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THE LIQUIDITY SHORTAGE IN ISLAMIC BANKS: AN EXPLORATORY STUDY OF SAUDI ISLAMIC BANKS

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ABSTRACT:

This study focused on the reasons for the liquidity problems and clarified its impacts on the Islamic banks and its performances. Regarding the study method, this study is known as a phenomenology and pure qualitative study that seeks in a recent phenomenon. The semi-structure interview was used which common in qualitative measurement with many scholars in the Islamic financial system and the experts in the same context in order to go deeper into the problems and see their roots. These interviews designed to meet the research objectives and to answer all the research questions. This study concluded that Islamic banks in Saudi Arabia have to improve their performances and instruments in many ways in order to serve the clients and the economy in a better way. In addition, the study showed that the Sukuk market in the Kingdom of Saudi Arabia was very weak and need for more improvement. Another finding may be clear in the experience that done in Sudan which may help all Islamic banks to cooperate together and come up with a strategy that is applicable to the sharia rule and in the same way it can help the liquidity enhancement among these banks.

INTRODUCTION:

Islamic finance recently becomes one of the important phenomena which spread rapidly not only in the Islamic nations but all over the world. It has been a focus of attention of the financial institutions and banks sector in the European countries because of the superiority of its performance. The successful experience of the Islamic banking shows different impacts which

appears in all transactions, performance, and its evaluation of the other banks and several investment projects. Islamic financial system is based on commerce law known as *fiqh al-mu'amalat* which considered issues of social justice, equity and fairness in all business transactions and promotes the entrepreneurship, protect property right and emphasizes transparency of contractual obligations [1]. There are prohibitions such as interest, *gharar*, gambling and speculative investment in Islamic law [2]. Islamic bank is defined as any company that used Islamic banking business and have valid licence [3]. Islamic finance and Islamic financial institutions is based on Shari'a law [4]. The global Islamic finance industry has been reported 16% of annual growth rate from 2010 to 2014 which its assets in 2014 are approximately USD 1.87 trillion [5]. There are more than 300 Islamic financial institutions in more than 75 countries in the global [6]. Liquidity is a bank capacity to fund increase in assets and met both expected and unexpected cash and collateral obligations [7]. Banks over the global are confronting issues with the liquidity crisis as a result of tight liquidity administration. As each deal or obligation in any bank has a lot of impacts for the liquidity, controlling liquidity risks are of central significance [8]. Banks and regulatory agencies are constantly focusing on monitoring liquidity positions to manage risks of failure and total collapse in the financial sector. The profit-sharing tradition in Islamic banks makes these financial instructions more stable, but liquidity risks continue to create financial distress to the point that they risk closure. Saudi Arabia has put several measures in places such as stringent monetary policy and best practices in liquidity management to manage liquidity and counter associated problems that may pose risks or total collapse of its banks [9]. Similarly, a global perspective of liquidity management is ideal for institutions that provide Islamic banking services. This strategy helps in counter the challenges that hinder effective liquidity management. Efforts to come up with a globally acceptable liquidity management tool that captures global standardization have been futile leading to uncertainties in the financial sector including that in Saudi Arabia. A global liquidity management tool would enhance transparency and confidence in Islamic finance that currently experience challenges, especially in terms of Shariah compliance to liquidity management [10]. There are other challenges such as gaps due to inadequate short-term fiscal instruments, infrastructure and liquidity market, documentation standards, regulatory and legal frameworks, integrated settlement and payment system, a system for liquidity monitoring, and accounting and tax uniformity. It is crucial for Saudi Arabia to develop a globally acceptable process to maintain an effective liquidity management tool or framework because liquidity management is crucial in the banking sector. Saudi Arabia can strengthen its monetary policies and adopt best financial practices to manage liquidity challenges in its banks. Similarly, the Saudi government can create awareness, promote sufficient cross-border liquidity, and embrace international monetary standards to enhance its liquidity management in the banking sector. This study focused on the reasons for the liquidity problems and clarified its impacts on the Islamic banks and its performances.

