

## **ADVENT OF ISLAMIC BANKS AND THE EMERGING BANKING LANDSCAPE IN SULTANATE OF OMAN**

**VIBHA BHANDARI**

Assistant Professor, Department of International Business Administration,  
College of Applied Sciences, Nizwa, Oman

### **ABSTRACT**

Islamic banking can be defined as a banking system which is in consonance with the spirit, ethos and value system of Islam and its operations are governed by the rules and principles laid down by Shari'a which means 'the way to the source of life'. Islamic banks do business just like their counterparts on the conventional side, with the difference that all their operations and businesses are conducted in accordance with the rules and principles prescribed by the Shari'a and the code of behavior called for, by the Holy Quran.

Islamic banking has been gaining tremendous popularity over the years, and not just in the Middle East and South East Asia, but even in the UK. Nearly non-existent 30 years ago, the global Islamic finance industry had assets forecast to cross \$1.8 trillion in 2013, up from \$1.3 trillion in 2011, according to Ernst & Young's World Islamic Banking Competitiveness Report 2013.

Though a late entrant in the field of Islamic banking, the Sultanate's banking sector is poised to grow. Since, the announcement to open the Islamic Banks in 2011, the banking sphere in Oman has witnessed positive activity with the launch of separate full-fledged Islamic banks as well as new Islamic outlets of the conventional - reputed banks.

Today, with the advent of Islamic Banks, the banking landscape of Oman is changing. The operation of Islamic banks along with the conventional commercial banks and specialized financial institutions is set to provide better services which are religiously appropriate to the customers and boost financial inclusion in the country.

The paper shall briefly describe the banking landscape emerging with the advent of Islamic banks along with the conventional commercial banks.

**KEYWORDS:** Banking Landscape, Commercial Banks, Islamic Banks, Sultanate of Oman

### **INTRODUCTION**

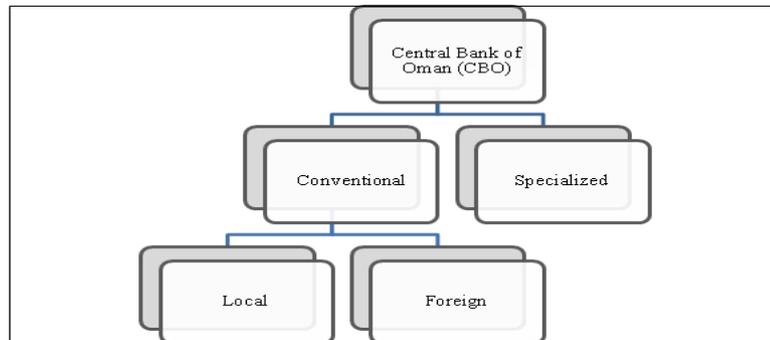
The banking sector in Sultanate of Oman has emerged as one of the strongest sectors in the economy, catering to the credit and banking services needs of the economy. The banking structure has played a very important role in promoting the economic development and diversification of the economy.

The banking landscape of the Sultanate today is made up of various commercial banks, specialized banks and Islamic banks with Central bank of Oman at the apex position. The Islamic banks are the latest addition to this landscape-the authorization coming in 2011 to be precise.

Established in December 1974, the CBO started exercising its full powers from 1.April.1975. The bank started with an initial capital base of Omani Rial (OR) 1million and reached to OR 500 million in 2010.The increasing funds of the CBO has enabled it to carry out its functions and cope up with the developments in the local and international monetary and financial fields (CBO, 2014).

The Central bank of Oman (CBO) works as central bank of the Sultanate of Oman, which is responsible for issuing, supervising circulation and maintaining the internal and external value of the Oman currency-the Omani Rial (OR). It acts as a single integrated financial regulator for Oman’s financial services industry comprising of Oman’s commercial banks, specialized banks, finance companies, leasing companies and money exchange houses. It also acts as depository agency for the government of Oman and also acts as the advisor of the Government in economic matters in general and monetary and financial matters in particular (CBO, 2014).

Islamic banking was incorporated into Oman’s banking system in 2011.Prior to that the banking landscape of Oman was dominated by conventional commercial banks both local and international and specialized financial banks. This is as shown in Figure 1.



