught in business schools in Canada (Hrycun). Recently, the Rotman School of Business in Toronto has set up an MBA course on IF.
- *Sha'riah experts employed by IF firms.* These scholars use their extensive knowledge of Sha'riah Law to assess the 'Islamic' character of a firm's operations, and assist the development of Sha'riah-compliant products. The availability of these scholars can pose as a limiting factor in the expansion of the IF industry. The scholars can act as

gatekeepers to the globalizing of IF services from their fundamental role in designing and screening innovative Islamic financial products which are rapidly becoming the 'appropriate' way of doing business within core Islamic markets. From a geographic perspective, this growth can also be promoted by controlling the way they build networks across a variety of scales, linking up IF firms, regulatory bodies, and stock markets (Bassens et al, 2011). Their particular educational background also influences the connection of IF centers with knowledge produced at universities teaching various aspects of Sha'riah and Islamic finance.

- *Harmonization/innovation vs. authenticity.* Given that there are widely divergent interpretations of Sha'riah provisions which are historically, theologically and culturally conditioned, varying interpretations of Islamic law can be applied to different contexts so as to satisfy both a minimum of congruency with Islamic tenets while simultaneously satisfying local business' and customers' demands (Jusic and Ismail, 2012). The authenticity of IF products will depend on: (i) compliance with the Shari'ah, (ii) segregation of Islamic and conventional funds, (iii) accounting standards, and (iv) awareness campaigns (Solé, 2007). The funds intended for Sha'riah-compatible investments should therefore not be mixed with those of non-Islamic investments. The rationale behind this principle is simply rather one of prudence intended to take all the necessary precautions to ensure that Islamic funds do not become mixed with other funds that may be involved with *riba*, *gharar*, or *haram* activities. Several authors have expressed concern over the integration versus the uniqueness of the system (Lewis, 2009; Al-Salem, 2009; Bianchi, 2007; Zaman & Movassaghi, 2002). IF institutions should set up independent Sha'riah supervisory boards to monitor the degree to which the institution has remained faithful to the Sha'riah rules documented (Alaxakis & Tsikouras, 2009). Khan (2007) is convinced that fixed interest rate, negligible risk Islamic securities, based upon mark-up arrangements, has to be in place if a successful secondary market is to develop to rival those in conventional financial systems. This seems to go against the authenticity of the design but he still considers that differences remain because the seller of goods (the financier) must legally own and possess the goods being sold. He argues that speculative short-selling is ruled out, helping to curb

the type of excessive speculation that has been so evident recently in conventional financial markets. Secondly, the sales-based financing methods do not involve direct lending and borrowing but comprise purchase or lease transactions based on real goods and services.

- *Regulation.* There is no single standard regulatory framework that can govern the practice and enhance integration of the two types of financial markets worldwide. Financial institutions are subject to national and international regulatory requirements. The reason that the IF instruments are complex is to do with the established legal and regulatory frameworks. A report by Thomson Reuters (2008) states that IF instruments can meet the needs of clients easily in places like Malaysia where the market framework complies with Sha'riah but it proves tricky elsewhere. However, if we look at the case of Britain, we see this isn't necessarily so. The ongoing globalization, as well as recent high-profile corporate fraud cases and bankruptcies, have led during the past years to calls for enhanced regulatory requirements and a renewed emphasis on the necessity for appropriate governance in the financial world. Corporate governance refers to a blend of law, regulation, supervision and appropriate private-sector practices which together enable the corporation to attract financial and human capital, perform efficiently, and thereby generate long-term economic value for its shareholders, while safeguarding the interest of other stakeholders and the society as a whole (Islamic Development Bank (IDB), 2003).

The approaches followed for conventional banks do not necessarily fit the needs of Islamic banks. The question that arises is whether the particularities of Islamic finance are completely covered by the existing Western standards (Alexakis & Tsikouras, 2009; Abu-Tapanjeh, 2007). Abu-Tapanjeh (2007) finds that there are not a fixed number of defined corporate governance best practices in IF and this makes it more difficult to apply in comparison to the OECD principles which implement a firm with six fixed best practices. Islamic banks are subject to an additional layer of supervision, that of the Sha'riah Supervisory Board (SSB), whose primary task is to ensure that the bank is operating within the framework of the Sha'riah. Alexakis & Tsikouras (2009) believe that adapting to the Basel Accord would not be the most appropriate solution for

Islamic banks. Instead, it would be preferable to build on the existing international capital adequacy standards, adjusting where necessary for the particularities of the Islamic financial system. Bianchi (2007) on the other hand believes IFIs have no choice but to comply with regulations of Basel II and hence there is a challenge in coming to terms with the Basel committee on one hand and the international Islamic finance regulatory boards on the other. *The Basel Committee consists of central bank governors from 10 nation, including Canada. It sets supervisory standards and statements for best practice to help governments converge towards common banking regulations.* The future according to Bianchi lies not in the central committee of handpicked advisors, but among the millions of Muslim and non-Muslims clients who will vote for competing approach based on their needs. We know, however, that in order to maintain authenticity, the need for guidelines and help from advisors always will remain. Both the prudential regulation and Sha'riah inspection and supervision are integral elements of the check and balances to ensure products and transactions meet the test of authenticity and compliance with Sha'riah (Shamshed, 2008).

- *Taxation and legal systems.* There could be tax modifications needed such as on the double stamp taxation. Certain products require the transfer of ownership from vendor to bank at the commencement of the lease and from bank to customer at the end of the lease. This requirement may attract the payment of two sets of stamp duty such the lease form of mortgage and this makes the IF system less cost effective. The UK has already taken steps towards resolving this problem. (Malik et al, 2011).
- *Misconceptions and lack of awareness.* Islamic finance has been usually associated with political Islam (Warde, 2000). Perceptions of Islam have been shaped by some of its most extreme political and media-based manifestations that are representative neither of the mainstream of the religion nor of its economic aspects. The geo-economics of Islam is indeed sharply different from its geopolitics (Warde, 2000). Conventional banks concerned about their image among non-Muslim customers might refrain from advertising the religious component and focus on the financial performance of Islamic banking, the high ethical standards, the risk sharing principle and the avoidance of highly speculative investments (Volk & Pudelko, 2010).

Karasik, et al. (2007) discuss a certain group of present day extremists who promote barriers to global integration in particular with the West. Indeed, this is an extremist occurrence, and goes against the basic ideology of Islam and the Islamic economy. Even if they were to bring up economic boycott as the authors put it, it needs to be acknowledged that this is not the general Muslim view and practice around the world, let alone in a secular and western setting like Canada. One of the basic Islamic principles is that all human beings have the basic rights of life and dignity without any discrimination against based on religion, color or race. The current trend in expanding the IF services globally is evidence to the will of IF practitioners to take to go global. Further leads to the misconception about the system may be that Islamic finance is only for Islamic people. Although a Muslim is prohibited from dealing with interest, there is nothing prohibiting a non- Muslim with dealing with instruments that are interest free. It follows the same concept as halal food. Halal, simply meaning 'permissive'.

This literature review has shown that the topic of interest-free mode of finance has attracted attention from several disciplines and areas, covering debates on its functionality and features, and practicality with regards to the existing frameworks in the west. We can see the gap of academic focus on the North American region. Much of the extant studies are exploratory including a general demand and supply perspective, and a few, being those which focus on performance issues, are empirical. The review has enabled the recognizing of main themes of opportunities and challenges faced by countries in respect to this emerging industry which can be applicable to the Canadian setting. My research question is situated in the discipline of business management, focusing on the perspective of potential supplier particularly in Canada, specifically within the province of Ontario. Although organizational reports and business magazines have recently taken interest, from an academic standpoint the area has not yet been explored.

3. Conceptual development

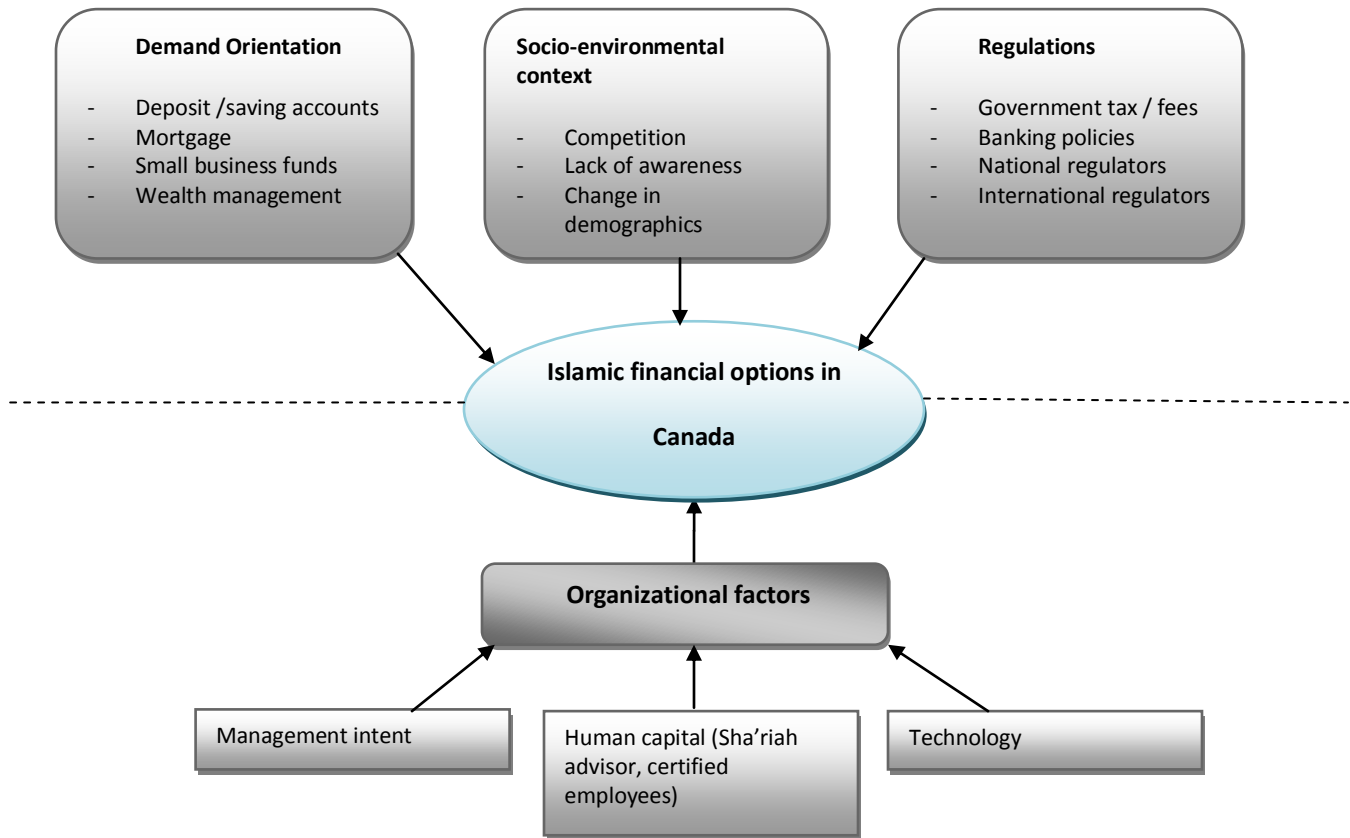
3.1 *The framework*

This section describes the process used to arrive at the hypotheses for the study. As will be discussed in Chapter 4 on Methodology, this study takes an exploratory approach. It does not start with a predetermined theory but, using a deductive and iterative process, develops a framework to arrive at the hypotheses. The project uses an archival research base including the literature review and secondary sources. The latter are mainly organizational and website publications, magazine and news reports (Table 3). The former has been used to arrive at the recognition of the gap, particularly the lack of academic research on IF on a Canadian setting and from a supplier perspective, while the latter sources have been used to match the opportunities and challenges identified to the Canadian setting to arrive at my hypotheses. Using a more inductive approach, the hypothesis was tested in the study through the primary data sources. As a result of this initial data gathering, four main dimensions have been identified:

1. Demand conditions
2. Social framework
3. Regulations and legal framework
4. Institutional factors

These have then been categorized according to their positions in the external and internal environment for clearer distinctions as shown in the following framework in Figure 1.