METHODOLOGY

This study used the qualitative method and included selecting a sample population that would represent a known population. This study strategy has built on the basis of the study questions which examined the possibility of having the good strategy for the Islamic banks to protect against the liquidity shortage since covering this problem in the Islamic banks have fewer opportunities comparable to the conventional banks. The procedure of collecting the data was through searching for the target population and contact the participant in different ways to get an appointment for a meeting. The interview questions were prepared with small review and sent the review to the participants to obtain general idea on this study topic. The qualitative research method was used to describe an occasion, action or phenomenon also known as phenomenological study. This study was an exploratory which in a form of research that made for the problems which had not been clearly identified. Exploratory research helped in determine the best design for the search, and the method of data collection and identification the subjects. This study had a specific population which consists of the sharia scholar or the experts on the Islamic banking who deal with the sharia board because this study was focused on the banks who applicable the sharia law in all transactions.

Table 1. represented participants profiles

Participant	Description
A	The head of the Sharia department in one of the famous conventional banks in Saudi Arabia. Member of the Commission of Sharia standards. Experience: more than thirty years in the field of Sharia consulting.
B	Islamic banking advisory institution. General consultant for an Islamic bank magazine and other newspapers regarding Islamic banking sector. Experience: more than twenty years in the sharia field.
C	Sharia consultant "in the advisory service department" in one of the Islamic research institute which is related to one of the Islamic banks
D	The Vice Chairman of an asset management company. Experts in the field of Islamic banks. Experience: more than ten years in the sharia field.
E	Investment officer in the treasury department of a famous Islamic bank.
F	Sharia consultant "in the advisory service department" in one of the Islamic research institute which is related to one of the Islamic banks.
G	Manager of the Islamic economic and finance research division of an Islamic bank. Experience: more than twenty years in the sharia field.

H	A financial analyst in Islamic banks.
I	Head of the financial product development center. The writer of many books in Islamic finance field. Experience: than twenty years of experience in the Islamic banking field.
J	Lead operational risk specialist in one of the Islamic bank. Experience: more than fifteen years of experience in managing risks in banks
K	Foresight strategist in an Islamic bank.

The interview used as a method to collect the data because interviews can be used to acquire first hand information on personal views, motivations, and experiences of participants. The interviews included the face-to-face meetings with the interviewee. These interviews lasted for about 30 minutes for each respondent and this enables me to collect and take more notes and to explain some of the ambiguous questions to the interviewee and ask further questions.

RESULT AND DISCUSSION

Study interview

The reason of poor liquidity in Saudi banks in general was decrease in the oil prices is the main reason. Most of the interviewees (8 respondents out of 11 respondents) mentioned that main reasons behind liquidity problems were similar. In addition, lower oil prices generally led to a decline in the government spending in the Saudi Arabia because of reducing the revenue due to the oil prices and the Saudi economic based on the government spending which associated mainly to the oil prices. If the oil prices were good then the government spending will be stable but if the prices dropped which affected in a negative way on the projects in the state and thus this will affect the level of liquidity in the country which lead to the liquidity shortage in the banking sector. There were 6 respondents agreed on the political situation as a reason which makes the expenditure larger than the revenue. Actually, the banks in Saudi Arabia depended on the deposits for the liquidity issues but in this case (because of the reducing of the oil prices) the government withdrew their deposits and sometimes borrow or lend money from banks to cover their needs which led to the sudden lack of liquidity in banks. This was not only solution that took from the country but issue some bonds and Sukuk which also financed by the banks and it affects badly on the level of the bank's liquidity. One of the legitimate administration managers in one of the Saudi banks. Meanwhile, 4 respondents believed that the liquidity problem Islamic banks in general always happens either in Saudi Arabia or abroad in two ways such as the management of the excess liquidity and the shortages in liquidity. This liquidity problem raised by the Islamic banks because other banks (conventional or commercial) have many tools' markets such as lending and borrowing even only overnight lending while Islamic banks have a lack in these mechanisms. The relationship was 100%, an inverse relationship between interest rates and liquidity in the banks which high interest rate leads

