

**Research Title: Islamic Finance in  
Swiss Banking Area: Characteristics,  
Opportunities and Challenges**

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**I would like to express the greatest appreciation of my supervisor \_\_\_\_\_ who has helped me throughout the entire research study. I must accept that in the absence of his/her guidance, it was not possible for me to complete this research.**

**In addition, I would like to thank the all of the course leaders, university management as well as my parents who have motivated me throughout the entire program.**

**Disclaimer: I hereby declare this entire research study is my own work and all the university guidelines are followed to meet the requirements.**

# **Abstract**

**Research Focus:** The primary focus of the research study is made to investigate the key challenges and opportunities currently being faced by the Islamic Banking in Swiss region.

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Research Method: This research study is purely based on the secondary data which is collected through accessing the financial statements and other publications.

Results & Findings: It is explored from the research that Islamic banking has been facing several issues i.e. lack of investment/capital and lack of supervision.

However, the integration with other financial institutes and inject of more capital can result in positive results i.e. success, growth and long term sustainability.

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# Chapter One

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## **1. Introduction:**

### **1.1 Research Background:**

#### **1.1.1 Overview of Global Islamic Finance:**

In Conventional Financing, lenders generate profit & earnings through lending the funds and charging the interest on the total amount. However, sooner the borrower pays all the installments i.e. principle amount, lesser the interest will be charged. However, Islamic Financing ignores the

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concept of interest based transaction which has called Riba (Solé, 2007). Instead, Islamic Financing believes that lenders are to buy something on the behalf of borrowers and then sell it to them, while keeping their profit. However, likewise in conventional financing in which interest rates are fixed on the agreed terms, Islamic Financing also believes in defining the profit margin and/or rate while making the contract (Girard & Hassan, 2008).

While conducting the initial research based on the Islamic finance in global banking sectors, it is noticed that Islamic banking has been growing at the significant rate over the past few years. According to Kuwait Finance House (KFH) research, the global Islamic finance industry is the size of over USD \$1.3 trillion by the end of 2012. In addition, the facts also reflect that the global Islamic finance assets were at the rate of 80.3% in 2012 which is forecasted to increase to USD \$1.5 trillion by the end of 2013 (Mubasher, 2013).

Moreover, International Monetary Fund (IMF) (2010) also concluded from the past 10 years' banking trend that as compared to conventional banking, the average return rate on assets & average return rate of equity of Islamic banking have been higher from 2005 to 2007 (i.e. conventional banking 3% and Islamic banking 4.5% for return on assets and conventional banking just over 20% and Islamic banking over 25% for return on equity). Similarly, the Islamic banking growth in terms of credits and assets was also higher than conventional banking (IMF, 2010).

### **1.1.2 Overview of Swiss Islamic Finance:**

Switzerland has always been considered as a safe haven for the banking industry because of its policies, regulations, monitoring as well as fastest growth as compared to the other regions across the world. In the past, there was only the concept and implementation of conventional

banking as in other countries, however the increasing demand from Muslim population has forced the Swiss banking industry to focus on Islamic banking too. According to the Bank Sarasin (the first ever Swiss bank to offer full range of Islamic banking services), nearly 8% of the total Swiss population is categorized to be Muslim. Because of increasing demand, the Swiss banking was also pushed to offer corporate banking services (Intercultural Magazine, 2012).

At the other end, the global investors of banking industry are also observed to be taking huge interest in strengthening the Swiss Islamic banking sector. Financial Times (2008) reported that one leading bank of Middle East along with the National Bank of Kuwait planned to invest in Switzerland in setting up an Islamic Bank. Similar global investor's interest towards the Swiss Islamic banking has improved the assets portfolio by 20%. As a result of it, the Swiss Islamic banking has improved its assets' portfolio from €316 million to €500 billion by the end of 2008 (England, 2008).

