

Implementation of Islamic Elements as a Parameter for Credit Evaluation Process: Exploring *Shariah* Adviser's Perceptions

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Abstract

The aim of the study is to explore the *Shariah* adviser's perceptions on credit evaluation process in commercial financing activities in Islamic banks. To achieve this aim, the study conducts in-depth interviews as to identify the Five C's and CAMPARI elements in credit evaluation process, *Adl'*, *Ukhwah*, *Istiqamah*, *Akhlak*, *Syura* and *Tawakkal* elements in credit evaluation process, *Daruriyyah* and *Hajjiyyah* in credit evaluation process and lastly is exploring the credit management (during and after the lifetime). The study found that any development to strengthen credit risk is always welcome. As already mentioned, the parameter provides the value add mechanism in achieving a thorough financing evaluation process. However, Islamic banks must be mindful that moving forward, the financing or credit officers must have the necessary skills and experience to handle the proposed parameter and they have to be well trained. As a result, it is good to implement this parameter if the clients are ready to embrace this parameter and the bank personnel have the necessary experience and skills.

Keywords: Five C's elements, CAMPARI elements, Islamic elements, Credit Risk Management, Islamic Banks

Introduction

The concept of management, in general, is the act of problem solving, as the management solves the problems that occur in organizations, and, the term management itself is to identify and control the issues, and chooses an appropriate course of action (Kreitner, 2008; Siti Nor Amira Mohamad et al., 2018). Risk on the other hand can be defined as the probability of something unpleasant happening that occurs when there is a likelihood of failure to achieve the goals targeted (Bessis, 2010).

Risk management is the process of identifying and evaluating the exposure loss, and implementing the most appropriate methodologies for treating such exposure (Saunders & Cornett, 2010). To extend this further, Bessis (2010) opines that the objective of risk

management is to calculate and measure each type of risk as it needs to be controlled and monitored.

Furthermore, in managing risk in commercial financing, Islamic banks must have a risk-sharing element (Siti Nor Amira Mohamad et al., 2014). As a financial intermediary, Islamic Financial Institutions (IFIs) play an important role in risk-sharing modes as the deposits in a bank's balance sheet normally involve this mode, while the financing business activity does not involve the risk sharing mode in which the activity is more on the asset side stated in the balance sheet (Khan and Ahmed, 2001). Therefore, this financing business activity may impact on the bank itself in the occurrence of credit risk. This is because the biggest risk in banking activity is the credit risk (Ho & Nurul Izza Yusoff, 2009).

However, the Islamic banking industry has come to stay but must consider all the dimensions of credit risk since there are different types of contract used with different types of exposure towards risks, because, if not, it will affect the whole performance and efficiency of the bank (Siti Nor Amira Mohamad et al., 2015). While carrying out their daily business activity, they cannot have any lack of management of credit because it can lead to a total disaster for the bank as well as affect the customers. Islamic banks are still underperforming and still developing, therefore, it is good for this study to explore in advance what and how Islamic elements are used in credit risk management in the credit evaluation process, and thus the results from the interviews are useful to implement parameters from the credit evaluation process.

Credit risk management really has a great role to play because it makes financing decisions less risky. It also helps banks to have a secure system of two-dimension credit risk management with different types of contract because Islamic banks are unique in terms of principles, which enhances the trust that banks might develop. It also helps to diminish the concept of risk to interest rates that the conventional banking approach applies. In addition, the study also came to realize that the commencement of credit risk management commences before the financing decisions until when it receives repayment from the customers.

Moreover, during the time of making financing decisions, the information needed and the most important elements collected are both valued differently by the different banks. Even though the trust is always borne mind, they must be aligned to avoid asymmetric information. No matter what the strategies used in attaining a good credit risk management, four (4) doctrines should be followed: The Day of Justice (Surah Al-Hijr, 15: 35), the Day of Evaluation (Surah Ghafir, 40: 32), the Day which is promised (Surah Al-Buruj, 85: 2) and the Day of Judgement (Surah Al-Mursalat, 77: 14).

Therefore, this study further to have a stand point to explore the Islamic elements that can be used in credit evaluation process for commercial financing approval for Islamic banks approach. Besides, this study further to propose the best parameter for credit evaluation process in commercial financing approval for Islamic banks approach.

Research Questions and Objectives

Table 2.1 below shows the research questions and objectives of the study:-

Table 2.1

Explanation of Research Questions and Objectives

<u>Research Questions</u>	<u>Research Objectives</u>
1. What and how Islamic elements can be used in credit evaluation process for commercial financing approval for Islamic banks?	1. To explore the Islamic elements that can be used in credit evaluation process for commercial financing approval for Islamic banks.
2. What is the best parameter for credit evaluation process in commercial financing approval for Islamic banks?	2. To propose the best parameter for credit evaluation process in commercial financing approval for Islamic banks.

Literature Review

The needs of good credit evaluation process in commercial financing for Islamic banking system has become one of the necessities in approaching good credit risk management in pre-approval stage. Its needs also would increase the value and performance of Islamic banks and make them resilient to crisis. Conversely, the effectiveness of contributions in current practices of credit evaluation process in Islamic banks with different types of contracts remains to be debatable.

To date, empirical research in commercial financing of Islamic banks failed to convince that they were approaching low of rate of return (ROR) on business financing. Makiyan (2003), in his research on the role of the rate of return on loans in the Islamic banking system of Iran, found that it is significantly dependent on the changes in total deposits, and the time lags of the variables and rate of inflation. This shows that they are not significantly dependent on the changes in the expected rate of return on debts.