Figure1: Framework for assessing the incidence of IF in Canada



The concept of the study began with the recognition that despite the rising prominence of Islamic Banking and financial services around the world, and despite the considerably large Muslim population in the country the practice has still not caught on widely and as successfully in Canada. Considering that this system can solve the dilemma of obtaining interest-free financing for small business startups, not to mention the recognition of multiculturalism and unity at the heart of the Canadian culture, innovative practices such as this have a potential to catch on. This raises the question of **why** it is seemingly not so. This study's focus is on the supplier. None of the country's largest or mainstream banks offer Islamic financial services. Despite much hope expressed in the news and reports, incidences have shown that IF institutions in Canada such as UM financial Inc., an institution issuing home mortgages compliant with Sha'riah practices, filed for bankruptcy in 2011 leaving around 170 Muslim clients in confusion (Macleans, 2012). In order to identify the *causality*, the dependent or central category is taken as the availability of IF

services in Canada. The other elements (3 external factors and 3 internal factors affecting suppliers) are taken as the independent or axial categories that affect it. This is captured in the framework in Figure 1. It should be noted that a few of these factors are interrelated, e.g. availability of skills may fall under both environments (e.g. Sha'riah advisory board as an internal factor and the availability of training programs for IF offered by educational institutions as an external factor).

This study is built on a management perspective. Taking a strategic management point of view, the external environment can be analyzed from a market-based or industrial organizational paradigm, while the internal environment can be viewed through a resource-based view. According to the former, industry structure or competitive environment influences the strategic choices of the industry, which in turn affects the performance of the firm (von Pock, 2007). Here, the constituents are the consumers, regulatory framework, and the social framework. According to the resource-based paradigm, the companies distinctive resource endowments will influence the conduct of strategic choice and hence performance of the company (von Pock, 2007). In this framework, the human capital endowments (skills), presence of Sha'riah advisors, and technology inherent in offerings are taken as the resource endowments that may affect the strategic choice and potential of operating an IFI in Canada. Financial institutions in Canada that want to compete in order to create competitive advantages in the marketplace could consider this new business model in its strategy. Strategic management in Banking encompasses issues of options for strategic positioning post global economic crisis and the use of IF in both retail and private banking, as well as asset and liability management represents what appears to be an unexplored opportunity.

3.2 Opportunities in Canadian context

Before arriving at the hypotheses, the impact of context was explored.

Figure 2. Muslim population in Canada as of 2001 and forecast for 2011

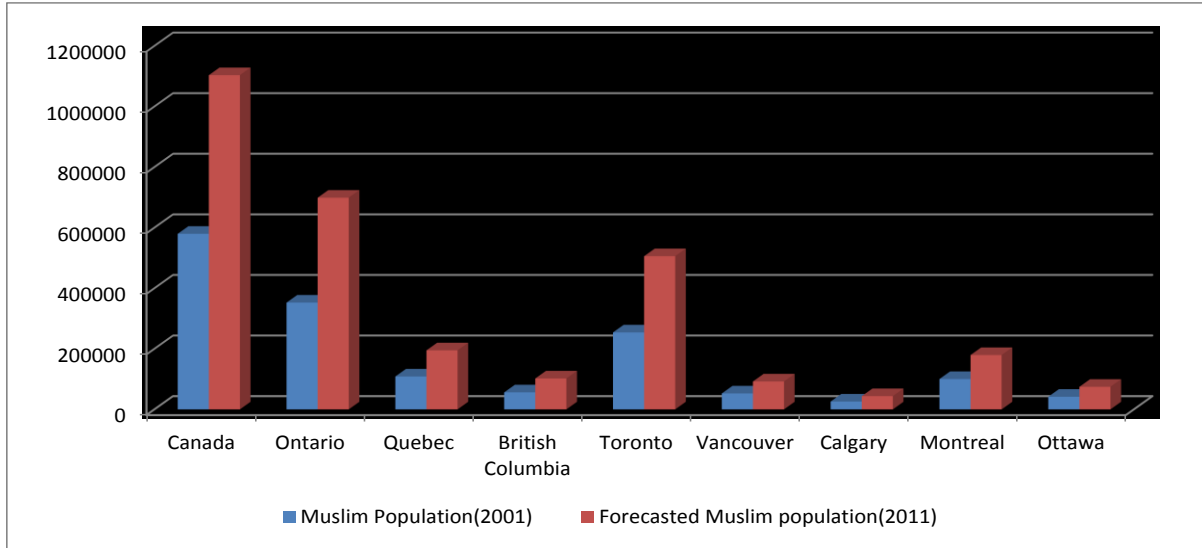
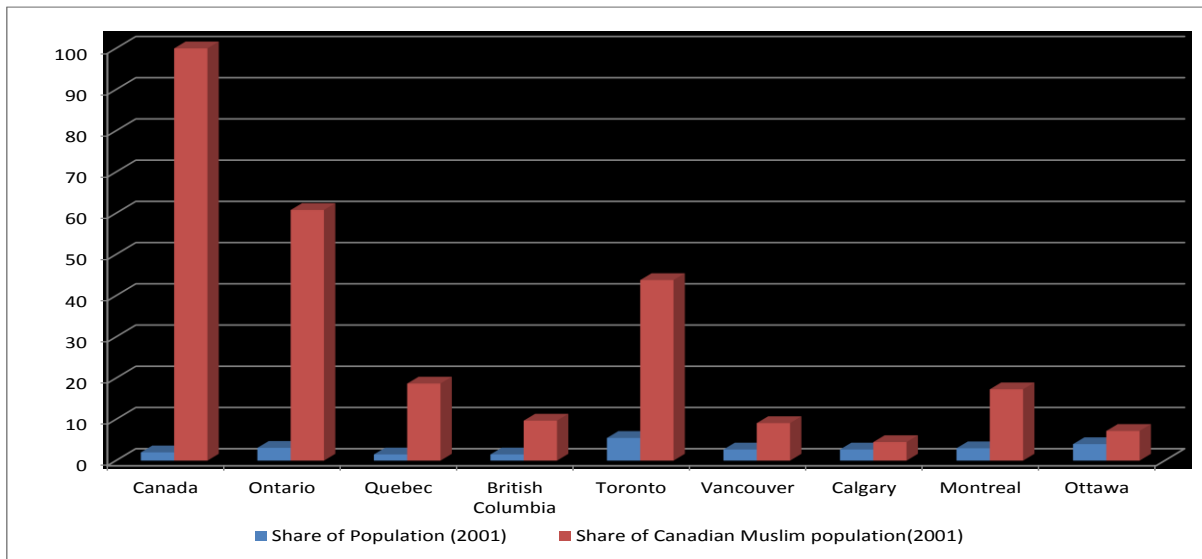


Figure 3: Region wide distribution of Canadian Muslims as share of population



Charts compiled by using data from Statistics Canada 2001 Census, “Religions in Canada” (<http://www12.statcan.ca/english/census01/home/index.cfm>). Estimates for 2011 Groups: Belanger, A. and Malefant, E. C., 2005. Population projections of visible minority groups in Canada, provinces and regions, Ottawa, Ontario: Statistics Canada, Table A2, page 53.

Demand orientation and Socio-economic issue

Among the potential users is the Islamic community as well as those non-Muslims who, despite not having religious affiliations in practice, are aware of and have an opportunistic attitude towards a new mode of finance. Business entrepreneurs are likely candidates for looking into the practice of small firm capital ventures (partnership modes) and a wider public may be available for the use of mortgaging and other types of loan financing services. Canada has a diverse, multicultural population. Canada has the highest per capita immigration rate in the world with over 250,000 immigrants entering every year (Citizenship and Immigration Canada). Despite the business being viable for everyone, it is postulated that most of the demand will exist among the Muslim Canadians. Fortunately there is a significant population that falls into this category, with 1 million adherents alone residing in Ontario. Canada has a larger Muslim population as a share of the population than the US. Figure 2 above shows that the 60 per cent of all Muslims in Canada are concentrated within Ontario, with 40 per cent living in Toronto. As a result, most of the Islamic financial institutions are predominantly located in Ontario and therefore from a legal perspective, these institutions benefit from avoiding differences between provincial regulatory environments that plague many Islamic financial institutions in the United States which are dispersed around the country (Yassar Media, 2009). Toronto is also home to Canada's five largest banks, 50 foreign bank subsidiaries and branches, along with 115 securities firms. In 2008, *Forbes* magazine listed Toronto as one of the top 10 most economically powerful cities in the world. According to Yassar Media report (2009), the Toronto Stock Exchange has launched the Standard and Poor's Sha'riah index, with plans to launch an Islamic Exchange trade fund in the near future. Thus the sampling will be based on this geographical area, particularly the belt from Ottawa to the Greater Toronto Area.

In contrast to the US, Canadians censuses are legally allowed to ask the religion of their population and therefore can more easily identify where Sha'riah compliant solutions are most needed. Conflict between the US and Middle-East in 2001 following terrorist

attacks sparked misconceptions against Muslims and promoted racial tension in the US (Warde, 2000) and this led to many Muslims shifting US investments to UK and closing their US accounts and investments (Malik, et al.). Based on this, we could assume that Canada could have been seen as another alternative to cultivate Muslim investments in terms of a better political climate. According to Imam & Kpodar (2010), having a British colonial heritage where regulatory systems are built on a solid foundation favors the development of IF institutions in Canada in a positive way. Proximity to IF hubs such as Middle East and Malaysia also represents a limiting factor for Canada.

A market research by Northstar for Amana Canada Holdings on a sample of 102 Muslim small business owners³ showed that about one-third of these businesses in the Greater Toronto Area are extremely enthusiastic about the idea of Shari'ah-compliant banking (what is the percentage), while 35 per cent were 'lukewarm' and 23 per cent found the idea less appealing. Listed in order, chequing accounts, business loans, and saving deposit accounts were the most commonly demanded products within the Shari'ah community. It was seen that devout owners were less likely to keep their income in the banks and twice as likely to switch when presented with the Sha'riah-compliant banking concept. About 44 per cent of these banking decision-makers had been in Canada for less than 10 years (Amana Canada, 2007).