Similarly, AMEInfo (2011) also reported that although principles of Islamic banking are comparatively younger than conventional banking, but the demand of Islamic banking has been increasing at the constant and significant rate. According to the report of AMEInfo (2011), majority of the banking investment in Swiss banking sector is being made by the Arab countries which mainly include Gulf Countries. However, it is also argued that Swiss banking sector is still lacking of developing strong relationship between Islamic sharia principles and corporate financing. The facts presented by AMEInfo (2011) reflects that the Islamic Banking Industry in Switzerland still has the potentiality to absorb over USD \$500 billion investment and this can enhance the performance and meet customer's demands.

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Furthermore, Belouafi & Belabes (2010) also concluded from the research that the recent global financial crisis influenced the Swiss region; therefore the growth of Islamic finance could not be achieved as per the initial expectations and forecasts. According to the statistics, UBS lost nearly SWISS FRANC 25 billion & Credit Suisse lost SWISS FRANC 2 billion in the year of 2007. These losses eventually affected the growth of Islamic financing within the context of Swiss region too. However, over the past few years, there have been various investment projects in Switzerland that tend to develop and strengthen the Islamic Financing in Switzerland. Saleh (2007) presented the fact that Faisal Private Bank established its Islamic Financing operations in Geneva which aims to ensure that the market gap can be filled.

Following on, the emergence and demand of Islamic Finance within the context of Switzerland region can also be observed from the fact that Sarasin, a leading asset management & investment advisory services firms in Switzerland has also adopted the Islamic Finance principles. The primary reason is observed to the fact that Islamic Finance is more reliable and ensures the minimal chances of economic failure (Dar & Presley, 2001).

### **1.2 Research Rationale:**

It is very clear and evident from the above global and Switzerland has been the major market for banking industry since decades. Investors across the world prefer in keeping their funds within the Swiss banks due to less risks, less chances of banking crisis and higher returns and outcomes. Similarly, since Islamic Sharia principles are designed and implemented, Swiss banking industry is also experiencing positive growth, in Islamic banking, if not in conventional banking.

However, the above facts also reflect that Islamic banking in Swiss region still has various opportunities & challenges to grow further. But it totally depends on the past performance to deal

with challenges and to avail the growth opportunities. Therefore, it is necessary to examine and evaluate the performance of Islamic banking in Switzerland to determine its future.

### **1.3 Purpose of the Study:**

The purpose of this study is to analyze the position of Islamic banks in Switzerland and especially after the credit crisis of 2008. The impact of these crises on the Islamic banking is to be analyzed whether these banks grew or behave similarly to the conventional banks in Switzerland. Since Switzerland has a great role to play in the development of global financial market therefore, the role of Islamic banks in Switzerland must be studied to measure the growth of Islamic banks.

The primary reason of focusing on Switzerland & Islamic Finance is the fact that Switzerland is recognized to be the financial hub in global context. Since many decades, it is one of the safest financial hubs that ensure the maximum financial return for the investors. Similar to the conventional financing, the Islamic financing is also emerging within the Swiss region. Therefore, this study will explore the current context of Islamic finance in Switzerland, its key characteristics, its current opportunities and potential threats. This study will therefore be very informative for the practitioners and analysts to focus on key areas and to maximize the chances of success & long term sustainability.

### **1.4 Research Questions:**

1. To explore the extent to which Islamic finance industry in Switzerland dealt with credit crunch?



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2. To determine the key Islamic Financing elements currently being considered by Swiss Islamic banking industry in ensuring its sustainability?
3. What kind of challenges & opportunities is it experiencing as a global financial centre within Europe?

### **1.5 Research Objectives:**

- This paper will examine whether the Islamic banking in Switzerland sustains its position after the credit crunch or benefited by the situation. Because it must be taken into consideration that, being an immerging industry, Islamic banking should have taken the burden of overcoming the crisis and allowed the country to meet its money requirement.
- Second objective of this study is to analyze the key areas considered by Swiss Islamic banking. Because of it resilient nature it is observed that the banking industry is moving towards the Islamic principles. It is to examine the effectiveness of areas considered by Swiss Islamic banking.
- Third objective of this study is to know the challenges and opportunities available to the Islamic banks in Switzerland as compared to conventional banking. Since both the areas are having different banking system, with monetary and fiscal policy totally in contrast.