To extent this further, ROR has inter-related with return on assets (ROA) as good performance on these will achieve sustainable of banking system. However, commercial financing has become riskier than other types of financing because of the probability of fulfill the payments on time because of their practices sharing the risks as well as bear for losses. One of the reasons is that lack of ethical contents among the related parties as well as impact to the efficiency of Islamic banks (Saiful Azhar Rosly & Mohd Afandi Abu Bakar, 2003; Chong & Liu, 2009; Faridah Najuna Misman, 2012). Also, Islamic financing offered is not expected to motivate them by practicing the Islamic elements in financing decision as to sustain in terms of business efficiency (Greuning & Iqbal, 2007; Abdul Wahab et al., 2014).

The low level transparency and public disclosure has become triggering issues in commercial financing as influenced by adverse selections and asymmetric information in approval stage. There were reflections of the Islamic banks in the case of low level transparency and thus trust is eliminated between the customers and the banks (Abdus Samad et al., 2005; Iqbal, 2008). Likewise, limited (negligible) due to the non-conduciveness of the existing natural environment of business practices affects the level of transparency and public disclosure which at the end will increase in risks associated (Siddiqui, 2008; Chusaini & Ismal, 2013; Muhammad Hanif, 2014).

Besides that, insufficiency in risk management tools has resulted to inefficiency of the sustainability of Islamic banks as they offered different kind of risks exposures. As pointed out by Fauziah Hanim Tafri et al. (2011) and Nazir et al. (2014), Islamic banks are lack of risk management tools compared to conventional banks as they found that there is a significant

difference in the strategies in credit risk mitigation and the other tools identified between conventional and Islamic banks. The determinants of nature of Islamic banks itself and lack of tools in mitigating the occurrence of risk are stated impacts the longevity of Islamic banks.

Asset quality and earning ability has become one of the necessities for good financial performance of Islamic banks. However, recent analysis in terms of financial performance, Islamic banking system performs better in terms of the capital adequacy and liquidity. The rest – quality and earning ability – is found to be better in the conventional banking system (Abedifar et al., 2013; Muhammad Jaffar and Irfan Manarvi, 2011; Thim et al., 2014). However, another study by Becka et al. (2013), Islamic banks are correspond to high asset quality, were better in the capital and intermediation ratio but were less cost-effective.

High ethical values bring continuous relationship among Islamic banks and their customers. By sustaining the use of the Islamic principles and adapting the appropriate Islamic terminology, the Islamic banking system could survive in the competitive market through its full-fledged Islamic identity that contrasts with the conventional financial transactions (Khan, 2010; Ebrahimi et al., 2011). Besides that ethics in evaluation should be looked at from the Islamic point of view, such as self-evaluation, plurality of evaluation tools, speed in evaluation, and consideration of individual differences (Rashid Ameer et al., 2012; Rudnyckyj, 2014). It is necessary for organizations to apply the usage of Islamic evaluation principles.

Therefore, to sum up from all the above empirical studies, several issues are identified for improvement. A few studies were conducted on the credit risk management in the evaluation stage, especially in the Islamic banking approach. This is because the current practices used the same practices as the conventional banking approach, since Islamic banks must be more proactive in evaluating the clients in commercial financing approval because they offer profit and loss sharing contracts and different types of contract, such as *Murabahah*, *Mudharabah*, *Musharakah*, *Bai' As-Salam*, *Bai' Al-Istisna'* and *Ijarah* financing contracts. Furthermore, there are still challenges for different types of banking system. Similar to the empirical study of the conventional banking approach, there are few studies in the Malaysian banking system in relation to the area of study. Therefore, this study further proposes to implement the Islamic elements in the credit risk management that can be applied in the credit evaluation process, since the techniques of credit risk management after the approval of the credit application have been widely discussed in the reviewed literature. By using the inductive approach, the study proposes the parameters for the credit evaluation process in the Islamic banking system.

Research Methodology

The inductive approach was chosen because it is the most suitable for the purpose of this study since the study uses qualitative data. Bryman and Bell (2007) stated the stages in the induction approach. Also, the inductive approach starts with observation, pattern, developing tentative hypotheses and then develops a theory therefrom. Cooper and Emory (2008) viewed that from the inductive approach, between a reason and a conclusion; there is no strength in them as both of them use the deductive approach. Therefore, to develop a theory from the observation, in-depth interviews will be used to gain the perceptions from the *Shariah* advisers in Malaysia. By using the interview guide, it is expected that the person's perception of the different *shariah* advisers might be different. In addition, the conclusion of the study will discuss the facts, situations, experiences and thus, ultimately, will support the conclusion. Since this study is inductive, the qualitative method is preferred because the study uses the relationship between the research and the theory, and, as there is no measurement,

hypothesis testing is undertaken. This helps to answer the research questions by in-depth interviewees with the authorities concerned in the area of study, and then the outcomes from the interviews are compared in terms of their answers with the theory.

Analysis

This part will attempt to analyze the *Shariah* advisers via qualitative data collected during the interview process connecting it to the theory, giving a clear and well-argued answer to the research questions and objectives stated in the study. Thus bring out the researcher's contributions and point of views.

As earlier mentioned, this section of chapter the interviewed respondents from five (5) different *Shariah* advisers who answered questions in the interview guide. However, regarding to the analysis and interpretation of the data, the study will discuss shallowly on some of the parts which related to help answers the research questions and objectives respectively. It is valuable to note that this analysis is based on what was said to the researcher by the respondents, the impression of the study acquired while carrying out the interviews and the way the researcher as an individual has interpreted what was said.