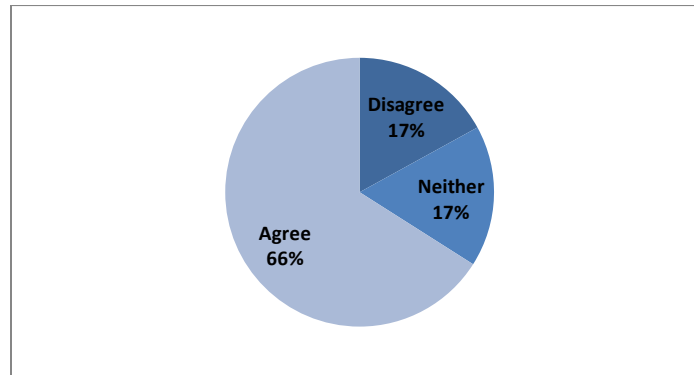
On the side of retail banking, Northstar (2009) interviewed 503 Muslim-Canadians responsible for making banking decisions⁴. TD was the primary bank of 60 per cent of the targeted customers. Their demographics indicate that they are young (average age 32.9), middle class, married and emotionally unattached to their banks. This number is almost consistent with the Statistics Canada National Household Survey (2011) result that the median age of Canada's Muslim population is 28.9 years. These were split between regular

³ Businesses less than five years old, with an average of 10 employees covering various industries from real estate to media communications.

⁴ Using public listings of Muslim names and phone numbers. Interviews were conducted by phone and online, using an established online panel partner as younger Canadians are less likely to have publicly listed landlines, older Canadians are less likely to be technologically savvy / respond to online surveys) to build a robust and representative sample of Muslim Canadian banking decision makers. 46% of the sample was women and 54% was men.

mosque-goers and others (Amana Canada, 2009). The following figure from the report shows the percentage of sample who had indicated that they were interested in taking up IF products.

Figure 4. Survey result indicating demand for IF products in the GTA area



Despite what appears to be an opportunity, Canada does not play as big a role as other Western economies when it comes to Islamic finance. For example, HSBC Canada, a leading player in international banking and alternative banking practices in Canada did not have an Islamic finance window as did its British counterpart. The question of why this is not so generally within the context of Canadian banking is analyzed through the challenges highlighted by the following components of the framework highlighted by the hypotheses of this thesis.

3.3 Arriving at the hypotheses

External environment: Socio-economic issue:

As discussed in section 3.2, there appears to be consistently changing demographics in Canada and the number of Muslim immigrants to Canada is expected to continue to rise. Islamic financial firms, however, have to go through an often challenging and expensive legal process to produce customized and compliant contracts. High prices and fees relative to conventional institutions could in turn deter demand or affordability (Guidance Residential, 2012; Islamic Mortgages.Co, UK). Those who find it religiously incumbent or are willing to use the Islamic system of financing could be exposed to high fees and prices

relatively to the conventional financing options due to lack of competition in the IF arena. The few financial institutions that do provide IF services in and around Toronto and a few other cities in Canada could currently therefore be operating in an oligopolistic manner. This may deter the demand or affordability for others in the community. In several western nations, Muslim customers have opted to stay with conventional banking and reconcile any interest payments or receipts with an equal amount in Zakat (charities), and are simply waiting for the premium for Sha'riah service to fall and match their current banking costs (The Banker, 2007). As a result, most new business ventures may stick to friends and family for the startup loans. Muslims with sophisticated banking needs have compared the fees and returns of Sha'riah-based services and found in many markets that there is a high cost for their faith.

Hypotheses 1: Consumer power is low and high prices are driven by supplier power to exceed those of conventional products (Cost of debt under conventional financing < Cost of Islamic financing alternative).

Regarding the demand, the most highly demanded products may be mortgaging for home and auto finance, savings and deposit accounts and small business financing (Yassar Media, 2009; DeLorenzo, 2013). Despite growing Muslim communities, demand may exist from non-Muslims too, but this requires a study beyond the scope of the present study. On the other hand, it may be assumed when it comes to community-based credit unions such as *Caisses populaires* that are already present in Quebec and which may be dominantly based in a Christian community; it is unlikely that IFB will have much demand. The whole notion of IBF is still a new one in North America. There may also be a pre-existent notion that the whole system of IFB is for a specific type of demographic (Non-Muslims may have the idea that this works for only Muslims) whereas in fact it is one that may be partaken by anyone. This leads to another related issue of cost economies of scale. There has not been much publicity about the system in the financial sector in Canada unlike in other Western countries where interest has been noted (e.g. UK); Hrycun points out that it is a system that

has yet to gain a place to be taught in business schools in Canada. As a result few know about its novelty or functionality.

Hypothesis 2: Islamic financial options have not achieved a substantial level of market penetration due to lack of awareness in the market.

External environment: Regulatory framework

The Canadian financial industry is strongly regulated. The regulation of nationally-chartered banks, insurance companies, trust and loan companies, cooperative credit associations and fraternal benefit societies is conducted on the federal level and a few at the provincial level. The federal regulatory bodies all operate within the laws and policies governing financial institutions created by the Ministry of Finance Canada. The Office of the Supervisor of Financial Institutions (OSFI) regulates and supervises financial institutions for safety and soundness at the institution and systemic level. The Canada Deposit Insurance Company (CDIC) is exclusively responsible for insuring depositors and works with the OSFI to accomplish this goal. The Bank of Canada, the country's central bank, manages the clearing, payment and settlement system, and is responsible for monetary policy and regulating credit and currency. Finally, the Financial Consumer Agency of Canada (FCAC) is responsible for enforcing consumer-related aspects of the laws governing financial institutions. Two applications for opening Islamic banks have not been approved since 2007 (Yassar Media, 2009). A Canada Mortgage and Housing Corporation study was expected by the end of 2008 to familiarize the regulators with the concept of Islamic finance. CMHC has published a study in 2010; however there has apparently been no known progress on the applications so far. Also, in order for IF products to gain ground institutions also need cooperation with the international bodies such as AAOIFI. This brings us to the hypotheses:

Hypothesis 3: The problem in setting up and expanding Islamic financial windows is due to a lack of a standard regulatory framework which results from insufficient information or lack of compliance with networks of international IF bodies.

Hypothesis 4: National regulation policies such as the Bank acts and taxation structure make Islamic financial products unfeasible options. (An example would be home mortgage where capital gains are double taxed).

Internal Environment: Management intent

Strategic decisions are determined by analysis and unforeseen environmental developments, unanticipated resource constraints, and changes in managerial preferences. In the case of conventional institutions adopting IF offerings this warrants attention to the change management culture inherent in both Canadian culture and the institutions within the Canadian environment. Change management has been defined as ‘the process of continually renewing an organization’s direction, structure, and capabilities to serve the ever-changing needs of external and internal customers’ (Moran & Brightman, 2001). By (2005) summarizes change management literature on how change can be brought about in the four ways: Planned (Burnes, 1996; Senior, 2012), Emergent (Burnes, 1996; Senior, 2002), Contingency (Dunphy & Stace, 1993) and by Choice (Burnes, 1996). In contrast to the planned approach, where the organization works under constant conditions, the emergent approach stresses the unpredictable nature of change and emphasises that change should not be perceived as a series of linear events within a given period of time, but as a continuous, open-ended process of adaptation to changing circumstances and conditions. The contingency approach to change is founded on the theory that the structure and the performance of an organisation are dependent on the situational variables that it faces (Dunphy and Stace, 1993). With the Choice approach instead of being forced to change their internal practices to fit in with external variables, organizations can exercise some choice over these issues. This issue also needs to consider how willing management is in up taking a venture like IF, alongside their conventional business. As part of this decision making process, we can consider the Uncertainty Reduction Theory (Berger & Bradac, 1982) which asserts that people have a need to reduce uncertainty about an issue by gaining information about it. Information gained can then be used to predict the

others' behavior. There are three basic ways people seek information: Passive strategies such as observation, Active strategies such as information seeking and Interactive strategies with direct communication.

Hypotheses 5: There is low management intent within financial institutions in Canada to take the necessary steps in developing Islamic financial windows or product offerings since these would represent significant changes in the way financial business is currently undertaken.

Internal environment: Research and Development

In order to stay ahead of the game, banks need to carry out R&D activities. These may be activities pertaining to market penetration, to the viability of new IF innovations within their existing organizational and operational framework or the up taking selling of existing designs ones in the global market with regards to available knowledge and resources they have. Concern with low levels of R & D in conventional Canadian banks or institutions may follow from the testing of *hypotheses 5*.

Internal environment: Human resources and skills

As any strategic management decision, this issue involves multiple stakeholders in decision making e.g., regulators issue and Sha'riah boards, and business teams. For Islamic financial instruments to go on the market, they need to be designed according to the Sha'riah compliant rules, at the same time be able to satisfy the alternate interest based offering in the market. Sha'riah scholar boards are needed to ensure authenticity of IF offerings. In a study focusing on the transnational capacities of Sha'riah experts, Bassens et al. (2012) show that the prominent experts around the world connect only a few Islamic financial hubs to knowledge and authority networks beyond the usual business and services. A lack of standard Sha'riah compliant design or lack of knowledge/consensus among the advisors may pose a barrier. Another shortcoming, based on the lack of Islamic

financial qualifications and degrees in the higher education sector, is the lack of relevant skills among employees in the bank. Canadian business schools, at least at the undergraduate level, lack programs on establishing a fundamental understanding of Islamic finance. This may call for the need of foreign trained individuals for efficient operations of the unit.

Internal environment: Technology

To attract younger professionals who expect easier modes of banking, banks and institutions need to incorporate e-banking facilities within their IF windows/ activities. Internet banking already being a major part of most conventional banks operations, it is vital for the future of Islamic banking that Muslim customers are attracted to bank with Islamic banks as to allow the expansion of Islamic finance to all (Malik, et al, 2011). The six largest Canadian banks spent \$69.6 billion on technology from 1996 to 2011 (Canadian Bankers Association, 2012). Along with any strategic change, it is important to note that the IT systems need strategic alignment through customization. Banks also need to work with software vendors to redevelop or certify that their products provide adequate documentation and audit capability to meet the requirements set by Sha'riah boards.

Legal personnel who are sufficiently educated in both Islamic financial law and Canadian regulations, an efficient Sha'riah supervisory board for governance of the IF model, employees with IF degrees or qualification and customized IT software are all resources required for the set up and smooth operations of an IF department or window. The discussion on internal environment pertaining to human resources and skills and technology leads to Hypothesis 6.

Hypothesis 6- There is a lack in supply of resource endowments specific to the set up of Islamic financial service offerings.

Hence hypotheses 2, 4, 5, and 6 are the focus of this study, the former two relating to the external environment (Market awareness and regulatory constraints) and the latter two on the internal (Management intent and resources). Hypotheses 1 is concerned more with the demand perspective and calls for more quantitative methods and prolonged stay in the field which will not be viable given the timeframe set for this Master's theses. Hypothesis 3 will involve further extensive research into the dynamics of the regulatory bodies, including the international bodies which, like hypothesis 1, can be advanced in future studies.