**Figure 1: The Banking Landscape in Oman: Pre Advent of Islamic Banks**

There were 17conventional commercial banks at the end of 2011, of which 7 were locally incorporated and 10 were branches of foreign banks. These banks operated through 461 local branches, 11 foreign branches and 2 representative offices abroad. Of the 7 domestic banks, 6 were listed on the Muscat Securities Market (MSM). All commercial banks are privately owned, with the Government having minority stakes in a few (CBO, 2011). The details of conventional commercial banks are as shown in Table 1.

**Table 1: Conventional Commercial Banks in Oman as on 31.December.2011**

Locally Incorporated Commercial Banks	Foreign Banks
Bank Muscat	HSBC Bank Middle East
National Bank of Oman	Standard Chartered Bank
Oman International Bank	Habib Bank
Oman Arab Bank	Bank Melli Iran
Bank Dhofar	Bank Saderat Iran
Bank Sohar	Bank of Baroda
Al Ahli Bank	State Bank of India
	National Bank of Abu Dhabi
	Bank of Beirut
	Qatar National Bank

Source: CBO Annual Report 2011

Besides these conventional banks, there were 2 governments owned specialized banks namely-Oman Housing Bank and Oman Development Bank operating with a network of 22 branches. 6 finance and leasing companies (FLCs) licensed by the Central Bank were engaged in leasing, hire purchase, debt factoring and similar asset based financing. They operated with 34 branches, all based in Oman (CBO, 2011).

In the year 2011, following the royal directives, Islamic Banking services were authorized in Oman and were made available from 2012 onwards.

### Islamic Banking

Islamic banking has been gaining tremendous popularity over the years, and not just in the Middle East and South East Asia, but even in the western countries. Nearly non-existent 30 years ago, the global Islamic finance industry had assets forecast to cross \$1.8 trillion in 2013, up from \$1.3 trillion in 2011 (Ernst & Young, December 2012).

Islamic banking can be defined as a banking system which is in consonance with the spirit, ethos and value system of Islam (GIIBC, 2014) and its operations are governed by the rules and principles laid down by Shari'a which means 'the way to the source of life'. Islamic banks do business just like their counterparts on the conventional side, with the difference that all their operations and businesses are conducted in accordance with the rules and principles prescribed by the Shari'a and the code of behavior called for, by the Holy Quran which calls for absolute prohibition on the payment and receipt of interest (Mirakhor & Khan, 1990). While, conventional banking is essentially based on the debtor-creditor relationship between the depositors and the bank on one hand, and between the borrowers and the bank on the other. The Islamic banks are based on the unique concept of profit and loss sharing with the customers by way of various Shari'a compliant financing and investment tools (The National Bank of Ras Al Khaimah, 2014).

The governing principles of an Islamic bank are majorly based on the following:

- The absence of interest-based (*riba*) transactions;
- The avoidance of economic activities involving oppression (*zulm*);
- The avoidance of economic activities involving speculation (*gharar*);
- The introduction of an Islamic tax (*zakat*);
- The discouragement of the production of goods and services which contradict the Islamic value (*haram*) (Mohammed & Manjula, 2012).

The growth of Islamic banking can be traced to early 60's in Egypt, where micro lending institutions started working on Islamic principles. The proper functioning of Islamic banks started in 1975, when Kingdom of Saudi Arabia, established Islamic Development bank in Jeddah. The rising oil prices and religious faith in Islam together, have contributed significantly to the growth of Islamic banks (Imam & Kpodar, 2010). Today Islamic banking-financial activity has become a material part of the global financial services industry. The major geographic markets are Iran, Kingdom of Saudi Arabia, United Arab Emirates, Malaysia, Kuwait, Bahrain, Qatar and Turkey which are based on Islam faith (Cyril, Cyril, Alexander, & Bhatnagar, 2012). Islamic Banks are not limited to countries of Islam faith, they have spread across to some western countries—notably among them are United Kingdom, Germany, France and United States of America (Kern, 2011).

The Islamic Banking system has three main types of players, viz:

- **Full-Fledged Islamic Banks:** These banks are either fully independent entities or subsidiaries of conventional banks, holding banking licenses.
- **Islamic Windows of Conventional Banks:** These are secluded Islamic banking departments within the conventional banks.
- **Islamic Finance Companies:** These companies focus on supplying Shari'a-compliant financing products such as auto and home finance, and are not allowed to take interests (Cyril, Cyril, Alexander, & Bhatnagar, 2012).