The respondents interviewed shared responses with same meaning to most of the questions although in different words. The study also found some differences in opinion from their experiences and perceptions hence, for better understanding of each of their position in the industry with regards to credit risk management and also Islamic finance. Next, the study will compare and analyze by using NVIVO software as same in the first phase of analysis in the previous chapter as too to validate the parameter.

To extent this further, this section will divided into four (4) themes of study that will be analyze further based on the interview responses which includes of discussions on five C's and CAMPARI elements in credit evaluation process, *adl'*, *ukhuwah*, *Istiqamah*, *Akhlak*, *Syura* and *Tawakkal* Elements in credit evaluation process, *Daruriyyah* and *Hajiyyah* in credit evaluation process and credit management (during and after the lifetime).

Five C's and CAMPARI Elements in Credit Evaluation Process

This point out those different respondents in different industry has different point of views in regards of five C's and CAMPARI elements in credit evaluation process. However there are some pit points of interest from *Shariah* adviser's perception. As the respondents may conjure up more than one image or word, Table 5.1 below summarizes the *Shariah* adviser's perceptions of credit evaluation process:-

Table 5.1

Words and Concepts Associated with Five C's and CAMPARI Elements by Selected Shariah Advisers

Words and concepts Associated with Five C's and CAMPARI Elements	Shariah Advisers	Total
Purpose	5	5
Ability to Pay	4	4
Character	4	4
Amounts	3	3
Margin	2	2
Repayment Terms	1	1

Insurance	0	0
Capital	0	0
Capacity	0	0
Collateral	0	0
Conditions	0	0

Based on table 5.1 above, the two (2) most common word associations with Five C's and CAMPARI Elements were "purpose" and "ability to pay" by respondents. Much effort is required in gathering the first utmost elements used with different types of respondents. These as experienced by respondents G, H, and I:-

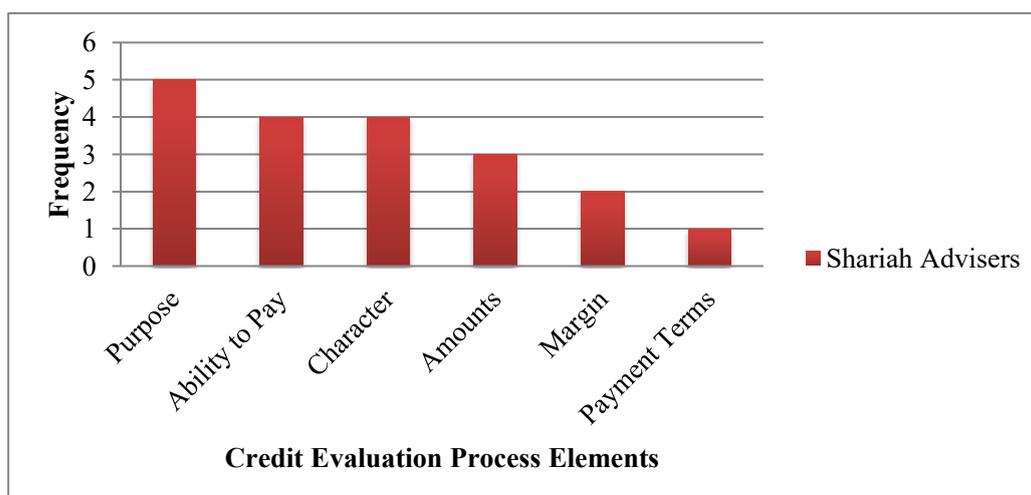
"In my opinion, both types of banks are guided by BNM guideline under the section of "Credit Risk Management Process", the first step discussed in this guideline is the purpose of credit. So that, Islamic banks for me, they should not use five C's in evaluation process because under this elements there is not stated the elements of purpose (niat)." (Respondent G)

"Being prepared for credit evaluation process, to me, purpose of financing is come first. Then it should be followed by ability to pay. Conversely, Islamic elements should be put as add the value towards Islamic banks practices. " (Respondent H)

"On behalf of different types of banks, Islamic banks should more strictly first evaluate their clients based on the purpose. For conventional banks, for me, they more first look at the character elements. As in Islamic practices, purpose (niat) comes formerly in making decision."(Respondent I)

To extent this further, figure 5.1 below stated categories elements in credit evaluation process agreed by *Shariah* advisers and some views of different perceptions from respondents in this research study:-

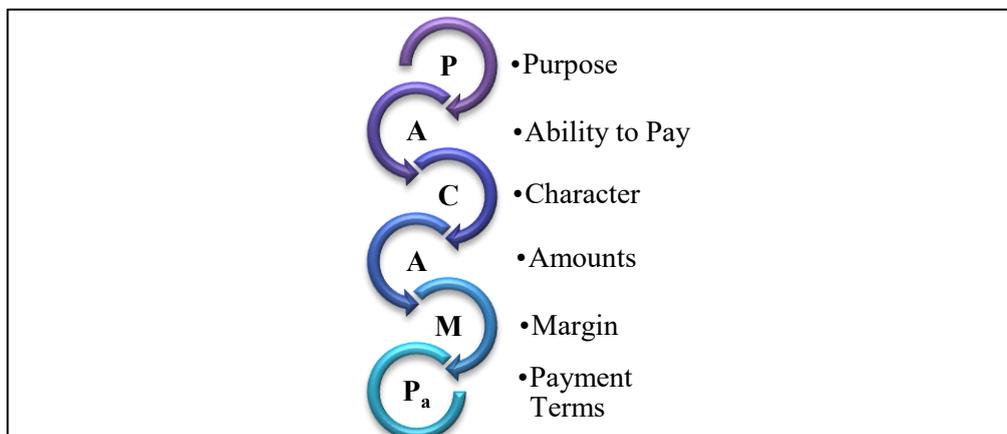
Figure 5.1 Categories Elements in Credit Evaluation Process agreed by *Shariah* Advisers