4. Methodology

4.1 Methodological Approach

Since this study calls for a subjective process of understanding social and legal constructions of an organizational setting, the qualitative approach was the most suitable.

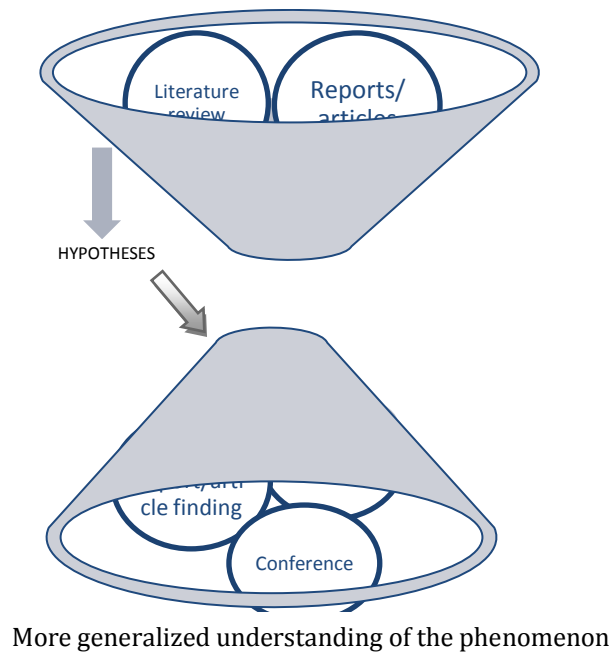
The research approach was exploratory and descriptive using qualitative data. As exploratory research the objective is to gather preliminary information that will help define problems and suggest hypotheses. Qualitative research is especially effective in obtaining culturally specific information about the values, opinions, behaviors, and social contexts of particular populations. The strength of qualitative research is its ability to provide complex textual descriptions of how a given research issue can be experienced through the identification of intangible factors. This is particularly salient in the field of management, an activity that is not just based on a set of fixed guidelines, but rather is shaped by the social and organizational context in which it is carried out. Since this study looks at how financial managers perceive the Islamic finance phenomenon and their identification of the numerous prospects it brings to their future performance, the qualitative, exploratory method has been chosen.

The study had two phases. Like most social research, this study involved both inductive and deductive reasoning throughout the research process. The first phase used a deductive approach and used a broad spectrum of information to work down to the specific hypotheses. This was based on a comprehensive review of existing academic and professional articles which led to the identification of the common challenges and opportunities for the expansion of the IF system in the West. Multiple sources of information available in the form of news and web articles as well as organizational publications in Canada were reviewed to cover the latest developments and opinions on Islamic finance. These were matched with the potential opportunities and challenges to Islamic finance to help in the development of the hypotheses.

The next phase was more open-ended and exploratory. In this inductive method, the field was approached through interview and conference/panel discussions as the

instruments to gain in-depth perspective of the sample of senior officials of financial institutions in order to deduce and confirm the validity of the hypotheses and come to a more generalized understanding of the phenomenon.

Figure 5. The two phases of the study



4.2 Data set and sampling strategy.

The study was initially guided by secondary data collected mainly through web search and consists of web articles, news and magazine articles that focus on financial developments as well as organizational publications, and qualitative analysis of primary data from interviews and panel discussions. Table 3 lists these sources.

Table 3. List of secondary sources of data on contemporary IF practices in Canada

Publication	Publication type	Date
Global Finance	Magazine	2007
CA magazine	Financial Magazine report	1995
The Globe and Mail	Financial Magazine report	2007,2011
Western Standard	Financial Magazine report	2007
Macleans.ca	Financial Magazine report	2012
CPI financial	Financial Magazine report	2012
Financial times special report	Financial Magazine report	2009,2011
The Canadian Press	News report	2010
Industry news (conference)	News report	2010
TheSpec.com	News report	2013
Yassar Media	Media news on Islamic finance	2009
KPMG	Organizational report	2012
Toronto Financial Service Alliance	Organizational report	2010
Thomson Reuters	Organizational report	2008
Amana Holdings Canada (Market research)	Organizational report	2009
Failaka	Research and Advisory report	2013
Social finance.ca	Finance blog	2010,2011

These, along with the literature review, helped inform the first part of the methodology, i.e. the hypotheses development through its insight on Islamic finance on Canada. These have mainly been written from a demand perspective and have helped confirm the assumption that this issue warrants attention in the Canada context. The hypotheses of this study focuses on the supply side of the issue and as such the sample consisted of the current and potential providers of Islamic financial instruments. They provide the primary data. The Canadian Muslim population is densely concentrated in Ontario, mainly covering the belt extending from Niagara through Toronto to Montreal (Figure 3). For these reasons the study targeted institutions within Ontario.

The institutions targeted were of three types:

1. Banks (Schedule I,II or III banks) operating within Canada
2. Conventional non-bank financial institutions
3. Existing independent Islamic financial providers

The former two were targeted so as to gain insight into the potential for mainstream conventional institutions to uptake this system as a complementary mode of business and the independent IF Institutions. The latter was included to get additional first hand insight on the challenges that have existed in the market so far.

The sampling technique was purposive, and can also be categorized as Creswell's criterion based sampling (Creswell, 2007). The criteria used to screen the choice of participants was based on whether they are working at or with a financial institution, and in particular hold a post that quite often involves decision making or business analysis, most likely the senior executives of the institution/bank. This phase also involved snowball sampling to make use of the social networks of people met in the course of the data collection (particularly conference attendance) to refer to other people and events which could potentially contribute to the study. Once potential interviewees were identified and their coordinates received, they were approached by e-mail inviting them to participate in the study. The Statement of Ethics from the Research and Ethics Board was also attached to the first correspondence. After the first response, a subsequent e-mail was sent asking for a convenient time and venue for the discussion. For the interviews, the response rate was 55 per cent. The list of the primary data points is given in Appendix B. In the course of recruiting participants, three candidates from the US holding senior positions in established IF institutions were also identified for further input from a broader North American Perspective. From their discussions, the US-specific comments were not included in the content analysis of this study.

There were overall 12 data points obtained through interviews and conference attendance. All respondents within Canada were Canadians. The participants had substantial number of years of experience in the financial industry. Two of them had been involved with consultancy roles with the government of Canada. Two respondents were

from Schedule I banks in Canada, one not offering any IF service and the other currently offering wealth management options under Shariah compliance. One respondent held the top position in a firm specializing in structuring Islamic financial products and services for the Canadian marketplace as well as for Middle East investors. Three others were from non-bank financial institutions; two offering a form of Sha'riah compliant alternative and one who had been involved in a past project in setting up an Islamic bank in Canada, the application of which has not gone through with regulators. Two informants had background in law in the US. One was a member of Shariah supervisory boards for institutions across Canada and the US. The details on sample are listed on Appendix B-1.

Data instruments:

The qualitative strategies, according to Miles and Huberman's (1994) taxonomies, were mainly interviews and archival research. There were 6 semi-structured, open ended interviews lasting from 30 to 50 minutes, 5 speakers at two different panel discussions on the issue of Islamic finance, and one media interview (a secondary source). The interview guide used for the study has been included in Appendix B-2. These raw data were gathered to check whether the current situation as perceived by the people directly involved in the finance industry in Canada and USA actually support the ideas and hypotheses in this study. Degree of contact was personal- face to face and through phone with email follow ups. The raw data was audio-recorded and supplemented with extensive field notes. This was then transcribed. The transcription was done personally by the aid of Dragon Naturally Speaking software, version 12.5. The iterative study design is evident in the research through the procedure of literature review and preliminary data collection through reports and news which informed the interview structure, the results of which in turn further extended the data archive. Accuracy was enhanced by involving a second person to confirm the transcriptions.

4.3 Ethics and anonymity

Willingness to participate in an interview depends on how well the participants understand what the study is about, what will be expected of them if they participate, and how their privacy will be respected. In developing recruitment guidelines, it was important to take special care to avoid saying anything that could be interpreted as coercive. Referring to the three core principles presented in The Belmont Report (Weijer et al., 1999), *Respect for persons* requires a commitment to ensuring the autonomy of research participants, *Beneficence* requires a commitment to minimizing the risks associated with research, including psychological and social risks, *Justice* requires a commitment to ensuring a fair distribution of the risks and benefits resulting from research. As a social science research, this study did not foresee much psychological or social risk to the participants in this study. The most important element would be ensuring their anonymity to the interviewees. An Ethics Approval Notice was obtained from the Social Science and Humanities Research and Ethics Board of the University of Ottawa before approaching the field⁵. A consent form was sent to the participants electronically for signing and was returned via the same means for the phone interviews.

4.4 Data Coding and Analysis

This phase made use of content analysis with the aid of qualitative data analysis software, NVivo, version 10 for coding the raw data. Based on the hypotheses, coding was carried out according to the selective approach, much similar to Miles and Huberman's (1994) systematic approach to create a provisional 'start list' of codes prior to fieldwork. This technique suggests categorizing the content into meaningful segments, separating into pre-determined themes, counting frequencies and noticing patterns. Data was categorized into main and sub-themes based on the conceptual hypotheses (Chapter 3). In this thematic analysis, the predetermined themes follow the 'open coding' phase of Strauss and Corbin (1990, 1998) where the texts and reports were initially read to look for common and

⁵ File number: 11-12-17

salient segments of information, followed by categorizing these segments into the themes. The themes were further reviewed to identify the causal nodes (that can be identified as the independent/axial variables in my hypotheses such as the three external and three internal factors affecting IF services as shown in the conceptual development) and also to reduce any redundancy among the themes. These categories were further narrowed down and new sub-themes emerged along the way to help organize and analyze the coding. This procedure also follows that of Creswell's coding process in inductive analysis (Creswell, 2002).

The process involved organizing data into files, according to source, reading and memoing. The two main themes were: *The Internal factors* and *External factors*. These have been organized with 3 levels of sub-themes. The most narrowed or refined level is taken as the final theme for coding the raw data. Table 4 shows the final coding hierarchy with the anticipated and emergent subthemes. The findings from sub-themes such as *awareness among current clients* and *demand* were also triangulated with data from secondary sources presented in the first phase of the methodology.

