

ISSUES AND CHALLENGES ON THE PRACTICES OF GOLD CERTIFICATE FINANCING IN ISLAMIC FINANCIAL INSTITUTIONS IN SRI LANKA: SPECIAL REFERENCE TO AMANA BANK PLC

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Abstract

Sri Lanka is a Multi-cultural country which practices Islamic banking and finance in most successive way along with operations of Islamic banks and financial institutions. As a result of rapid growth of Islamic banking and finance industry, the Islamic pawning system has been introduced to provide shari'ah based experience to the community who need micro credit facility. Amana bank PLC introduced Gold certificate financing as an alternative for Conventional pawning and is the first of its kind to be introduced to the nascent Islamic banking and finance industry in Sri Lanka. The objective of the study is to identify Issues based on Legal and General Issues as well as Challenges based on Operational and Promoting Challenges. This study is designed as qualitative research. The sources of data is primary, collected by way of interviews. Research finding indicates Gold certificate financing is the best and successful alternative product to conventional pawning along with some identified issues and challenges which can be mitigated in future of its sustainable development.

Key Words: Islamic pawning, Gold certificate financing, Islamic bank, Islamic finance

Introduction

Pawn broking is basically a loan contract involving the deposit of the pawn item to the pawn broking institution as a pledge by individuals who need quick money and this pawning was introduced by the Chinese traders during the Malacca Sultanate in the 15th century (Hamid, 2014). Further pawning is a system where a customer approaches the particular financial institution to pledge his or her valuable article such as Gold, Silver, Platinum, Wrist Watch etc. In order to obtain money of which the article value and pay back the amount of money along with interest. But now a day the Gold is accepted as a common pawning article because of its purity and accuracy.

The establishment of the Ar-Rahnu scheme in banking institution with an intention to provide Sharia compliance and better alternative of financing method for Muslim community. However, it may not be consumed at a good level of usage due to two reasons. They are; A perception that banking institutions always associate for those who have money and not suitable with a low income group with only a few

gold as pledge assets (Hamid, 2014). Although, there are competition and environmental factors in Islamic pawn broking in banks, the most important challenges are the lack of knowledge about Islamic Pawning. Further, the absence of standard regulation among the Ar-Rahn institutions has affected the operation of Ar-Rahn and creates several issues (Bahari, 2015). Likewise, there are unhealthy opinions available among public on the effective Islamic Pawn broking system in Sri Lanka such as the application and Sharia compliance (structure of sharia board, sharia board members, Monitoring Process, fatwa Issuing, Sharia Product Approval process) and so on.

In Sri Lanka, Amana Bank's Gold Certificate Financing Facility was introduced as an alternative for conventional pawning and is the first to be introduced to the nascent Islamic banking and finance industry. As a successive alternative product, Gold certificate financing of Amana Bank PLC faces Issues and challenges. This study focuses on issues and challenges on the application of Gold certificate financing practicing by Amana Bank PLC: An empirical study based on Ampara District.

Literature Review

Pawn broking is neither a new practice nor does it appeal to just one social class. As humankind's oldest financial institution, pawn loans can be traced back at least 3,000 years to ancient China as well as early Greek and Roman civilizations. During the 14th Century, King Edward III of England is said to have frequented pawn stores in Europe. Queen Isabella is reported to have pawned her royal jewels to finance Christopher Columbus' voyage to the New World (Appannan & Doris, 2011).

Customers are using pawning for their convenience such as household and emergency. Following the financial liberalization in 1980s, banks increasingly introduced charges on several services. Since people without bank accounts would find it extremely difficult, and most likely impossible to obtain bank or finance company loans, the trends may indicate an increase in the percentage of the population forced to turn to pawnshops to meet short-term credit needs. However, the demand pawn broking industry continues until today as one of the sources of capital to the society (Bahari, 2015).

The word Ar-Rahn means a pledge or security for a loan. The Holy Quran refers the idea of a mortgage, as a pledge with possession. Under the *Ar-Rahnu* concept, the borrower (Ar-Rahin) is required to pledge or produce redeemable collateral (Ar-Rahn) in the form of gold or silver to ensure repayment of the loan. This collateral acts as an instrument of guarantee that the loan will be repaid (collateral redeemed) at the maturity of agreement (Bhatt, 2008).