Based on the above figure 5.1 explained, there are no elements of five C's suitable for credit evaluation process for Islamic banks approach. The first come in evaluation process is element of "purpose", and followed by "ability to pay", "character", "amounts", "margin" and

“payment terms”. Therefore, it is suitable for Islamic banks Approach implements CAMPARI elements as topmost elements in making evaluation process. However, in this implementation of CAMPARI elements, the first come is “C- Character”. All of the respondents in this research study agreed if change the terms used as make easier for Islamic banks yet in credit evaluation process.

Figure 5.2 PACAMP_a Elements for Islamic Banks Approach



Based on the above figure 5.2 explain the flow of proposed synchronized elements of credit evaluation process in Islamic banks (PACAMP_a) elements as a purpose to make easier for Islamic banks to first evaluate the credit applicant by first looking up for the purpose followed by others elements stated.

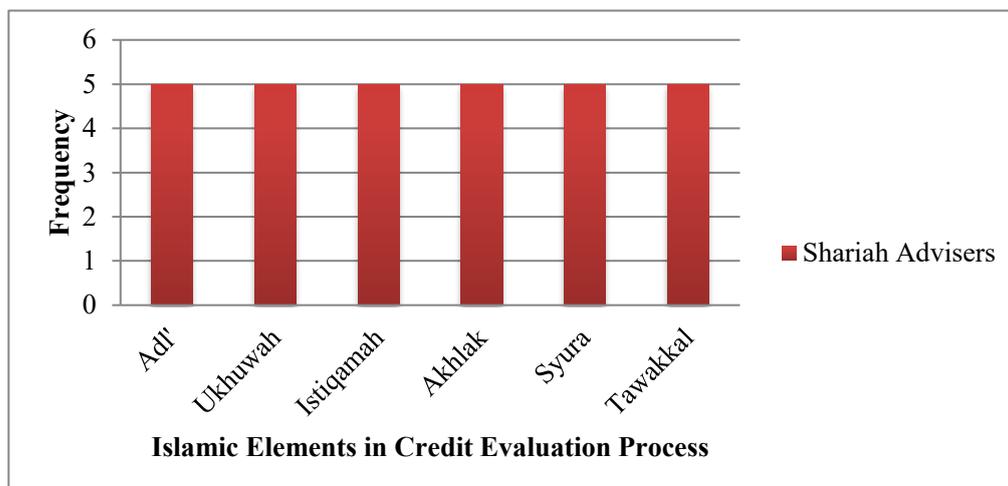
Adl', Ukhuwah, Istiqamah, Akhlak, Syura and Tawakkal Elements in Credit Evaluation Process

In this sub-section explained further the views and perceptions of *shariah* advisers on what and how the Islamic elements can be used in credit evaluation process. Table 5.2 shows words and concepts associated with *Adl', Ukhuwah, Istiqamah, Akhlak, Syura* and *Tawakkal* elements by selected *Shariah* advisers in Malaysia and hence figure 5.3 shows categories of Islamic elements in credit evaluation process agreed by *Shariah* advisers:-

Table 5.2

Words and Concepts Associated with Adl', Ukhuwah, Istiqamah, Akhlak, Syura and Tawakkal Elements by Selected Shariah Advisers

Words and concepts Associated with Adl', Ukhuwah, Istiqamah, Akhlak, Syura and Tawakkal Elements	Shariah Advisers	Total
<i>Adl'</i>	5	5
<i>Ukhuwah</i>	5	5
<i>Istiqamah</i>	5	5
<i>Akhlak</i>	5	5
<i>Syura</i>	5	5
<i>Tawakkal</i>	5	5

Figure 5.3 Categories of Islamic Elements in Credit Evaluation Process Agreed by *Shariah* Advisers

Based on the above table 5.2 and figure 5.3, these indicate that the Islamic elements are useful to implements in regards of evaluation process as a parameter to credit risk management. All of these elements agreed by all respondents as one parts of transparency in managing credit risk. These as experienced by respondents J and K:-

“Transparency is needed for banks as customers disclose all the information that bank need in financing decision. Adl', Ukhuwah, Istiqamah, Akhlak, Syura and Tawakkal Elements for me are necessary in pre-approval stage as to ensure that the value is added in financing decision.” (Respondent J)

“Since Islamic banks approach practices continuous relationship as well as share the risks so that one of the Islamic element is ukhuwah as this to accomplish a sustainable and continuous relationship. Besides that, Adl', Ukhuwah, Istiqamah, Akhlak, Syura and Tawakkal elements will also help them in making financing decision.” (Respondent K)

To sum up from above discussion, the Islamic elements- *Adl', Ukhuwah, Istiqamah, Akhlak, Syura* and *Tawakkal* gives good impact to the transparency for Islamic banks since they are practicing risks-sharing activities in business financing. Therefore, as neglect the issue in asymmetric information and moral hazard in time-line of financing tenor, these proposed elements can be value add the credit risk management strategies, or, if not, *ukhuwah* may be jeopardized.