Table 4. Hierarchy of themes in coding

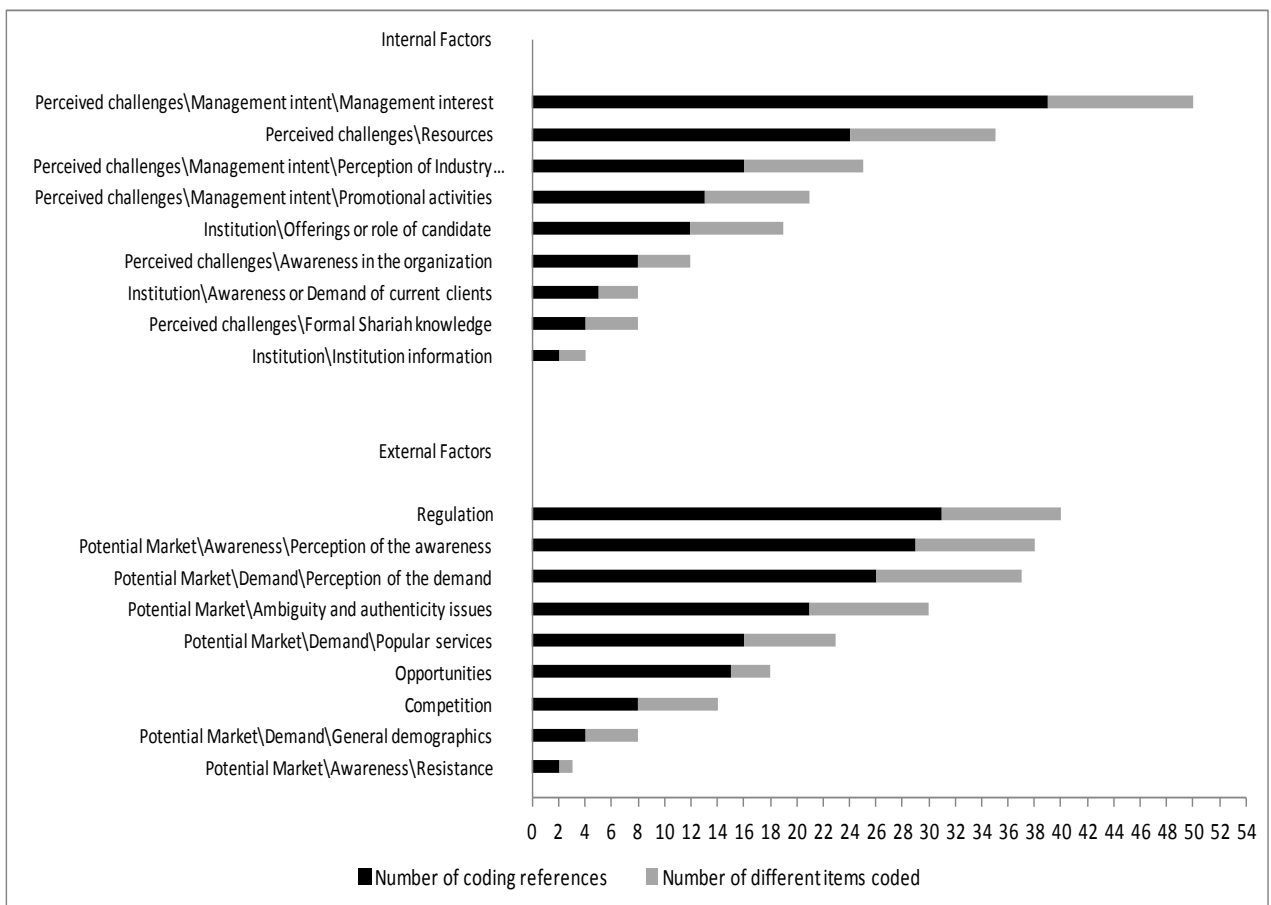
Main theme	Sub theme- level 1	Sub theme- level 2	Sub theme- level 3	
Internal Factors	• Institution	• Offerings		
		• Institutional info		
		• Awareness among current clients		
	• Perceived Challenges	• Management intent		• Management interest
				• Perception of industry potential
				• Promotional activity
			• Resources	
			• Formal Sha'riah knowledge	
			• Awareness in organization	
External Factors	• Potential Market	• Demand	• General demographics	
			• Perception of demand	
			• Investment types	
		• Awareness	• General awareness about the Sha'riah concept and offerings	
			• Resistance	
		• Ambiguity and authenticity issues		
	• Regulation			
		• Competition		
		• Opportunities		

5. Results

5.1 Findings

The following chart highlights the most salient themes found from the responses. A theme captures something important about the data in relation to the research question and represents some level of patterned response or meaning within the data set.’ (Braun & Clarke, 2006). The labels on the Y axis show the level at which each theme appears in the hierarchy. It is seen that from the content analysis, the themes of *regulation*, *awareness*, and *demand* under external factors, and *resources* and *management intent* under internal factors appear as the most frequently mentioned issues. These are represented by the length of the black bars. The grey bars represent number of different sources/data points each theme appears in. The ratio of the two bars is almost consistent throughout.

Figure 7. Frequency of themes found in coding and among sources



framework from Chapter 3. All respondents currently involved with structuring IF services are of the view that the main demand comes from a growing demographics of younger, more educated and affluent population of Muslims in the Greater Toronto Area. It is evident that the most sought after product is home financing, followed by investment products. Home finance represents something that is very relevant to the market. It can be expected that for the majority of the people the purchase of a home is the most significant purchase that they will ever make in their lifetimes and for that reason, this service is the most important business part of the financial services industry.

It is apparent that investment products would be fairly easy to set up. It was found that the wealth management arm of a schedule I bank now offers investment services under Sha'riah compliance. Among the IF services, investments are fairly easy to set up in the West. IT sector stocks are found to be the most viable. They provide customers with a portfolio that is allocated amongst the assets in the industry to diversify risk. Another subsidiary of a Canadian financial services company allows its consultant to help its clients invest in particular funds that don't pay out any interest and invest only in stocks fully compliant with Islamic beliefs.

The challenges identified among the themes have been analyzed as per the four hypotheses.

Table 5: Summary of findings

Hypotheses	Relevant themes	Main findings
1. <i>Islamic financial options have not achieved a substantial level of market penetration due to lack of awareness in the market</i>	<ul style="list-style-type: none"> • Awareness • Ambiguity • Promotion • Current clients 	<ul style="list-style-type: none"> • Low awareness, even among Muslims • Small percentage of them have used it so far • Doubts and misgivings • Rising awareness, especially among younger, married groups/small business owners believe it's a positive development on proposal of concept. • Banks not aware of these projections • Lack of promotional outlets
2. <i>National regulation policies such as the Bank acts and taxation structure make Islamic financial products unfeasible options. (An example would be home mortgage where capital gains are double taxed).</i>	<ul style="list-style-type: none"> • Regulation • Shoehorning • Resources 	<ul style="list-style-type: none"> • Applications for IF institution in Canada still pending • No clear justification given • No double tax issue with mortgages • Capital market structure • Results in shoehorning- further ambiguity
3. <i>There is low management intent within financial institutions in Canada to take the necessary steps in developing Islamic financial windows or product offerings.</i>	<ul style="list-style-type: none"> • Perception of industry potential • Promotional activity 	<ul style="list-style-type: none"> • High interest • Low action/intent to sell- uncertainty avoidance culture • Low competition • Lack of promotional activity • Interest spread out among members, not necessarily to top management's knowledge
4. <i>There are lack in supply of resource endowments specific to the set up of Islamic financial service offerings</i>	<ul style="list-style-type: none"> • Resources • Formal knowledge 	<ul style="list-style-type: none"> • Lack of funds • Embedded IT infrastructure • Access to Sha'riah knowledge and skills not considered a problem

Hypothesis 1: External/Awareness

Finding: It is found that the general awareness about what Sha'riah financing is, or what options are potentially available, is low. Even regarding the general Muslim population, awareness can be an impediment to the growth of the industry. This can be attributed to general lack of knowledge about the options, the principle itself, or to lack of faith in the industry stemming from issues of Sha'riah authenticity and past failures of IF institutions in the community.

-“Not many people know about this just as not everybody knows about meat being halal...Don't understand it they think it's just 'No Interest' ” (Respondent involved in structuring IF products)

- “People are not aware that these products do exist or that Sha'riah compliant wealth management do exist and I think that would be the biggest impediment to the success of it nationally.....it's just that hasn't happened before simply because of the awareness”.-
(Respondent from a Schedule I bank)

According to another respondent involved offering an IF service, about 20 per cent of the Muslim clients are not concerned about affiliation with interest or the type of investment and most of them are those who have been in Canada for a longer time. Another respondent was of the view that most people don't have the financial sophistication to analyze the difference between a Musharaka, Murabaha, Ijarah, they just want to know that the product is scholar approved and as long as these are common practices across the Muslim world it's fine. However, there is evidence of rising awareness among clients, especially the younger, middle income, married group who tend to be well educated. Those more likely are regular mosque attendees. Research by Northstar on a group of Muslim owned small businesses found that only 47 per cent were aware of Sha'riah applicability to finance, 17 per cent were not aware whether any Sha'riah banking was available in Canada, and 69 per cent were not aware of Sha'riah compliant banking products (Amana Canada Banking report, 2009). On the retail side, 72 per cent of the sample was aware of IF in general, of which 29 per cent aware of Canadian Sha'riah products and overall only 7 per cent have used IF so far in

Canada. Hence there appear to be a gap between the awareness and the practice. 62 per cent were very likely to choose the IF product, 10 per cent very unlikely (Amana Canada Banking report, 2007). Therefore it appears that those at the bank level may not be aware of these projections.

Regarding the potential Muslim clientele who lack awareness on the issue, the reason other than non adherence to the principle can be attributed to the fact that most immigrants don't come from countries with highly developed Islamic financial infrastructure. Also, understanding the IF system needs a fundamental understanding of Islam as a faith first.

Another salient issue is that many of those who are aware of Sha'riah alternatives have doubts and misgivings. Sha'riah authenticity is at the heart of the IF business. Many would need to be convinced that products are genuinely Shari'ah-compliant. All respondents involved with structuring IF products were unanimous on this issue. Structures that are Sha'riah compliant may abide by the letter of the law but not essentially the principle. For example, the sub index of the SNP broad market index has many shares which are claimed to be compliant but may be involved in non-halal industries. Apple Inc is known to be a Sha'riah compliant stock because of the way it does business. Another issue is that in some cases people do invest in Sha'riah compliant products but are not aware of it. In order to have credibility on a global level, scholars from all over the world -Pakistan, India, Malaysia, Syria, Saudi Arabia, the Gulf, and the US – all came together to establish the authenticity of the single Dow Jones index back in 1998. All the major index providers now provide Islamic indexes which show a growth of the acceptance. Many business owners in the GTA area believe Shariah compliant bank is a positive development for the community.

The discussion also gave accounts of interest from the non-Muslim clientele as well. The two providers of investment services state that *"They have actually heard about it and they are actually fascinated to hear that I am specializing in this market...Sometimes they ask me how does the portfolios differentiate that from a non-Muslim clients portfolio.... and actually some of my non-Muslim clients have shifted around their portfolio from bonds to commercial real estate, where you are not earning interest but you are earning rental income"* and *"The*

people who find out about it are obviously very pleased because they now have an option, but most people we take on tell us that we were very surprised to learn that this is now offered now in Canada”.

Hypotheses 2: External/Regulation

Finding: All respondents are of the view that regulations can pose one of the main bottlenecks in the progress of the Islamic financial options in the market. A couple of applications for the setting up of an Islamic financial bank have so far remained pending. Also, the capital market structure in Canada may make certain IF products unfeasible.