### **1.6 Research Structure:**

This research report is based on the following structure;

Introduction: This chapter of the research report aims to introduce the audience about the entire research report. In order to do so author has included research background, research aim, objectives, and research purpose as well as research rationale.

Literature Review: This section of the research report is constructed to critically review the previously conducted research studies, research papers and other publications. This will allow the audience to understand the key area of the research topic and other associated concepts.

Research Methodology: This section of the research report is designed to explain and justify the methodologies that are adopted throughout the entire research. Every adopted research method is explained along with the reasons and justification.

Data Analysis & Findings: This is one important section which aims to present the research findings and then to analyze them.

Conclusion & Recommendations: The last chapter of the research report is designed to conclude the findings and present the recommendations for the practitioners as well as researchers.

## **Chapter Two**

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### 2. Literature Review:

#### 2.1 Overview of Islamic Finance:

Within the context of finance & banking industry, Islamic finance has emerged as a prominent and fastest growing system in last couple of decades (Umer, 2007). Although, the primary focus of Islamic Finance was to serve the Islamic followers, but its principles today are widely accepted across the world in many countries. Hearn et al (2012) highlighted the importance of Islamic financing by adding that unlike conventional financing, Islamic financing offers rich financing solutions that also minimize the chances of failure and risks. Similarly, Sulz (2007) concluded from the research that although Islamic finance tend to cater the Muslims, but its diversified spectrums and segments as well as ethical financial solutions have attracted the non-Muslim customers too. Platt (2008) supported the above theoretical stances by adding that Islamic banking system does not only focus on the Islamic systems, but also offers ethical, moral, economical as well as welfare elements that are most likely to strengthen the Scio-economic environment in any region.

Ghannadian and Goswami (2004) quoted the definition of Islamic finance by adding that '*a financial institution whose statues, rules & procedures expressly state its commitment to the Principles of Islamic Shariah & to the banning of the receipt & payment of interest on any of its operations*'. From the above definition, it is very much clear and evident that '*interest*' is the main element that distinguishes the Islamic finance from conventional financing. Ramlee (2012) also defined that the Islamic principles is based on the non-interest operations and activities. Khan and Bhatti (2008) further defined that the main reason of eliminating the element of interest from financing is the fact that Islamic principles believe that interest is the root cause of

all economic issues and risks. Therefore, it is strictly prohibited from the Islamic principles, rules and regulations associated with financial management.

Fernando (2006) defined that Islamic financial institute is rather an intermediary that aims to share the profit (i.e. financial return) & loss with its depositors. However, at the other end, Asim and Mian (2005) argued that likewise conventional banking structure, Islamic finance and banking structure follows the similar procedures, but perceives them differently. On the other side, Feroz (2007) accepted that although the funding instruments & mechanisms of Islamic finance are similar to the conventional financing, but since its default experience is improved, it increases the chances of success and minimize the risks.

Throughout the literature, numerous scholars and researchers (i.e. Nazir, 2012 & Platt, 2008) have criticized the Islamic principles by adding that Islamic finance is rather a newly developed and implemented concepts, therefore it cannot surpass the conventional financing systems. However, at the other end, numerous scholars (i.e. Richard 2007 & Stijn, and Perotti, 2007) defended the Islamic financing by arguing that the success & effectiveness of Islamic finance can simply be noted from its growth, adaptation as well as demand, not only in Muslim populated regions, but across the world including western regions.

## **2.2 Key Principles of Islamic Financing:**

Islamic finance is purely based on its own defined principles & system (also known as Shariah), that clearly distinguish from conventional financing & banking system. Below are the key principles of Islamic finance;

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**Interest:** It is defined as Riba in Arabic language and is strictly prohibited from the financial management & system. According to Zamir & Abbas (2007) within the context of Islamic finance, all the transactions must avoid the interest which is paid by borrowers & collected by lenders. The primary reason is defined to be the fact that interest generated from any transaction has no value in accordance to the Islamic principles. However, it clearly defined by Pepinsky (2013) that interest prohibition does not mean that no profit can be generated, but it is rather stressed to process and consider it as profit or loss, rather than interest.