Daruriyyah and Hajiyyah in Credit Evaluation Process

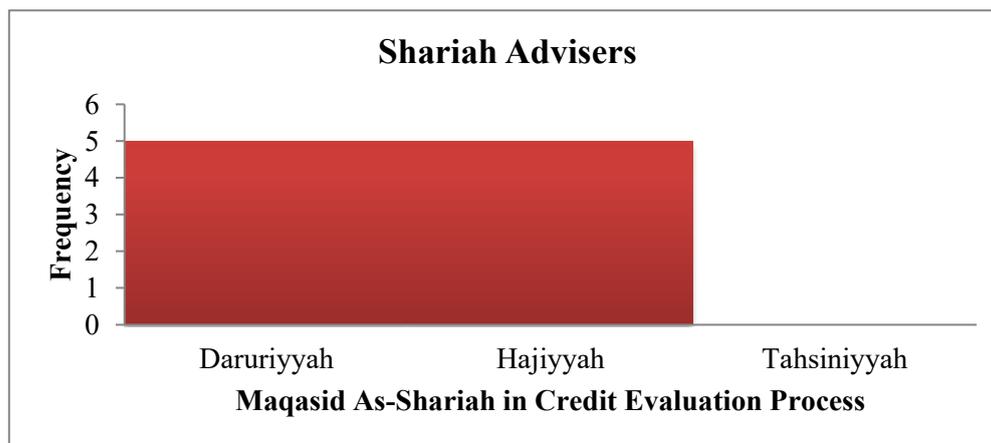
Focus in this sub-section is analysis of *Daruriyyah* and *Hajiyyah* in credit evaluation process. Different respondents have different views and beliefs in these two of classification of *maqasid as-shariah* in credit evaluation process. Table 5.3 below shows the words and concepts associated with *maqasid as-shariah* in credit evaluation process by selected *Shariah* advisers in Malaysia and hence figure 5.4 shows categories of first utmost *maqasid as-shariah* needed in credit evaluation process agreed by *Shariah* advisers:-

Table 5.3

Words and Concepts Associated with *Maqasid As-Shariah* in Credit Evaluation Process

Words and concepts Associated with <i>Maqasid As-Shariah</i> in Credit Evaluation Process	<i>Shariah</i> Advisers	Total
<i>Daruriyyah</i>	5	5
<i>Hajiyyah</i>	5	5
<i>Tahsiniyyah</i>	0	0

Figure 5.4 Categories of First Utmost *Maqasid As-Shariah* Needed in Credit Evaluation Process agreed by *Shariah* Advisers



Based on the above table 5.3 and figure 5.4 stated, in part of credit evaluation process, the two of *maqasid as-shariah* needed- *daruyyiah* and *hajiyyah*. All of the respondents viewed that the first two of classified the entire range of *maqasid as-shariah* is important in making financing decisions- the *daruriyyah* (the essential) and the *hajiyyah* (the complementary). These as qualified by respondents G, H, I and J:-

"For me, daruriyyah and hajiyyah seeks to validate all measures necessary for preservation from harmful in timeline of financing." (Respondent G)

"The daruriyyah and tahsiniyyah are a very important category, as they are all-pervasive and relate to all the other masalih. So that, from my oipinion, it is good for Islamic banks to first analyze the concept of daruriyyah and tahsiniyyah before the financing is approved." (Respondent H)

"Daruriyyah is the fundamental to hajiyyah and hajiyyah is the foundation of tahsiniyyah. Or in another word, tahsiniyyah (beautification) is the complement of hajiyyah (requirements) and hajiyyah is the complement of daruriyyah (necessities), and when the basic necessities of humanity (daruriyyah) were not met, it fall into the 'state of emergency' or Darurat. Hence, these two maqasid as-shariah are complimentary each other in timeline of financing as well as credit evaluation process."(Respondent I)

"As for my opinion, if Daruriyyah state is not met, customer will be in darurah situation. If Hajiyyah is not met, customer will be in Hajah situation. If a customer is in Hajiyyah state, it

will be treated as a Darurah state. So that these two of maqasid as-shariah cannot be apart in the time of making financing decisions.”(Respondent J)

Based on the above point of views, respondents have tried to explain the aims and objectives of *shariah* upon which it is established. *Maqasid as-shariah* comprises those benefits/welfare/advantages for which Allah has revealed His *shariah*.

Daruriyyah is which one’s must and basic for the establishment of welfare in this world and the world hereafter in the sense that if they are ignored then the coherence and order cannot be established and *fasad* (chaos and disorder) will prevail in this world and there will be obvious loss (*al-khursan al-mubin*) in the world hereafter. Based on the analysis, *daruriyyah* relates to five things: Protection of Faith (*Din*), Life (*Nafs*), Posterity (*Nasl*), Property (*Mal*) and Reason (*'Aql*).

Besides, *Hajiyyah* aims at facilitating life or removing hardships. All such provisions of *Shariah* which aim at facilitating life, removing hardship, etcetera, are said to fulfill the *hajiyyah* (requirements). Besides, the permission for *qirad* (risks-sharing through financing), *musaqat* (profit-sharing/risks-sharing), *bai as-salam* (forward buying of a commodity which does not yet exist), which are apparently illegal interest bearing dealings, are the examples of *Shariah* provisions that aim at facilitating life or removing hardships in the life in this world. The exploitative, usurious and doubtful dealings and contracts have also been forbidden for the same purpose.