to limit the lending rate. The impact affected directly on the other banks due to the fact that all banks borrowed from each other. Thus, if customers felt that this problem will occur, there will be run and withdraw their deposits because they will be afraid of and don't have confidence in the ability of banks to give them if they asked for their money. In fact, the impact was evident and clear when the lending rate become higher. The banks actually were not keen on the establishment of the liabilities products. It called the side to attract the money because of the full accreditation was on deposits and the current accounts. It considered as free money to the bank which becomes lower due to the decline in income of individuals. After that, banks start issuing Mudaraba certificates to attract customers and to deposit their money into banks and feed their liquidity. The effect of the poor liquidity in the Islamic banks might be equal with conventional banks. The conventional banks had covered the shortfall in liquidity more quickly because of the availability of appropriate liquidity products such as interbank lending or using the overnight lending. Meanwhile, the Islamic banks did not have enough products to help in covers the deficit in liquidity. Thus, the impact on the budget of Islamic banks is bigger than conventional banks. On the other hand, the legitimate administration director in one of the large Islamic banks in Saudi Arabia said that Islamic banks may be less effective due to the lower cost of money because most of the deposits in the Islamic banks are short-term (current accounts) and this means that customers will not take interest and the banks will not pay benefits. Currently, Twarroq operations in Islamic banks became more used and led to speed coverage of liquidity problems and based on that the effect will be equal in all types of banks. Recently that on Sunday 25 of September 2016, SAMA supports the banking sector by paying SR20 billion (\$5.33 billion) to cover the poor liquidity and keep the stability in the financial market. There were 10 respondents agreed the reason behind this announcement was only to reassure the customers and even banks' administration especially the treasury departments and gave a good signal which illustrated that the market is stable and it's no need to worry about their deposits. However, other respondents said that the reason was first time for the Kingdom of Saudi Arabia to face this level of weakness in its economy. Meanwhile, 4 respondents mentioned this amount was insufficient and paid to reassure clients and to stop raising the interest rate, 6 respondents believed that this amount was sufficient. Besides, 2 respondents believed the amount was very low compared with the current situation in the country and declare that SAMA will have to pump other amounts to cover the liquidity shortage. All respondents agreed that main duty of SAMA to support the banks in the event of fall or default and they call it the final solution for banks because the fall of banks will lead to the collapse of the whole economy in the country in general. The respondents also mentioned that the SAMA can issue bonds or Sukuk in the event of a decrease its liquidity. Meanwhile, 4 respondents said that the improper application will lead to many problems. For example, banks that rely on two types of contracts which are Mudaraba and Musharaka. The banks faced the risks in these two contracts which was very high compared to other contracts and if the banks did not get the specific target and threat the liquidity of the bank. So, banks tried to use the Murabaha contracts rather than speculative and Musharaka

because of the risk ratio of the lower here. The head, financial product development centre in an Islamic bank in Saudi Arabia said that the real situation was there were not a significant difference in the transactions among conventional and Islamic banks. The Islamic finance supposed to prevent debt to be doubled while the situation now in Islamic banks is very different. Islamic banks must apply "Wadh Aljawaneh"⁴ which was an Islamic law or called the theory of emergency conditions when faced with difficulties such as cutting off part of the employees' salaries or Pandemic to protect the clients. In the case of Saudi Arabia, SAMA was the responsible in case of liquidity shortage in Islamic banks. This organization will help the banks if they faced any shortfall by putting injections of money till making them stable enough. This study assumed that the Islamic financial system had perfect ways and meant to solve the liquidity problem with these banks. Islamic banking provided protection for banks against poor liquidity such as hire the good management of liquidity in Islamic banks was considered as one of the daily responsibilities of any bank especially in the Treasury Department to be ready all the time to confront any type of crises that may be faced by the Bank. The internal solutions that can be set by banks to protect liquidity could be the marketing and offer to open current accounts. Banks can also borrow from abroad and invest this money internally by sell shares. However, Islamic banks have only the short-term control of the liquidity level under the supervision of the Treasury Department and these problems often need simple solutions because of the troubles in applying the liquidity management strategies. Some of the interviewees pointed to "Alqardh Al-Hasan" transaction among Islamic banks as a solution to reduce the lack of liquidity or the possibility of establishing a fund call "Takaful Fund" between Islamic banks to guarantee each other for a long time. IN addition, the activation of the Sukuk market in Saudi Arabia which may be a perfect solution to the problems of liquidity in all Islamic institutions, not only Islamic banks. Basel III has been mentioned with more than one participant and its huge role in playing in the level of liquidity in the banks. Most of the requirements of the Basel 3 had a side effect on the liquidity. Islamic banks have resorted to the use the tools or instruments that have a close structure to the conventional banks' tools such as Tawarroq because the rate of risk is very small or almost non-existent compared with tools such as Mudharaba or Musharaka. All responders agreed that not easy to apply in the reality which depends on many other factors, but if there is an active market for issuing the Sukuk in Saudi Arabia and also established a private financial regulator to issue Sukuk on the stock market and they can make this organization the supervision of the issuing process.