**Maysir & Gharar:** It is another important Islamic finance and Shariah principle which states that all the transactions must avoid the speculation i.e. Maysir & uncertainty i.e. Gharar. Zamir & Abbas (2007) defined that the inclusion of uncertainty & speculation only leads towards the unfair exploitation of one contracted party, while ignoring the benefits of other. As a result of it, investors are able to change economic systems for their own interest, while ignoring others completely. Eventually, it creates the economic imbalance and causes the economic crisis (Ramlee, 2012).

**Unethical Business Operations & Activities:** Last, but not the least, Islamic finance and banking regulations also de-motivate several products which include tobacco, drugs & alcohol etc. Therefore, there is no support for businesses that are into the production & supply of these prohibited products. Nazir (2012) defined that since Islam tends to keep socio-cultural environment healthy, clear and ethical, there is no room for these unethical businesses within the Islamic finance.

### **2.3 Fundamentals of Islamic Financing:**

Although, the Islamic finance is based on entirely different essentials, however some of its fundamentals are widely discussed throughout the entire literature review.

**Musharakah:** It is also known as partnership finance which defines that if a bank & an individual investor develops partnership for any project, the profit & loss must be shared among the parties on agreed terms & conditions (Nazir, 2012). It avoids the concept of interest which is fixed under conventional financing, in which the partner is liable to accept all the losses & profit, but only repays the principle amount including interest to the bank.

**Mudarabah:** It is defined to be the trust financing in which the investment is made by a bank, but skills, efforts & experience is invested by the partner. However, the profit is divided based on agreed terms, but when loss is recorded, bank will have to absorb the entire loss and working partner will be left unrewarded (Nazir, 2012). The primary reason of this fundamental is to motivate every potential individual to contribute towards the economic development through the utilization of personal skills and competencies.

**Murabaha:** In other words, the Mirabaha is known as cost plus financing. Rosly (2010) defined that it is also a method to establish a contract between investor & bank. The concept of Murabaha is to share the profit margin between banks and investors. Since, this concept also avoids the element of interest, it is said to be a popular mode of Islamic finance & banking system.

**Bai-muajjal:** According to Khalil & Shafii (2012) the Bai-muajjal is payment sale contract in which banks trade with investors with no extra cost & charges. Likewise, other Islamic principles

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and fundamentals, the Bai-muajjal also avoids the concept of interest and focus on interest free transaction.

**Ijara:** Within the context of conventional financing, the Ijara is known as leasing, which is one of the most popular financing method for numerous products & services throughout the world (Nazir, 2012). However, at the other end, Islamic financing principle presents the idea that rather than offer leasing and charging extra as interest, the Ijara is a rent contract that allows the borrowers to rent goods from bank. From time to time, the rent is reduced until borrowers pay the entire amount of the good which must also be equal to the market value.

Siddiqi (2006) concluded from the research that although Ijara has been very successful in general, but when it comes to the home financing, it has gained much appreciation and experienced significant growth in recent years.

### **2.4 Growth of Islamic Finance:**

While reviewing & analyzing the literature review, it is observed that the emergence and success of Islamic finance has gained much attraction among the researchers too. Throughout the entire literature, numerous researchers and scholars have conducted numerous studies and research papers to reflect the past & present success of Islamic financing. Hussain (2011) deduced from the findings that the principles, effectiveness and success of Islamic finance has not only accepted in Muslim world, but also the non-muslim regions are also following the Islamic principles to strengthen the banking environment. Pollard & Samers (2013) explored that in last 8 to 10 years, the total funds under Islamic banking and financial institutes are increasing at the rate of 15% to 20% annually. Hearn et al (2011) predicted based on the past performance of Islamic banking that by the end of 2015, the net value of Islamic funds management is going to