The first two players are active in Oman's banking landscape today.

### Islamic Banking in Oman

Historically, the growth in Islamic banking has been driven by the needs of retail banking customers seeking to borrow and invest in accordance with their personal religious beliefs. This holds true today as well. Besides individuals, increasingly corporations too want to conduct all financial transactions in accordance with Shari'a. There is evidence of pressure from the public and shareholders in the Middle East and Southeast Asia on corporations and sovereigns to apply Shari'a-compliant solutions (Peter, Philipp, Peter T., & Haimari, 2008). The Sultanate of Oman being a Middle-eastern Islamic country, having a predominantly young population which is sophisticated about financial services offered, commenced Islamic banking 2012 onwards.

Pursuant to the Royal Decree No.69/2012, a new addition to Oman's banking landscape commenced, when CBO put in place the necessary legislations (Curtis, 2013). Since then, the banking sphere in Oman has witnessed positive activity with the launch of separate full-fledged Islamic banks as well as new Islamic windows of the conventional banks.

Bank Nizwa and AlIzz Islamic Bank are operating as full-fledged Islamic banks-Bank Nizwa being the trailblazer in this arena started in 2012, while AlIzz formally launched its operations in September 2013. All the other conventional banks(except one) have opened their Islamic windows, while taking the form of separate brands, albeit still under the control of their conventional parent companies(Oxford Business Group, 2013).

A brief of Islamic windows of conventional banks, operating at present in Oman is presented in Table 2.

**Table 2: Islamic Windows of Conventional Banks in Oman**

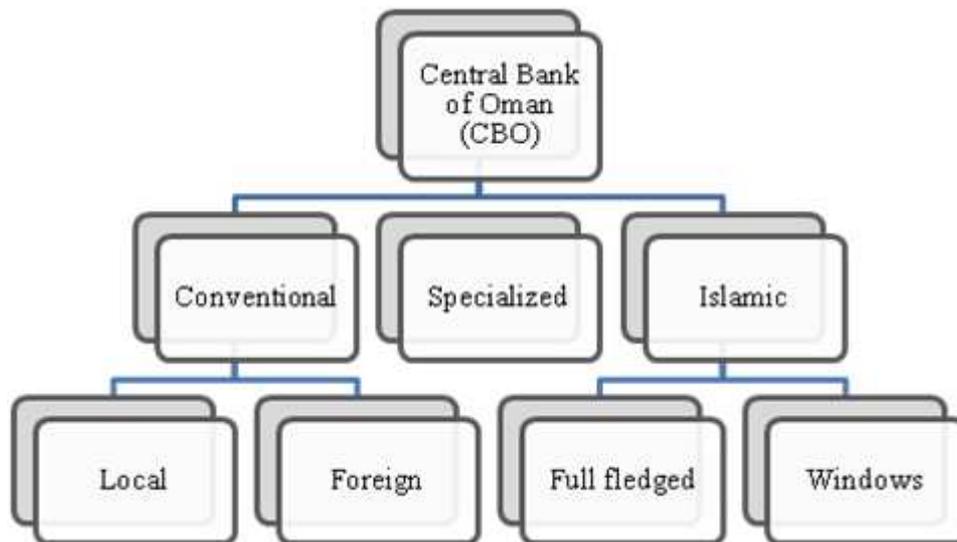
Conventional Banks	Islamic Windows
Bank Muscat	Meethaq
National Bank of Oman	Muzn Islamic
Oman Arab Bank	Al Yusr
Bank Dhofar	Maisarah
Bank Sohar	Sohar Islamic
Al Ahli Bank	Al Hilal

**Source:** Websites of various conventional banks

### The Way Forward

The year 2012 was marked some changes in banking landscape of Sultanate –important among them were the advent of Islamic banking and the merger of Oman International Bank with HSBC Bank Middle East Oman's branches to form HSBC Bank Oman (CBO, 2014).

The advent of Islamic banking in Oman has changed the banking landscape in Oman today, as shown by Figure 2.