Islamic Financial Institutions have started developing during the last few decades. They have introduced many *Shariah* compliant products in the financial market and *Rahn* is also one of them. Financial institutions are using *rahn* as a guarantee for other products and services, but some of them are offering it as an independent product also. Both movable and immovable property are subject-matter of *rahn*. It

is very important to mention that *rahn* or security is voluntary charitable contract; it is not a profitable business for creditor. All the rules governing *rahn* will be applicable on *rahn* provided by Islamic Financial Institutions (Aisha &Hafiz, 2015).

Islamic Pawning (Ar-Rahn) is based on Sharia and it is 100% free of prohibited elements which is in Conventional pawning and Islamic pawning is interest (*riba*) free, transparent transaction and low cost. Short-term cash borrowing scheme is much preferred by the pawning customers. Besides that the cost of borrowing in this scheme is the lowest compared to the conventional pawn broking scheme (Hisham, 2013).

Certain issues are necessary to be discussed further. For instance, Mukhlas has studied the gold that bought by the customers (pledgor) from the pawnshop they engaged (using murabahah) could provide financial assistance to the customer. However, the issue of the existence of the gold bar as a pledge and the higher price from a normal market price resulted from earlier purchasing of gold (between pawnshop and gold manufacturer) could contribute to the situation of gharar (uncertainty). The profit amount of murabahah determined by the pawnshop could possibly represent the gold price in the future if it is bonded in a long term. The sample of calculation on how the pawnshop gained from the deal is insufficient as the sample shown for a short term basis (Sharif, 2013).

The second issue of Shari'ah perspective is the absence of a clear justification of the *ujrah* fee rate charged by the bank and pawnshop. Is the rate of *ujrah* fee really based on the storage box or the other justifications such as weight of the pledge and the risk of losses are about to concern? If those justifications are included in determining the rate, then what kind of measuring standard are to be followed? Those questions are crucial to be reviewed and discoursed (Shariff, 2013). The absence of standardize regulation among the Ar Rahn institutions has affected the operation of Ar Rahn and created several issues that are highly discussed among the scholars and community on the current practice of Ar Rahn (Bahari, 2015).

The demand for Ar-Rahn services increase continuously. The industry has tremendously contributed to the Muslim economy because it plays an important role as a means of community service that fullfils the desperate needs of low income families. It also acts as a source of capital to small businesses that provides quick and easy source of financing as compared to loans from commercial banks (Bahari, 2015).

Sharia Pawning (*Rahn*) is one of the products of Islamic banks which have grown rapidly in the Islamic banking industry today. Sharia Pawning has become a superior product to sustain the development of Islamic banking. The abundant prospects and potential that exist in the Sharia Pawning product has made a number of Islamic banks place it as a superior product for the future (Report of Indonesian Banking development Institute, 2012).

Data Source and Methodology

Data Source

As per the research methodology, the overall data collection were conducted through Interview (Semi Structured) to obtain appropriate and sufficient data to attain research objective and the researcher conducted the interview in most successful way with satisfied comfort zone of Amana Bank PLC, Ampara district accompanied by official appointment obtained from officers of Amana Bank PLC. The researcher carried 4 different interviews on various days which were suit to the time schedule of the bank.

Table 3.1

Summary of Research Design

Type of the Research	Qualitative
Research Methodology	Survey
Population	20
Sample	20
Sampling Technique	Non-Probability Sampling
Unit of Analysis	Individual
Types of Data	Primary Data
Data Collection Techniques	Interview (Semi Structured)

Source: Author Compiled

Data Analysis

In this study to investigate the issues and challenges on practicing gold certificate financing; an Exploratory Data Analysis was conducted. The recorded and collected data have been categorized based on the structured questions and Spot questions and the researcher used thematic analysis (Braun & Clarke, 2013) to Interpret data for the accurate results so for the easy reference the researcher has designed codes to explain easily. According to this requirement the coding was designed based on the following method.

Table 3.2

Codes for Branches

Details of Branch	Code
Amana Bank PLC- Nintavur	NB
Amana Bank PLC-Akkaraipattu	AB
Amana Bank PLC-Kalmunai	KB
Amana Bank PLC-Sammanthurai	SB
Amana Bank PLC-Head Office	HO

Source: Author Compiled

The above coding system was an useful mechanism to present and interpret collective data in a simple manner. Now let us present the data according to the questions with their answers categorized under sub topics.