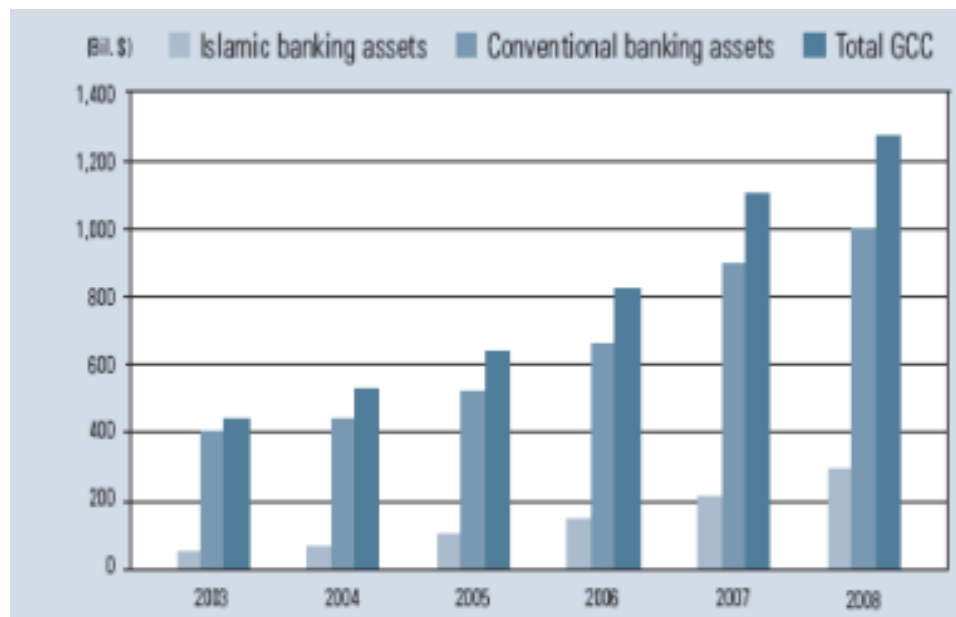
be more than USD \$200 billion. Based on these facts, it can be argued that the rate of Islamic finance growth has been very significant over the past couple of decades.

Similarly, Ahmed (2010) predicted that by looking at the current performance, growth rate and success of Islamic finance, it can be said that in next couple of decades, Islamic finance will be a complete alternate solution for conventional financing. Khan and Bhatti (2008) explored from the independent research Islamic financing has entered into more than 60-65 countries across the world, including western regions. However, in some countries i.e. GCC countries, Pakistan, Iran and some of the African Muslim countries, the Islamic finance has fully penetrated and is much stronger than the conventional financing. Likewise above presented predictions about Islamic financing, Ahmed (2010) foresee that by the end of 2020, more than 50% of the global savings, will be managed, controlled and monitored by the Islamic finance and banking.

Also, when examined the Muslim populated region i.e. GCC, it is observed that the growth of Islamic finance & banking has become a serious threat for conventional banking (Standard & Poor's Financial Services, 2012).