-‘Until you have some kind of clear rules from your regulator you don’t really have the ability to negotiate any specific with any counter party, and that’s where we ended up being left with the deposit product.’ (Respondent from a Schedule I bank)

-‘I would say the major barrier to the growth of Islamic finance is government.’ (Respondent from a currently running IF bank in the US)

-‘The regulators have not had the comfort level to say let’s go ahead and do this.’ (Respondent from a Schedule I bank)

On the plus side, in comparison to the UK Canada does not have problems such as the double stamp duty on mortgages which cancels out a barrier. *‘From a regulatory perspective it’s not as daunting as the UK - in Canada property can be bought and sold the same day – commercial property, residential property, there’s no double lands tax. That should make Murabaha, and Ijarah structures easier’ (Respondent from an institution structuring IF services)*

However there is an issue with the capital market structure. Unlike the UK or USA where they have longer term (20 years) mortgages where Murabaha fits better, in Canada most of the money is five-year and there isn’t as big a capital market. Also, Canada is very strictly guided by her Bank laws. The institution e.g., is not allowed to own property and hence this

may not accommodate certain IF products such as the Murabaha where the institution buys the product on behalf of the client and then sells with a mark up. The financial market is heavily regulated as many say it should be. One of the respondents believe that *'In the US and Europe there is less burdens from a regulatory perspective and more people are able to enter with lower barriers of entry. In Canada that is not the case, others have the cash to ensure that if the financial institution is set up it's going to be set up in the best interest of Canadians and that it has a reasonable chance of succeeding.'* Institutions can lend out money but the Bank Act doesn't allow banks to sell widgets.

Not all IF structures would contradict the Bank Act. Despite this, there have been delays in terms of their comfort with the process and applications for IF banks still remain pending. One plausible reason given by a respondent who had intended to start an Islamic Trust company was that it was due to lack of funds in the institution. It must be noted that a potential source of investment for such institutions may involve foreign investors, e.g. The Gulf. Hence there also remains question of whether the regulators are comfortable with that kind of an arrangement. While a couple of the respondents who had taken the initiative for the service expressed frustration over the matter, a couple others feel that it may be a matter of resource and demand forecast.

It is found that as a result of regulatory hurdles, institutions so far have tried to structure products in the context of existing laws, and so that they would be within the technical rules of Sha'riah law, but not requiring any change in existing bank laws or tax laws. This type of shoe-horning may work in the case of certain services, for others this may raise the issue of Sha'riah authenticity which in turn affects consumer perception of the industry in general. There is the debate on whether this integration or harmonization can go to such lengths that the very uniqueness of the system is lost (Lewis, 2009; Bianchi, 2007; Zaman & Movassaghi, 2002).

Hypothesis 3: Internal/Management intent

Finding: The discussions have highlighted a high level of interest but low levels of action. Given the opportunities projected the existing financial institutions are not proactively seeking out the feasibility of up-taking Islamic finance. Most believe there is a demand but do not know how much and have not taken steps towards any market research as yet, with the exception of an individual IF.

This hypothesis was tested focusing on the themes of management's perception of the potential of the industry, awareness and interest in the organization, and any proactive steps taken to uptake or promote it. It is seen that awareness, even if it exists within the conventional organizations so far, does not come in a top down approach; rather it depends so far on personal interest among members of the institution:

-“I'm aware of it on the basis that periodically we get asked whether we do have a program placed for this type of financing, typical reaction is no we don't, but we would be interested in learning more.. I've got a personal interest in it just from, you know, having worked for a few years in Asia” (Respondent from a schedule 1 bank currently not offering any IF services).

-“The first day I came here I actually attended a presentation a colleague was doing on Islamic finance and I really did not know too much about it so I really had to like research it talk to other Islamic scholars” (Respondent from a financial subsidiary)

The main concern of the respondents was whether this kind of institutional change and new venture would be a viable investment. With regards to the banks and Islamic financial window, a project commissioned by the Canadian Mortgage and Housing Corporation to Gowlings LaFleur (Gowlings LaFleur Henderson, 2010) found that despite some demand being there, the existing global IF industry is not demand driven, but rather supply driven, so to penetrate the market financiers have to go out and sell. The banks however say that demand is unknown and believe there is only anecdotal evidence that it is big, and hence, the bank would not step in to any investment. However, the banks themselves have no plans of carrying out any marketing research as yet.

-“Are we as a bank ready to take the plunge on the credit side – no. Are we willing to keep for years and eyes open – absolutely, and the more evidence that is suggested out there the more we will be enticed’

- “Not right now. No plans of putting any effort into market research into it”

- “limited investor interest, potential investors manage risk, they are generally not creative, they don’t want to be first, they don’t want to hear of anything novel, they certainly don’t want anything to do with uncertainty”

Management needs to be willing to carry out market research and push the products. The individual IF service providers are of the view that the Banks are missing a good opportunity in capturing this niche market. According to the president of a now successfully running IF bank in the US *“It has much to teach Western Society”*.

There is no doubt this will take time to fruition but the dynamic and the landscape is changing. As one respondent stated *‘but for that to happen we need to move now, we can’t really wait 15 years and then realize wow, all these Muslim Canadians around is that we care about, we’ve got nothing to offer them. We have to be ahead of the ball and think about it now and see where we want to position ourselves in Canada and on a global scale for that matter’*. As for the push marketing that is seen inherent in the way a Schedule I bank now opportunistically offers Islamic investment products. The bank identifies clients who keep large amounts of the money in cash as either term deposits, GICs, etc. as someone who is potentially avoiding earning interest. Trained banking representatives follow up with them on whether they are concerned about Sha’riah compliance. If this is the case, this approach typically surprised the clients and even more so when they realize that the institution actually does offer Sha’riah compliant investments.

Hypothesis 4: Internal/Resources

Finding: The main resources bottlenecks that pose a risk to an IF venture are the availability of funds and the IT infrastructure of current conventional system.

The issue of sufficient funds may be one that affects both new IF subsidiaries and individual institutions. This highlights another difference with the UK-they had a lot of Gulf money there backing up financial institutions. Also, in the US Freddie Mac and Fannie Mae securitized funds which made it easy to set up a company that would originate the mortgages. But Canada needed a bank to provide the liquidity. Three of the current respondents involved in structuring Sha'riah products have stated that their demand exceeds their liquidity and they are hoping to get investors from the Gulf. According to Hijazi (2013), one way Canada can be more competitive in the global economy and one thing which is very important for Canada is that it lacks foreign investments. The gulf economy excess liquidity and this should pose opportunities for Canada and the gulf for foreign investment. Furthermore, many investors in the Middle East are shying away from the US since 2001. If there are increasing flows between middle east and Canada the issue of Sha'riah finance may also arise and one needs be aware of the concept what it is even if you are not doing business in that area. Hence this issue of funds can potentially be overcome with open access to foreign investing activities, and this may also concern regulators.

Standalone core banking software systems for Islamic banks are needed to fit the Islamic banking principles, accounting, cash management, credit facilities and other operations as Islamic financial services could require very specialized IT systems. Most of the large banks have huge legacy systems which are fairly costly to tinker with. For example, if a new mortgage product was to launch across Canada it would require creation of special division, different reporting system and a new customized IT system. This will be expensive, and again, is an issue of management intent. This brings us back to one of the regulator concerns being a bank that might fail at some point because of having expense without really enough revenues to support it, hence a hurdle for banks (but this may be an opportunity for new financial institutions who wish to start up as an IF institution).

It has also been expressed that in terms of competitive services, the industry has a shortage of trained skilled sales representatives dedicated to quality customer service. It takes an enormous amount of effort to build a good trust and reputation. US Muslims - consumers are very particular about their associations. So with regards to the issue of trust and awareness discussed earlier, the institution needs not just sale and service personnel, but also professionals who understand their business and consumer. Recently there are options arising for formal education and qualifications on Islamic finance within the Canadian academia. The Rotman School of business now offers an MBA course on IF and Centennial College, Toronto offers a certification in the field.

The respondents in this study did not point to access to Sha'riah knowledge being an impediment. The running institutions did state that when they had started out there were no Sharia scholars in Canada. In another category, there are who do know a lot about Islamic finance and conventional finance, however, it is hard to get the on the phone sometimes. It must be noted that while Sha'riah scholars would be required for the structuring of the products, it is other member of the society who need to act as point of contact to provide the information to the client base. It has been expressed that this option is very limited. People are likely to approach their local heads of the mosque before approaching a bank but although the Imams can inform them on the basic principles, not all Imams have knowledge about how Sha'riah compliant investing options in Canada.

5.1.1 Discussion

The findings of the analysis are consistent with the conceptual framework. However, the coding process gave some additional insight by the formation of newer subthemes that came through from the respondent data, which went beyond the general framework of 6 general components.

There was a surprising frequency with which *management intent appeared*. 55 per cent of the responses related to internal factors were attributed to management intent. Of this, 57

per cent were responses related to management interest within the organization, the remaining drivers being management's perception of industry and involvement with promotional activity (Figure 7). Regarding their *perception of the industry*, all respondents, including those not offering the services believe there is a good potential, but the level of *promotional activity* that they are involved in, or have seen, is almost non-existent. For conventional banks, it is seen that there is high *interest* on the conceptual level but a low level of proactivity. They are not prepared to take the plunge due to lack of information. However, that would call for intention to seek information in order to reduce the uncertainty. This brings into focus the change management culture inherent in the financial industry and in Canada as a whole. The strategic intent to carry out market research can be related to how they perceive the industry and in turn the inherent nature of strategic decision making in the organization uncertainty reduction issue. Despite this, they need to realize that this is a market that is underserved right now. *'Forecasts tell us that the Muslim community is going to triple in size in the next 20 years, and they will continue to have these things, so why not go after that niche market. It is a smaller market absolutely but it's a easier market to track because nobody else is competing for that business, I'm grateful to be part of an institution that has that outlook'*. Hence these notions have to be dissipated throughout higher management, and those involved in the strategic decisions as well.

In analyzing the change management culture referred to in evaluating the hypotheses, these institutions in question can be said to have the Choice approach where instead of being forced to change their internal practices to fit in with external variables, organizations can exercise some choice over these issues. An emergent approach where they take a continuous, open-ended process of adaptation to changing circumstances and conditions could be a more relevant attitude to the kind of steps required. Also in evaluating how willing management is in up taking a venture like IF, alongside their conventional business, we can consider the Uncertainty Reduction Theory (Berger & Bradac, 1982) which asserts that people have a need to reduce uncertainty about an issue by gaining information about it. Information gained can then be used to predict the others' behavior. There are three basic ways people seek information: Passive, Active, and Interactive strategies. The findings show that despite the interest shown, the approach has

so far been passive. Geert Hofstede proposed dimensions to compare the national and organizational cultures based on a factor analysis. Among these, the dimension of Uncertainty Avoidance has to do with the way that a society deals with the fact that the future can never be known. The extent to which the members of a culture feel threatened by ambiguous or unknown situations and have created beliefs and institutions that try to avoid these is reflected in the Uncertainty Avoidance score. A low score is indicative of the easy acceptance of new ideas, innovative products and a willingness to try something new or different, whether it pertains to technology, business practices, or consumer products. The Canadian score on this dimension is 48 and Canadian culture is “uncertainty accepting.” Canadians are also tolerant of ideas or opinions from anyone and allow the freedom of expression. However, the Canadian culture scores higher than the English culture (35), which implies confrontation or ambiguity is not as highly avoided by the latter (The Hofstede Centre- <http://geert-hofstede.com/canada.html>).