Ensuring Quality of Data

According to Ambert et al. (1995) qualitative research generally requires a great deal of time expenditure (Vaivio, 2008) on the part of the researcher but the significant amount of time spent in the field should not be considered as a waste of time as it ensures the validity of data (Vaivio, 2008). Accordingly, 12-14 hours were allocated for conducting interviews and 2-3 hours were allocated for gathering data through documentary analysis. This prolong time spent in the field helped to ensure quality of the research as it facilitated collecting rich data from the field.

Further, confidentiality of the interviewees was ensured while assurance was given not to divulge their names (Irvine &Gaffikin, 2006; Qu&Dumay, 2011). Through this, it was expected that the interviewees will express their ideas freely while giving rich in-depth ideas about the particular phenomena. In addition, all the interviews were tape recorded and detailed notes were taken down during the interviews along with the interviewees' expressions, feelings and reactions together with Researcher's personal reflections of the research context. Further, as illustrated in section 3.1s the data collection methods were spelt out in detail mentioning the people interviewed, why and how they were selected for interviewing, how much time was spent on interviewing, so the readers of the research could have a clear understanding on the process of data collection while facilitating the traceability of data. Accordingly, it is believed that this process facilitated data triangulation (Lillis, 1999) while ensuring quality of the research.

Findings and Discussion of Results

Findings and Discussion

Islamic Pawning (Ar-Rahn) is based on Sharia and it is 100% free of prohibited elements which is in Conventional pawning and Islamic pawning is interest (*riba*) free, transparent transaction and low cost. Short-term cash borrowing scheme is much preferred by the pawning customers. Besides that the cost of borrowing in this scheme is the lowest compared to the conventional pawn broking scheme (Hisham, 2013).

According to Islamic law, the Islamic pawn broking system is considered as permissible, similar to a buying and selling transaction, as an item which is judged as 'permitted to be sold' can also be judged as 'permitted to be pawned' except for a few particular items (Asmadi, 2004).

The researchers explore about the Issues and Challenges on the application of Gold certificate financing such as Legal and General Issues, Operational and Promoting Challenges. These are the identified issues;

Legal: Function under same pawn broking license approved by central bank of Sri Lanka and Issue in Identification of pure gold

General: Customer's misconception, Delay Process in Hifala & Musa'da and Low amount of advance to customers

And the challenges are;

Operational: High Documental Working Process, Poor Quality of Infrastructure and High Internal cost & Employee remuneration

Promoting: Competition with Conventional pawning, Lack of Advertisement

The Issues on the Application of Gold Certificate Financing.

According to the analyzation, Issues on the application of Gold certificate financing are categorized as Legal, Shari'ah and General Issues.

1. Legal Issues

1.1 Function under same pawnbrokers' ordinance law approved by central bank of Sri Lanka

In Sri Lanka Gold certificate financing which is a newly introduced instrument, is adopted under the conventional gold pawn broking license. The Central Bank of Sri Lanka as a sole regulator of the country not consist any separate legislation for this yet. So, unfortunately the available legislation does not accomplish the need and want of the industry. It may affect the Shari'ah compliance of the product.

1.2 Issue in Identification of pure gold

Third Legal Issue is Identifying the accurate gold article without obtaining fake jewelries. For this issue Hifala officer uses different gold identifying tests such as density meter test and acid test. With the aid of these tests, this kind of issues can be mitigated in some exceptional cases with the identification of

this test, but unfortunately these test are not applicable for some kind of jewelries. In such situations bank faces difficulties in decision making.

2. General Issues

2.1 Customer's misconception

It is easy for one to conclude that Islamic Gold Certificate Finance and conventional pawning system displays no obvious difference when compared at a very superficial level. There are some similarities in terms of economic objectives as well as product types being offered by both Islamic and conventional banks. On top of that, both are similarly priced in order for Islamic banks to remain competitive.

However, when one looks deeper into the mechanism and contracts being used in Islamic financing products, then the differences becomes much clearer. Where interest-bearing agreements are prohibited, Islamic finances utilizes an array of Dual contracts such as Hifala and Musa'da contracts. These enables consumers to undertake financing in a manner where there is risk-sharing and interest or riba is avoided.