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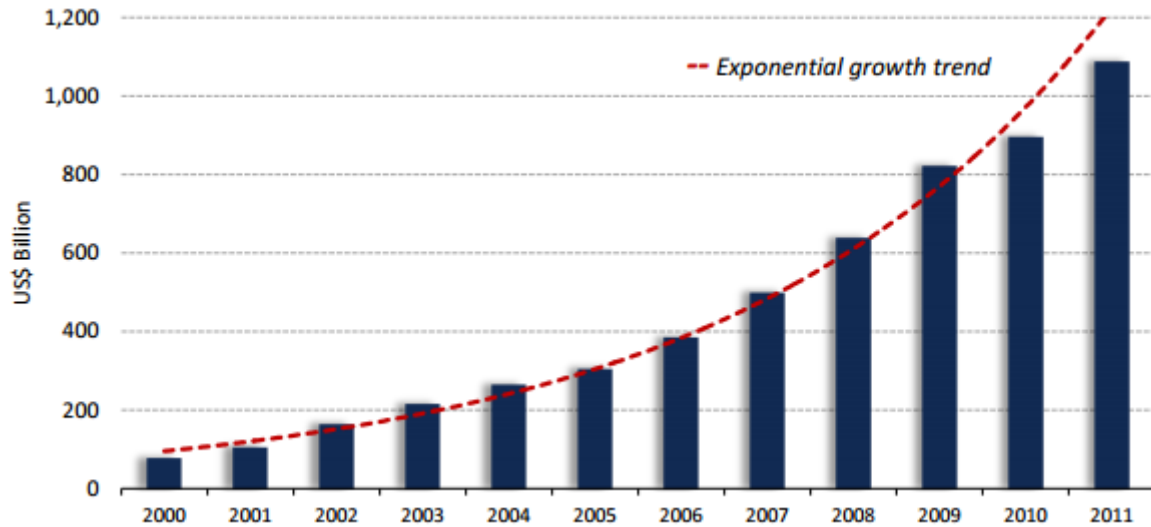


**Source: Standard & Poor's Financial Services, 2012**

From the above chart, it is apparent that in GCC region, the Islamic finance & banking assets have experienced significant growth from 2000 to 2008. The above chart clearly reflects that in the year of 2000 the total Islamic banking assets in GCC region were just few billion US dollars. However, it kept increasing and by the end of 2008, the total Islamic banking assets in GCC region reached to over US\$ 300 billion.

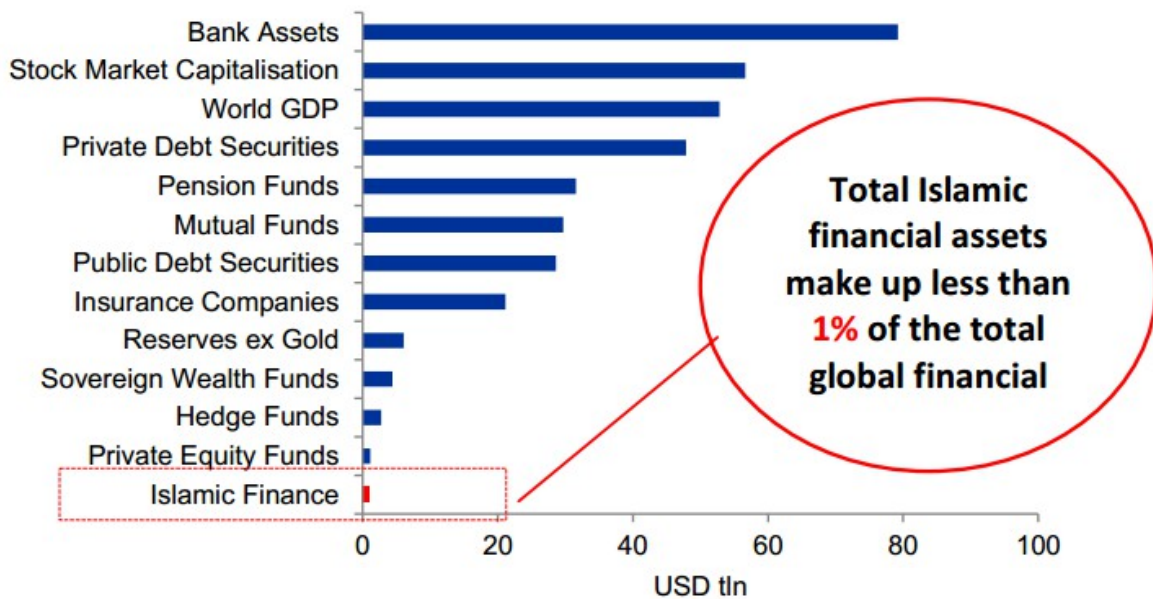
However, in some countries, in GCC region, the Islamic finance & banking sector has overtaken the conventional banking sector (Standard & Poor's Financial Services, 2012)

Following on, when examined the global growth of Islamic finance, Statistical, Economical & Social Research & Training Centre for Islamic Countries (SESRIC) (2012) presented some interesting facts. According to the SESRIC (2012) in 2000, the global assets of Islamic finance were recorded to be less than USD \$100 billion, however, by the end of 2011, the global assets under Islamic finance increased to over USD \$1trillion.