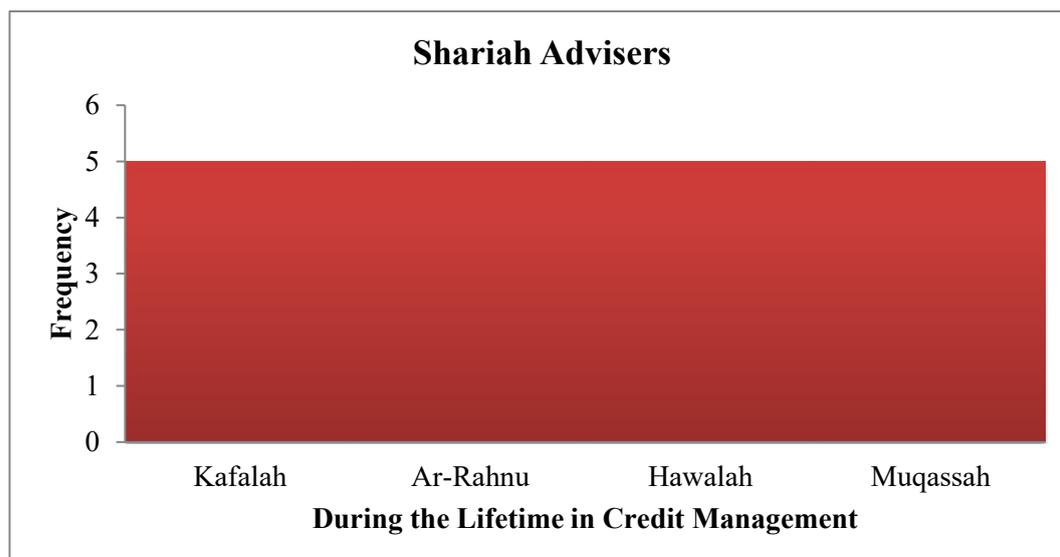
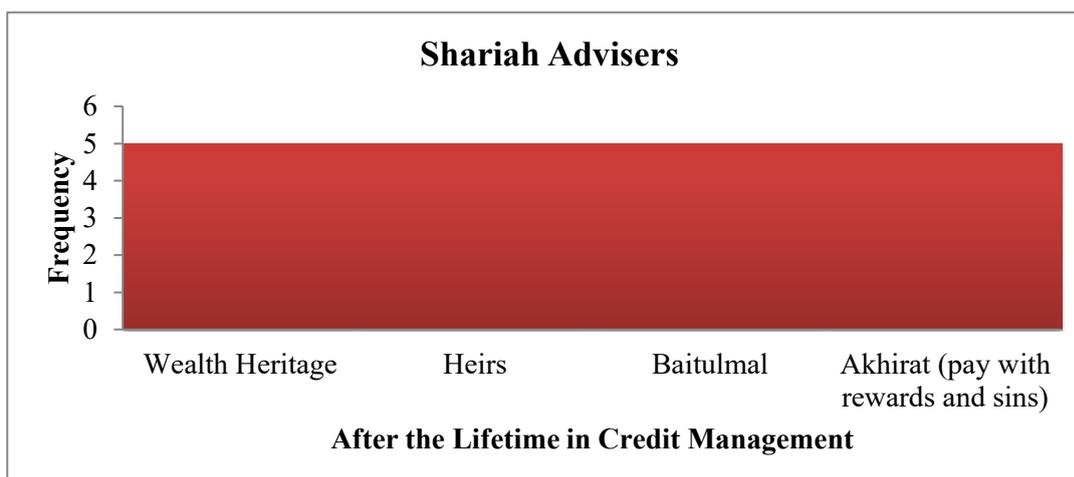
Credit Management (During and After the Lifetime)

Focus in this sub-section is analysis of credit management (during and after the lifetime). Different respondents have different views and beliefs in credit evaluation process as part of during and after the lifetime in terms of credit management in Islam. Table 5.4 below shows the words and concepts associated with credit management in Islamic way by selected *Shariah* advisers in Malaysia and hence figure 5.5 shows categories of first utmost during the lifetime in credit management and figure 5.6 shows categories of after the lifetime in credit management agreed by *Shariah* advisers:-

Table 5.4

Words and Concepts Associated with Credit Management in Islamic Way by Selected Shariah Advisers in Malaysia

Words and concepts Associated with Credit Management in Islamic Way by Selected <i>Shariah</i> Advisers in Malaysia	<i>Shariah</i> Advisers	Total
<i>Kafalah</i>	5	5
<i>Ar-Rahnu</i>	5	5
<i>Hawalah</i>	5	5
<i>Muqassah</i>	5	5
Wealth Heritage	5	5
Heirs	5	5
<i>Baitulmal</i>	5	5
<i>Akhirat</i> (Pay with Rewards and Sins)	5	5

Figure 5.5 Categories of First Utmost during the Lifetime in Credit Management**Figure 5.6** Categories of First Utmost after the Lifetime in Credit Management

Based on the above table 5.4, figure 5.5 and figure 5.6 stated, in part of credit evaluation process, the two phases in credit management is needed- during and after the lifetime. All of the respondents viewed that these two phases in the entire range of credit evaluation process is important in making financing decisions. These as qualified by respondents I and J:-

“For me, during and after the lifetime in credit management is important as seeks to certify all measures required for safeguarding from risky in timeline of financing-kafalah, ar-Rahnu, Hawalah and Muqassah and thus take from wealth heritage, or if not, take from heirs or if not take from baitulmal, and lastly, the financing will bring to akhirat.” (Respondent I)

“The two phases in credit management is very important in a way of Islamic financing, as they are all persistent and relate each other and cannot be separated. So that, from my opinion, it is good for Islamic banks to first analyze the concept of during and after the life time in credit management before the financing is approved.” (Respondent J)

As a conclusion, credit management (during and after the lifetime) gives good impact to the Islamic way of financing for Islamic banks since they are practicing risks-sharing activities in business financing. Therefore, as neglect the issue in default cases and possibility the customers will not fulfil their obligations in time-line of financing tenor, these proposed credit management (during and after the lifetime) can be value add the credit risk management strategies, or, if not, 'security' in financing may be jeopardized.