The Canadian Bank sector is dominated by the ‘The Big Five’. According to Bloomberg, in 2011 the big five dominate the world's ten strongest \$100-billion-asset banks, with Canadian Imperial Bank of Commerce, Toronto-Dominion Bank, National Bank of Canada and Royal Bank of Canada at 3rd, 4th, 5th and 6th place, respectively, while Bank of Nova Scotia sits at 18th place (Wikipedia, 2013). One reason why they don't feel the impetus to take advantage of the niche market could be attributed to the fact that the five banks do not have much to compete against with regards to this industry. It may also be a revenue incentive. Currently there are no advertisements for projects on IF from investors who are needed to make this business work. Education and communication needs to be undertaken through the use of social media and technology, it takes a lot of patience. One has expressed the opinion that given the environment, it may be better to carry out the activity quietly, not explicitly calling it Islamic finance. There needs to be more research on the different types of industries most of the Islamic stocks were concentrated on the technology side, energy and resources.

With regards to resources, an equal number of respondents mentioned resources, as management intent, however 24 per cent of the responses coded under internal factors was resources. It cannot be overlooked that the various themes discussed in the findings are interrelated. For instance, the intentions with respect to IF of financial institutions' management indeed depend upon the regulatory constraints. The latter in turn may lead to designing the Shariah compliant product to comply with regulation, which may raise questions of Sha'riah authenticity, and which in turn affect people's general perception of the industry and the offerings. Trust is hard to build once lost. This requires the right professionals, supervision and accounting. UM financial in Toronto was a small unregulated non supervised institution that ended up putting a lot of homeowners at risk and affected the perception of many potential clients on the promise of this industry.

As for the IFs which have taken proactive initiatives, hurdles have so far been regulation and also the availability of funds. Nine of the respondents have mentioned regulation to be a hurdle with 20 per cent of the responses relating to this issue. Regulation can be a bottleneck as evident from the pending applications for Islamic financial banks in Canada, but the reason behind this lack of intent from the regulators has not been made clear through feedback. Likewise, in contrast to in the UK where regulators promoted the industry as a result of the changes they had to make, no such hype has been created from the top levels in Canada. A lack of funds and resources appears to be an issue holding back regulators from providing the green signal as well; then again it also appears that regulators may have choices in filtering out sources of funding and this raises the issue of whether potential sources of funding such as from institutions in the Gulf are being taken advantage of. There is an implication of recognizing these possibilities for the Canadian economy. Canada's prosperity depends on its reach into the global economy, there needs to be more investment abroad as well as more foreign investment in Canada and for this knowledge on Islamic Financial structures can be an advantage. Furthermore, this trade relationship can also bring the necessary funds that are required to cover the financial constraint in the progress of this industry. Many of the oil rich nations are nations that practice Islamic principles within their financial system. Therefore, when Canadian business students exit school they may encounter sovereign-wealth funds that have the principles of Islamic

finance and it can be an advantage to be prepared for the system functioning within the Canadian banks and institutions as well. This would require the engagement of key partners such as knowledge sources, networking and the government.

Another hurdle is awareness. Again 20 per cent of the responses about the external factors are attributed to the issue on lack of knowledge in the communities. The concept however has to be taught to people, even the Muslims. There are not enough advertisements or source of information for those who may want the products. Given that this globally growing industry is supply driven, there is need to market fairly hard against existing products. It is important to find high cluster of Muslim populations. Education, communication and outreach with centers of influence of consumers have important implications of addressing the skepticism that exist.

Another observation is that, given that the investment side of IF such as wealth management options is easier for clients to understand, that is one area that can be taken advantage of by both conventional and Islamic financial institutions to start off with. This area can also be promoted on the grounds of ethical investing – that is also a concept easier to grasp since socially responsible investing is already understood. Most common sources of information for the general Muslim population would be mosques, word of mouth, internet, brochures and newspaper. Given that regular mosque attendants have higher intentions than those who don't strategies can be targeted at informing the Imams of mosques and setting information booths in spaces around mosques as an opportunity to reach many potential customers.

Even though people who want the service may be willing to pay a premium for it, this lack of supply also reduces the competitive pricing. This is another issue that deters those who are aware of the offerings. It can also be part of programs in banking institutions that may be targeting immigrant strategies and offer services that appeal to them. The use of these services can also potentially give rise to small business opportunities. The small businesses can use Murabaha, for example to buy new equipment over time, without giving equity in the company or it can be lease to own with Ijarah. If Muslims are looking for Angel funds this would not necessarily need a Islamic structure, unless its capital that was targeted for the

Muslim community or to promote Islamic financial companies that way it can be promoted to the community. Overall, with the growing market out there, and the initiatives taken so far, there is no doubt that this industry has potential in Canada. A report to CMHC published in 2010 states that 'under Canadian accounting standards, Islamic financial products should not present any particular difficulties given the experience in UK and USA' (Gowling Lafleur, 2010).

5.2 Validity and Limitations

External validity: Generalization

The in depth discussions should make the research findings more externally valid. The greater the similarity between subjects, the higher is the possibility of making generalizations. The sample consisted of senior employees of financial institutions, all of whom have institutions in the same market and may have similar resources; hence their responses can be taken to be the general idea. This research is very context dependent and the impact of the context is important. It looks particularly into the Canadian setting, and although other western developed countries may have the similar conventional practices as the mainstream practice, generalization cannot always occur on a country to country basis. However, within Canada, this research is expected to show the general landscape of Ontario which does have 60 per cent of the Muslim population living there. It can be recalled that some of the inputs were from participants running Islamic financial institutions in the US. Even so if the views are deleted from the analysis, the same conclusions will be obtained.

Internal validity: Internal validity was checked with triangulation (Johnson, 1997; Benz and Newman, 1998). This was done through peer review with the supervisor of the study. Also, to help input some reliability into the coding an initial grid was used during the interviews to help identify the issues found most salient by each participant, e.g. the type of instruments they find potential in, the most challenging issues:

Themes	Speaker 1	Speaker 2
Most popular service	√	X
Lack of human resource	√	√

For a couple of instances, member checking was done where interviewees were followed up to re-check the recordings. Dependability and conformability can be maintained through careful auditing of the research process (Creswell, 2007) and records should be documented and organized appropriately for retrieval purposes.

Personal objectivity of the researcher: The literature key words, using online database such as Scopus, ABI Global Inform as well as Google search were solely based on the topic, they were: *Islamic banking and finance, West, Canada, North America, Challenges, Profit sharing, Potential*. Clarifying researcher bias is important. Personal biases are not expected to affect the objectivity of the issue, as this study looked at a supply and management perspective in order to get an illumination on why something is not happening and how it may happen in order to contribute to academy and help inform future policy.

Limitations

There are a couple of limitations to the study. It is being assumed that the findings in Ontario can be generalized throughout the country. It does not include any institution from Quebec, Alberta or British Columbia which also have Muslim communities. Also, all the hypotheses identified in chapter 3, although very important for a better and holistic picture, cannot be tested within the constraints of this study. Some small institutions are established in niche communities as community banking to provide for specific areas. These are not likely to be listed in official sites or reports and as a result they were left out of the sample of independent IF institutions. Another limitation initially was the ease of finding and access to the appropriate positions in the organization who could give a well informed perspective on the issue. However, with the sample used, the responses led to a saturation point with uniform themes and perspectives on the relevant hypotheses. As seen on Figure 7, 75 per cent of the respondents all brought up the main issues identified in the

findings. Since the analysis was more from a management perspective this study took the perspective of the financial institution as to why regulation has not been keen on the application for IF banks in Canada. However one limitation related to this was lack of access to a direct respondent from within the regulatory body for insight from their perspective on the issue of regulation. This additional aspect could have helped inform the topic better.

Conclusion and contribution - A journey in progress

To quote one of the respondents in a senior position at an IF bank in the US, *'Islamic finance, I think, is more of a journey, not a destination'*. This observation has a very significant bearing on the matter. This study has attempted to identify a direction for that journey in Canada, and set the ground for deeper look into the dynamics of a potential industry. The results of this project are expected to benefit academia through a new insight into alternative modes of finance feasible in the Canadian economy and the dynamics of the organizational resources and factors that need to combine to enable such a development. This research can aid financial agencies, potential entrants into IF activities (banks and institutions) as well as regulatory authorities gain an insight as preliminary assessment into the dynamics of the system before making decisions on new IF developments. Hence knowledge on this can have implications for banks seeking to expand their investment portfolios. These can subsequently aid institutional or government regulations in the future. From another perspective, trade and investment flows between Canada and the Muslim world can also be enhanced if financial institutions in Canada possess knowledge on Islamic financing.

With the given dataset and scope of the project, this study is not claiming to cover all causal factors behind the progress of this industry. Further research need to focus on the specific dynamics of the regulatory bodies, performance of the Islamic financial institutions vs. the conventional ones, small business financing, particularly with respect to immigrant Muslims, and also take a primary approach to studying demand dynamics. There is

definitely a niche market that is growing; however it is one that will take time to grasp a hold in the Canadian market. All participants were positive on the potential of this niche industry, that Islamic banking and finance provides an innovative and new way to initiate new ventures and carry out other common financial transactions such as loan financing, mortgages and insurance all under the Islamic principal of non-interest based transactions. Top management of one of the three main established IF banks in the US has expressed that the industry in North America needs a step by step approach *'For us it took ten years to break even. We started small, we started as a small success, we built on that, continued to re-invest in the business and R&D to develop the business very slowly. This is not the get-rich- quick kind of business, and everyone who has taken that approach has spectacularly failed or lost a lot of money trying'*. They are also of the view that unlike 10 – 20 years ago when there was a premium for Islamic financial services, it is no longer the case.

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APPENDIX A-1 Common IF product structures

Product	Mode	Description	Examples of Derivatives
Murabaha	Debt based/Cost-plus contract	A bank buys an item for a client and is repaid the price and an agreed profit (although the good can be delivered immediately). Murabaha account for 80 to 95 per cent of all investments by Islamic financial institutions. The bank is compensated for the time value of its money in the form of the profit margin. This is a fixed-income loan for the purchase of a real asset (such as real estate or a vehicle), with a fixed rate of profit determined by the profit margin. The bank is not compensated for the time value of money outside of the contracted term however, the asset remains as a mortgage with the bank until the default is settled.	- <i>Bay muajjal</i> (credit sale), delivery of goods is made immediately; predetermined price is paid at a given date in the future. - <i>Bay salam</i> (advance payment / forward buying) is the sale of goods to be delivered to the at a future fixed date. Not widely used yet, it has potential in areas such as agricultural. - <i>Istisna</i> (commissioned manufacture), an agreement for processed goods and commodities, allows payment in advance or future on future delivery
Musharaka	Equity based, PLS	Partners contribute capital. Profits and losses depend on the contributing ratio, in contrast to fixed income investing through loans since the risks and gains are shared. It can be compared to a joint venture or to a conventional joint-stock company. Equity funding is made by the Islamic Bank or by other investors such as investment funds, and the assets are the entrepreneur's own.	Diminishing musharaka entrepreneur allowed to purchase the shares owned by the investor as soon as the undertaking becomes profitable (which forms the basis of an Islamic mortgage)
Mudharaba	Equity bases, PLS	Much like the angel financing, where the partner or financial institution provides the financing and the entrepreneur/manager is the 'working' partner, The ownership of the assets is with the investor, and there is a fixed profit sharing ratio, the entrepreneur does not bear the financial loss of capital unless he is responsible for	Used for investment accounts for depositors, the bank is the mudarib or agent

Product	Mode	Description	Examples of Derivatives
		any carelessness in his part. May be two tiered contracts with an intermediary This double aspect of the investor, one bringing equity and the other bringing work could be compared to the French " <i>société en commandite</i> " /limited partnership.	
Ijara	Asset backed/Equity based(Leasing)	A bank buys an item for a client and leases it back for an agreed period. At the end of that period the lessee pays the balance on the price agreed and becomes the owner of the item.	The <i>Ijara</i> is often used to structure Islamic bond or <i>Sukuk(derivative)</i> , similar to a bond in Western finance. Because the traditional Western interest paying bond structure is not permissible, the issuer of a <i>Sukuk</i> sells an investor group the certificate, who then rents it back to the issuer for a predetermined rental fee. The issuer also makes a contractual promise to buy back the bonds at a future date at par value. however, the repurchase is taken by some scholars to be guaranteed return.