2.2 Delay Process in Hifala & Musa'da

Waiting can be time-consuming, annoying, and incredibly frustrating. Waiting is a complex phenomenon to which a consumer often reacts in an emotional way. Waiting is often psychologically painful, there are both extrinsic disadvantages of waiting (e.g., profitable alternatives foregone) and intrinsic costs (Schwartz, 1975).

In case of Islamic Gold Certificate Finance, the bank practices Dual contracts such as Hifala and Musa'da. So it gets a long time period to accomplish the documentation. Consequently, it will create a negative impact on customer perception of service quality.

2.3 Low amount of advance to customers

The cost of borrowing from the bank was the main thing that customers were least satisfied with. And cost was regarded as one of the main disadvantages of using the bank. Even so, when asked their views about the costs of borrowing from the bank, on the whole customers regarded that, the main purpose of engage in Gold certificate financing is to obtain liquid cash. In this situation the cost of borrowing offered by Islamic Bank is very lower than competitors.

The Challenges on the Application of Gold Certificate Financing.

1. Operational Challenges

1.1 High Documental Working Process

Documentation is generally viewed in a secondary or support role to the sale and function of primary products. This study discusses regarding the impact of documentation on customers' perception of

product quality. The results showed that the level of satisfaction with documentation plays a critical role in explaining customer satisfaction with primary product quality. Consequently, before organizations make decisions regarding cuts in documentation, they should carefully evaluate documentation's effects on company performance.

1.2 High Internal cost & Employee remuneration

The bank faces major business challenges depending on high internal cost & employee remuneration. The cost and employee remuneration often constitute the largest line in a corporation's budget. The cost of labor is broader than the amount paid to employees, taking into account recruitment, training, turnover, infrastructure and overhead, and it will badly impact on corporation's budget.

1.3 Poor Quality of Infrastructure

Limited access to quality infrastructure is a key constraint to the growth of the corporate success. Infrastructure and its related services are critical to the operation and efficiency of a modern economy. In addition, quality of infrastructure significantly affect the productivity, cost, and competitiveness of any economy. Indeed, the adequacy of infrastructure helps to determine one corporate's success and failure. The poor quality of infrastructure of Amana Bank (PLC) negatively impact on product growth and development.

2. Promoting Challenges

2.1 Competition with Conventional pawning

The major competitors of Islamic Gold Certificate Finance are Conventional banks and pawning canters who have more experience in this field. Also the product cost of Islamic Bank is higher than others, this is even more critical and requires bank to focus messaging around the expertise of their people, the breadth of its service, speed to market, innovation, supply chain efficiency and more – the things that simplify customers' lives and mitigate risks associated with poor quality and sluggish timelines.

2.2 Lack of Advertisement

Lack of advertisement is one of the challenges faces by Amana Bank in case of Islamic Gold Certificate Finance. Modify the advertising strategies can be maximize the sale. But the important thing is the advertisement should be under the Shari'ah guidance.

Conclusion

The researcher has been done this study in order to examine Issues and challenges of Gold certificate financing practicing by Amana Bank PLC, especially within Ampara district with the intension to move forward Muslim society in to the sharia based pawning practice where necessity. The major objective of this research is to investigate the Issues and Challenges of practicing Gold certificate financing product of Amana Bank PLC. This study is a platform to investigate Issues and challenges of this product facing by bank which practicing since 2014 up to now and the results of the study suggest that

Gold certificate financing is a prominent product to Muslim society in order to avoid conventional pawning practices which contradict with sharia rules. The result of this study suggest that, there are some issues and challenges of practicing Islamic Gold Certificate Financing in Amana Bank PLC in Sri Lanka and it impact on growing of the corporation. The issues are such as Function under same pawn broking license approved by central bank of Sri Lanka and Issue in Identification of pure gold, Customer's misconception, Delay Process in Hifala & Musa'da and Low amount of advance to customers and the challenges are such as; High Documental Working Process, Poor Quality of Infrastructure, High Internal cost & Employee remuneration, Competition with Conventional pawning and Lack of Advertisement. And this study especially helps Amana bank PLC to overcome from identified issues and challenges in future aspect. Further, this study will be a complete documentation to the general public to get clear idea and knowledge about this product those who willing to involve in future.

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