Findings of Analysis

The analysis from *Shariah* Adviser's perceptions comes into the sense. There are several main themes found. It includes of the current practices in credit evaluation process (five C's and CAMPARI elements), the Islamic elements that can be applied in credit evaluation process as parts of credit risk management, *daruriyyah* and *hajiyyah* in credit evaluation process and lastly, credit management (during and after the lifetime).

All of the respondents answered the research questions as to achieve the goals of research study. Likewise, all of the respondents positively associated credit evaluation process with the proposed of the Islamic elements that can be used in addition to five C's and CAMPARI. Some of these perceptions were linked to the positive values of credit risk management in first dimension (pre-approval) stage for Islamic banks approach.

Furthermore, it was found that the flow of proposed synchronized elements of credit evaluation process in Islamic banks (PACAMP_a) elements as a purpose to make easier for Islamic banks to first evaluate the credit applicant by first looking up for the purpose followed by others elements stated.

This research also found that a positive responses pertaining to the Islamic elements used in credit evaluation process especially for Islamic banks approach, since they are practicing *Shariah*-compliant financing and risks-sharing activities. Besides, this research also found that a positive value from all the respondent's responses viewed that the first two of classified the entire range of *maqasid as-shariah* is important in making financing decisions- the *daruriyyah* (the essential) and the *hajiyyah* (the complementary) plus with credit management in way of Islam (during and after the lifetime).

Development of Parameter

The knowledge that the study contributed is based on the present challenges of Islamic banking approach in Malaysia. Based on the previous theory regarding this topic of study, guarantees and collateral have been mentioned as being there to make up for a credit if a customer is unable to fulfill the payments within the specified time.

However, from the results of the interviewees' responses, one of them believed that Islam provides rules for good credit management. According to him, good credit management is based on the management during the lifetime and after death. During the lifetime, if customers are unable to make payments, he/she should appoint a guarantor. The contracts used are *kafalah*, *rahnu*, *hawalah* and *muqassah* contracts. In addition, after the death of the customer, the bank may collect the financing from wealth heritage, or from their heirs, or from *baitulmal*, or, the financing will be brought to *akhirat*, as he/she must pay with rewards and sins.

Figure 7.1 Parameters of Credit Evaluation Process in the Islamic Banking Approach

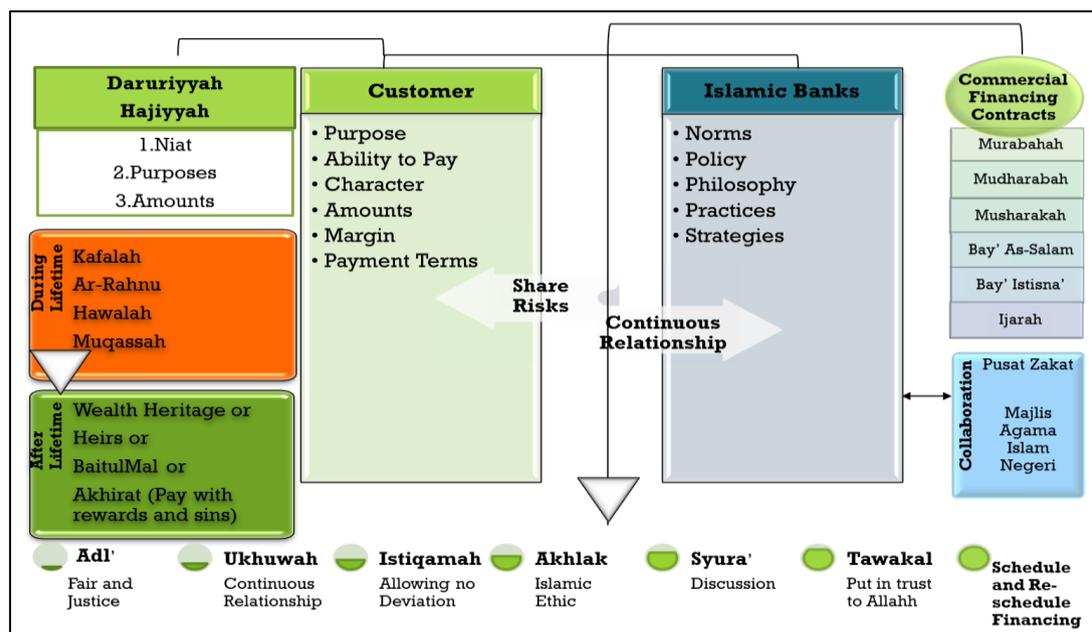


Figure 7.1 above explains that the good parameters of the credit evaluation process in the Islamic banking approach also mitigate the credit risk issues. The proposed parameters have been validated by *Shariah* advisers to endorse the proposed parameters that resulted from the interviews to explore how Islamic principles are used in credit risk management in the credit evaluation process, and, therefore, to implement good parameters for the credit evaluation process in the Islamic banking approach.