APPENDIX A-2 International Bodies Governing the IF industry

Islamic Development Bank Group (IDB Group),	Foster the economic development and social progress of member countries
Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)	Autonomous non-profit corporate body that prepares accounting, auditing, governance, ethics and <i>Sha'riah</i> standards for Islamic financial institutions.
Islamic Financial Services Board (IFSB),	IFSB complements that of the Basel Committee on Banking Supervision, International Organization of Securities Commissions and the International Association of Insurance Supervisors.
Basel Committee	Sets supervisory standards and statements for best practice to help governments converge towards common banking regulations (10 governments including Canada)
International Islamic Financial Market (IIFM),	Facilitate international secondary market trading of Islamic financial instruments
International Islamic Rating Agency (IIRA),	Rates insurance, research, analysis, rating of the obligations, dues, commitments, and other securities and to give an independent assessment of compliance by the concerned entity,
International Islamic Centre for Reconciliation and Commercial Arbitration	Settles financial and commercial disputes between financial or commercial institutions
General Council of Islamic Banks and Financial Institutions (GCIBFI).	Autonomous non-profit corporate body that represents IFB globally

APPENDIX B-1- Primary Data Sample

Source	Current position	Past Positions	Years in industry	Qualification	Institution	Currently involved in offering	Muslim	Instrument	Date
A	Director- Firm structuring IF products (This participant was as in 2 data points: An individual interview and a conference on alternative modes of finance in Canada)	Ex-senior Economist (Department of Finance)	15+	B.A, Masters in Economics	Non-bank financial institution, GTA	Yes	Yes	Face to face interview & conference	23/03/2013
B	Senior Vice President and Head-Global Investments and Financial Operations- Financial service provider	Ex Senior Vice President-Finance & Operations, Wholesale Banking at a large commercial bank	25+	C.A, MBA	Non-bank financial institution, Toronto	No	No	Phone interview	11/03/2013
C	Director- Product Management & Development –Large commercial bank	Ex- Vice President, Risk Management – foreign bank	23+		Schedule I Bank, Toronto	No	No	Phone interview	04/04/2013
D	Investment Advisor – Large commercial bank	CIBC world Markets	12	MBA,CFA	Schedule I Bank ,London, ON	Yes	Yes	Phone interview	17/04/2013
E	Mortgage broker and real estate investor		15+		Non-bank financial institution, Ottawa, ON	Yes	Yes	Phone Interview	13/05/2013

The Barriers to, and Incidence of, Islamic Banking and Finance in Canada
Tahmina, T.N.

Source	Current position	Past Positions included	Years in industry	Qualification	Type of institution	Currently involved in offering	Muslim	Instrument	Date
F	Consultant –Financial services provider		3	B.Com	Non-bank financial institution, Ottawa, ON	Yes	Yes	Phone Interview	24/04/2013
G	Associate Professor of International business	Government consultation	18	MA, PhD	University, Toronto, ON	Involved	Yes	Conference	14/03/2013
H	Member-Sha’riah supervisory boards(including Dow Jones Islamic markets)		30			Involved	Yes	Conference	14/03/2013
I	Chairman and CEO – Islamic bank, subsidiary of a larger conventional group		25	BA	Islamic financial institution, Michigan	Yes	No	Conference	06/04/2013
J	Senior vice president and General Counsel – Islamic home finance provider		25	BS-Accounting, JD,LLM	Non-bank Islamic financial institution, Virginia	Yes	No	Conference	06/04/2013
K	Chairman-Board and CEO-Community bank, Member-FDIC		20	BA, JD	Islamic financial institution, US	Yes	No	Conference	06/04/2013
L	Lead on a project for CMHC				Law firm, ON	Involved	No	Media Interview	28/06/2010

APPENDIX B-2 Research tool-Interview Guide

Theme 1: Interviewee's perspective on prospects for Islamic financial products in the market.

1. Does your institution currently offer financial services that include any form of non-interest based options?
2. Has your institution, to your knowledge, ever been approached by a client seeking Islamic financial services, e.g. interest free saving accounts, home and auto mortgages?
3. There are over a million Muslims living in Canada, 40 % of whom are residents of Toronto. Do you think constitutes a potential market for introducing the Islamic banking products?
4. Despite being similar in demographics and regulatory framework as countries like the United Kingdom, Canada is not an active market for Islamic financial investments. Why do you think this is so?

Probes:

- Can you explain further?
- Can you please give an example?

Theme 2: Opportunities and top management incentive

5. One way of offering Islamic banking instruments would be through an Islamic finance window. Do you have any plans to open such a window? (*Looking for management incentive and motivation behind the prospects of the process*)

Probes:

- If answer: No -- Would you explain why not?
- If answer: Yes -- Which types of instruments have you considered?

Further probes:

- How may this be done?
- Can you please elaborate on that idea?
- Can you give an example?

- What other ways do you think clients can seek interest free and profit loss sharing modes of investments, if not through Islamic windows?
 - Have you considered promoting the Islamic financing investment vehicles to the public at large?
6. Islamic banking-based products and investments can be purchased by everyone in the market, not just Muslims. What is your perception of the level of awareness of this system among investors in Ontario?
7. In the area of small businesses growth, Musharaka and Mudharaba, partnerships similar to joint ventures and angel financing, can be levered as interest-free investment vehicles. Other options are mortgages and loans and day-to-day banking accounts. Which to you would seem to be the most attractive option to offer?

Theme 3- Challenges

8. What have been the main challenges to up-taking the Islamic banking operation? OR (depending on their responses to Question.5) what, in your view, would be the main hurdles in up-taking the Islamic banking operation from an organizational perspective?

Probes:

- Can you give me an example?
 - Would you say internal resources are bottlenecks in the process?
9. (*Looking for: Employee qualified in Islamic financing accounting standards, access to a personal Sha'riah board for the institution*) Do you sense any barrier from the external regulatory environment

Probes:

- Do you think the tax environment may be an issue, e.g. the double tax stamp duty on buy and sell deals?
 - Co-ordination with international bodies such as the AAOIFI, Basel committee III, etc.
10. Do you see any possibility for these hurdles to be overcome?

Probes: How?

NOTE: IN THE CASE OF INDEPENDENT ISLAMIC FINANCIAL INSTITUTIONS THE
CONTEXT MAY DIFFER.

Q.1, 2, 3- Theme 1: Questions 1, 3, 4

Q.4, 5, 6- Theme 3: Questions 10, 11, 12

7. What challenges have you faced during setting up the institution?

8. What types of Islamic financial instruments are you offering at the moment?

Probe

- Why do you not offer the other options?
- Which are the most popular in terms of demand?

9. Are you approached by clientele from the non-Muslim community as well?

10. What are your plans for expanding your business?

11. Where, in your view, is the market heading now?

Conclusion:

Thank candidate

Answer candidate questions

APPENDIX C- Coding Node Summary

12/07/2013 1:09 AM

Node Summary

M.Sc. Islamic Banking and Finance

22/07/2013 1:09 AM

Source Type	Number	Number of	Number of	Number of	Duration Coded
Node					
Nickname:	Nodes\\External factors\\Competition				
Classification:					
Aggregated:	No				
Document	6	8	502	8	
<hr/>					
Nickname:	Nodes\\External factors\\Opportunities				
Classification:					
Aggregated:	Yes				
Document	3	15	1,640	15	
<hr/>					
Nickname:	Nodes\\External factors\\Potential Market\\Ambiguity and authenticity issues				
Classification:					
Aggregated:	No				
Document	9	21	1,173	21	

Nickname: Nodes\\External factors\Potential Market\Awareness\Perception of the awareness

Classification:

Aggregated: No

Document	9	29	1,889	31
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Source Type	Number	Number of	Number of	Number of	Duration Coded
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Nickname: Nodes\\External factors\Potential Market\Awareness\Resistance

Classification:

Aggregated: No

Document	1	2	157	6
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Nickname: Nodes\\External factors\Potential Market\Demand\General demographics

Classification:

Aggregated: Yes

Document	4	4	236	4
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Nickname: Nodes\\External factors\Potential Market\Demand\Perception of the demand

Classification:

Aggregated: No

Document	11	26	1,776	32
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Nickname: Nodes\\External factors\Potential Market\Demand\Popular services

Classification:

Aggregated: No

Document	7	16	1,063	16
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Nickname: Nodes\\External factors\Regulation

Classification:

Aggregated: No

Document	9	31	2,395	39
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Source Type	Number	Number of	Number of	Number of	Duration Coded
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Nickname: Nodes\\Internal factors\Institution\Awareness or Demand of current clients

Classification:

Aggregated: No

Document	3	5	224	6
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Nickname: Nodes\\Internal factors\Institution\Institution information

Classification:

Aggregated: Yes

Document	2	2	172	2
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Nickname: Nodes\\Internal factors\\Institution\\Offerings or role of candidate

Classification:

Aggregated: Yes

Document	7	12	1,146	19
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Nickname: Nodes\\Internal factors\\Perceived challenges\\Awareness in the organization

Classification:

Aggregated: No

Document	4	8	406	19
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Nickname: Nodes\\Internal factors\\Perceived challenges\\Formal Shariah knowledge

Classification:

Aggregated: No

Document	4	4	154	4
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Source Type	Number	Number of	Number of	Number of	Duration Coded
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Nickname: Nodes\\Internal factors\\Perceived challenges\\Management intent or

Classification: Drive\\Management interest

Aggregated: No

Document	8	16	1,299	20
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Nickname: Nodes\\Internal factors\Perceived challenges\Management intent or Drive\Perception

Classification: of Industry potential

Aggregated: Yes

Document	9	16	867	17
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Nickname: Nodes\\Internal factors\Perceived challenges\Management intent or

Classification: Drive\Promotional activities

Aggregated: No

Document	8	13	376	13
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Nickname: Nodes\\Internal factors\Perceived challenges\Resources

Classification:

Aggregated: No

Document	11	24	1,327	27
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APPENDIX D- Timeframe of the study