DISCUSSION

The reasons behind the liquidity problems are mainly due to the reduce of oil prices in Saudi Arabia and its effect on the Islamic banking institution. The other reasons included the political conditions, and that led the clients to withdraw deposits from the banks. The government had issued Sukuk to cover the budget deficiency and this Sukuk was financed by banks which also effect on the bank's liquidity. Islamic banks have less amount of tools that help to

make the liquidity stable. The increases in the interest rates was directly effect on the level of lending in banks which decreased the borrowing ratio. Then, the liquidity will also have a negative effect because clients will be no longer lend money from banks due to the high-interest rate. The effect of this liquidity shortage on the Islamic banks was not easy and lead to collapse the whole system. The liquidity shortage had increased the interest and decrease the lending levels which guide to lack in financing a lot of the investors and delay of paying the salaries for the employees. The economy growth will be lower over time as results and lead to the collapse with bankruptcy of banks and that means the high collapse of the economy. The influence in both Islamic and conventional banks might be same, but the main difference is solution way and cover the shortfall in liquidity. The traditional banks had enough of the products that used to cover liquidity such as interbank borrowing or it could be only overnight lending in emergency cases. On the other hand, Islamic banks had some problematics in the liquidity deficit due to lack of products comparing to the conventional banks. Therefore, the study found that the Islamic banks have started to use Tawarroq in its transactions to curb the liquidity problems. However, there was a view which was contrary to all other views which claim that Islamic banks are having advantage of the lack of cost of money because most deposits in Islamic banks are short-term which means that there is no interest and the bank will not pay to customers for their deposits and it will remain the liquidity stable in this case. The application of the Islamic financial system in the Islamic banks have different points of view among supporters and opponents. These problems in the application could happen unintentionally. The reason of that was the employees at Islamic banks were originally employed in the conventional banks and this make the task of dealing the Islamic system, which was a radical change to what they used to do, something difficult to implement. In the situation of liquidity problems, the only institution that may support and help banks are SAMA and they called this stage last lending resort. In some cases, banks may have to support each other through interbank lending among themselves, but these are only a short-term solutions and may issuing bonds or Sukuk if shortfall was huge. The solutions differed in the views of the respondents from one to another that they have to follow and apply the Basel Convention 3 to maintain the liquidity needed or focus more on liquidity management in the Treasury offices department in banks, or issuing Sukuk, or maybe by dealing with conventional banks in the absence of other solutions. Qardh Al-Hassan between Islamic banks was a solution by many of the interviewees through establishing Takaful Fund only among Islamic banks. Revitalization the experience of Treasury bills in the central bank to help other banks in case of liquidity problems was also one of the solutions. Finally, the applying of these solutions are not easy because each one of them is depending on specific factors.

CONCLUSION

In conclusion, Islamic banks in Saudi Arabia have to improve their performances and instruments in many ways in order to serve the clients and the economy in a better way. In addition, the study showed that the Sukuk market in the Kingdom of Saudi Arabia was very weak and need for more

improvement. Another finding may be clear in the experience that done in Sudan which may help all Islamic banks to corporate together and come up with a strategy that is applicable to the sharia rule and in the same way it can help the liquidity enhancement among these banks.

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