**Figure 2: The Banking Landscape in Oman: Post Advent of Islamic Banks**

At present, there are 7 local and 9 foreign conventional commercial banks, 2 specialized banks, 2 full -fledged Islamic banks and 6 Islamic windows of conventional banks, besides the other components, which dominate the banking landscape in Oman.

The advent of Islamic banks will meet the growing social and economic needs of the country. These banks are expected to bring the hitherto uncovered segments into the banking fold and give the existing customers a choice between conventional and Islamic banks. Islamic banking is expected to inject more liquidity in the local markets as individuals seeking Shari'a compliant investment options would no longer have to look abroad(Oxford Business Group, 2013), as they will get the opportunities at home itself. The Islamic banks shall promote financial inclusion and promote industrial and economic development and diversification.

The Islamic banks have considerably changed the banking landscape in Oman and are expected to expand the current market, bring in new customers and enhance competition within and between Islamic banks and conventional banks. As such the way forward for the Omani banking arena seems to have more options for both the individuals and corporate and is expected to bring the benefits of banking to all the sectors.

## REFERENCES

1. CBO. (2011). Annual Report. Muscat: Central Bank of Oman.
2. CBO. (2014). Function of CBO: CBO. Retrieved March 5, 2014, from Central Bank of Oman: <http://www.cbo-oman.org/>
3. CBO. (2014). Mid-Year review of the Omani economy. Muscat: Central Bank of Oman.
4. CBO. (2014, February). News: CBO. Retrieved March 12, 2014, from Central Bank of Oman: <http://www.cbo-oman.org/>
5. Curtis. (2013, January 14). Islamic Banking Law Decree in the Sultanate of Oman. Retrieved March 15, 2014, from Oman law blog: <http://omanlawblog.curtis.com/2013/01/islamic-banking-law-decree-in-sultanate.htm>

6. Cyril, G., Cyril, G., Alexander, V. P., & Bhatnagar, M. (2012). *The future of Islamic banking*. Dubai: AT Kearney.
7. Ernst & Young. (December 2012). *World Islamic Banking Competitiveness Report 2012-2013: Growing beyond-DNA of successful transformation*. Dubai: Ernst & Young.
8. GIIBC. (2014). *Islamic Banking: GIIBC*. Retrieved March 5, 2014, from Global Institute of Islamic Banking, Insurance and Consultancy: <http://giibic.com/test-your-knowledge/islamic-banking/>
9. Imam, P. A., & Kpodar, K. (2010). *Islamic Banking: How has it diffused?* Washington: International Monetary Fund.
10. Kern, S. (2011, May 19). *Islamic "Shariah-Compliant" Banking Takes Root in Europe*. Retrieved March 2014, 2014, from Gatestone Institute: International Policy Council: <http://www.gatestoneinstitute.org/2130/islamic-shariah-compliant-banking-europe>
11. Mirakhor, A., & Khan, M. S. (1990, January). *Islamic Banking: Experiences in the Islamic Republic of Iran and in Pakistan*. *Economic Development and Cultural Change*, pp. 353-375.
12. Mohammed, A. A., & Manjula, V. (2012). *Islamic Banking is not a subject it is a means*. International Conference on Challenges and Opportunities in Mechanical Engineering, Industrial Engineering and Management Studies 2012 (pp. 1008-1009). Bangalore, India: Bonfiring Intellectual Integrity.
13. Oxford Business Group. (2013, June 28). *Economic updates: Oman: New development in Islamic financial services*. Retrieved March 15, 2014, from Oxford Business Group: [http://www.oxfordbusinessgroup.com/economic\\_updates/oman-new-developments-islamic-financial-services](http://www.oxfordbusinessgroup.com/economic_updates/oman-new-developments-islamic-financial-services)
14. Oxford Business Group. (2013). *The Report: Oman 2013*. London: Oxford Business Group.
15. Peter, V., Philipp, W., Peter T., G., & Haimari, G. (2008). *Competing successfully in Islamic banking*. USA: booz&co.
16. The National Bank of Ras Al Khaimah. (2014). *About Us:Islamic-Banking*. Retrieved March 5, 2014, from The National Bank of Ras Al Khaimah: <http://rakbankdirect.ae/wps/portal/amal/quicklinks/aboutus/islamic-banking>