To attain good and effective credit risk management in line with Islamic principles, instead of assessing customers using the five C's and CAMPARI elements, it does so while first reviewing and applying the elements of 'adl in making decisions as no asymmetric information, practicing *ukhuwah* with continuous relationship as both of them share risks, *Istiqamah* as acting rightly in performing financing, practicing good deeds or *akhlak* with Islamic ethics in business, make a *syura'* as well as discuss with customers constantly, place trust in Allah s.w.t. as practicing the conception of *taqwa*, and, lastly, schedule and re-schedule for financing if needed to extend the financing until the customer is able to pay. In addition, while evaluating all these elements, it does so while appraising its norms, policies, philosophy, practices and strategies.

For customers to have an effective knowledge for good credit management in line with Islamic principles they should make sure that two (2) main beliefs of credit/financing in Islam – *daruriyyat* (necessity) and *hajiyyat* (wants) – are aligned with the principles. Then, it will also be in line with the three (3) conditions for financing, which embraces *niat* (intention), *ghardu* (purposes) and eligible rate/amount for financing.

Furthermore, Islam also gives guidelines in respect of Islamic credit management with which the individual should be acquainted and applies in their daily routine of business activity. This includes during lifetime and after lifetime. In respect of reducing the credit risk arising during the lifetime, Islam gives rules for the use of *kafalah*, *hawalah*, *ar-rahnu* and *muqassah* contracts. These may also reduce the burden for customers in making payments. If not, Islamic banks may charge *ta'widh* or *gharamah* at 1 percent; the compensation being channeled for *sadaqah* (charity) purposes. Furthermore, in respect of after the lifetime, Islam gives rules for the use of wealth heritage to fulfill the financing, or take it from heirs, or take

from *baitulmal*, or, if not, the financing will be brought to *akhirat* and will be paid from rewards and sins.

However, after the validation process, there are four (4) issues stated which include Islamic elements, five C's and CAMPARI, sources of documents and lastly, software documents. First, how these Islamic elements to be applied in practical? To solve this issue, banks may incorporate these elements in its Product Disclosure Sheet (PDS), the elements has to be explained to the customer at the time of signing the acceptance of the letter of offer and the financing documentation. Second, what is the significant of Islamic elements over five C's and CAMPARI? It is positive or negative consequences? To explain this issue, of course it is positive when Islamic banks and customer practice the Islamic elements. The Islamic elements add value over the five C's and CAMPARI but the terms should be synchronized as mention in findings in this research study. Third, how Islamic banks get sources of documents in making financing decisions by using these Islamic elements stated in parameter? To explain this issue, Islamic banks has to rely on the client for his financial and business information. Additionally, Islamic banks can source client's credit/payment history from Bank Negara Malaysia (BNM) and other reliable sources such as referral from the customer's existing financier(s). For instance, if the customer is found to be a bad paymaster of his/her existing bank (whether conventional or Islamic bank), then his *akhlak* is questionable. In this case, his/her application with Islamic banks may be rejected. Lastly, do Islamic banks need to develop software as aim of implementing this parameter? To solve this issue, for sure, having the necessary software will definitely help the Islamic banks to perform their credit evaluation process effectively. For instance, Islamic banks may have already installed Financing Origination System (FOS) or any similar system to track the status of the clients' business financing application.

To sum up from the above discussions, the study found that any development to strengthen credit risk is always welcome. As already mentioned, the parameter provides the value add mechanism in achieving a thorough financing evaluation process. However, Islamic banks must be mindful that moving forward, the financing or credit officers must have the necessary skills and experience to handle the proposed parameter and they have to be well trained. As a result, it is good to implement this parameter if the clients are ready to embrace this parameter and the bank personnel have the necessary experience and skills.

Conclusions

The study recommends that for the Islamic banking industry to have a developed industry with Islamic elements that are well-practiced, as well as to accomplish greater success, they should continuously ensure an ability to value all the information regarding the customer's business operation, physically and spiritually of customers, with a high level during the financing decisions. The reason of being that the information that they might consider as being not very important might possibly lead to a miscarriage in their financing decision process or the capacity from which customer's default arises.

Bank practitioners should be duty-bound to bear in mind that the two dimensions of credit risk management in the line of the pre- and post-approval stages of financing is not to be acquainting with or stopped at a particular stage of the business banking activity, but should be a continuous process. Therefore, the study believes that this will lead to greater attainment or success since credit risk, which leads to supplementary to the key activity of the banks and cannot be avoided.

In addition, to sustain in the banking industry, bank practitioners should follow the step-by-step process in managing credit risk, policy guidelines and make sure their customers know them well. Both should have a continuous relationship as well as share the risks. The study believes that these may avoid some problems and the issue of confusion in the case of the absence of the predecessor.

The study also believes that for a good relationship with customers, as in the business financing activity, both should be aligned from the beginning in making financing decisions, and throughout the business to make it easier to identify, and, if possible, solve problems in time before they get out of hand. This can diminish the issues beforehand, and automatically lead to good solutions.

In addition, bank practitioners should always bear in mind “*what if*” questions in making financing decisions. This is because they are operating banking business in a very unstable and dynamic environment. To extend this further, as proposed by the responses from the respondents in this study, Islamic banks should be more pro-active in making financing decisions, the implementation of Islamic principles in the pre- and post-approval stages of financing decisions as well as collaborate more with *Pusat Zakat* and *Majlis Agama Islam Negeri* in handling issues arising from high default cases.

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