Source: SESRIC, (2012)

Despite all the facts above, Islamic Financial Services Board (IFSB) (2011) accepted that the global Islamic financial assets have not been able to make up even 1% of the total global financial portfolio.



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**Source: IFSB, (2011)**

Based on the above statistics presented by different scholars, researchers & organizations, it can be argued that Islamic Finance & Banking system although has been growing at the significant rate, but as compared to conventional financing, it is still to grow. However, the predictions made by analysts do reflect the strong growth of Islamic financing in future.

In addition to the above, when focused on the growth of Swiss Islamic finance, Swissinfo (2008) defined that Islamic finance in Switzerland has been growing at the fastest ever rate. According to Swissinfo (2008) the Islamic finance sector in Switzerland worth of nearly USD \$800 billion, and is growing at the rate of 20% annually. It is also predicted by analysts that in the nearest future, the Swiss Islamic finance sector will worth thousands of billions.

### **2.5 Islamic Finance & Wealth Management in Geneva - Switzerland:**

From the above part of this section, it is much clear and evident that not only in Muslim populated regions, but also in the western world, the Islamic finance and banking sector has been growing at much significant rate. However, in the case of Switzerland banking industry, the first major initiative towards the development of Islamic finance & banking was system was made on early 1980s with the establishment of the Dar-al-Maal Al-Islami Trust. This trust was initiated by the Saudi Prince Shah Faisal.

Since, it was the first major development, the Dar-al-Maal recorded significant growth. However, in 2005 it was restructured to ensure that the attainment of organizational goals and improve growth rate. As a result of it, this organization reported the net profit of more than USD \$52 million in the following year. According to Hearn et al (2011) over USD \$2 billion of total funds

were managed. The success and rapid of growth of Islamic finance in Swiss banking sector has motivated the authoritative bodies to ensure easier legal implications. According to Claessens and Perotti (2007) in order to improve the Islamic finance growth in Switzerland, the Islamic banks are only required to meet the legal obligations. Pollard & Samers (2013) on the other end defined that Swiss Law treats the Islamic banks exactly in the same was as conventional banks. Furthermore, it is also noted that banks in Switzerland that operates in accordance with the Islamic Sharia principles and rules have no separate and/or additional legal implications. The primary focus of Swiss Banking Commission is to ensure that Islamic Banks and Financial Institutes; comply all the legal obligations that are more of management, controlling and monitoring areas. However, when it comes to the product & service differentiation, there is no legal implication that can restrict the Islamic Banking & Financial Institutions in Switzerland to grow.

However, at the other end, Hussain (2011) argued that likewise conventional banks, Islamic finance institutions are to ensure that investment funds are managed in accordance with the EBK principles. Other than this, there is no restriction at all. Based on the above views, it can be deduced that EBK in Switzerland only controls the banking policies, but allow the Islamic banks to offer all types of Islamic services & products to their potential customers.

The success of the above regulatory environment in Switzerland can simply be observed from the fact that through the country, more than 300 Islamic financial institutions and banks are operating with the net worth of their assets of over USD \$300 billion (SFr 391 billion) (Swissinfo, 2006).

### **2.6 Challenges of Islamic Finance & Banking System in Switzerland:**

The above section of literature review clearly reflects that Islamic finance in Switzerland has produced quite positive results, in terms of net assets and growth. However, Iqbal, Ahmad & Khan (1998) argued that likewise other regions, Switzerland is also experiencing various challenges which include infrastructure, institutional & legal framework, policies and regulations. Wilson (2000) also supported the above argument and added that Islamic banking in Switzerland is still very weak because of the fact that conventional banking has become more mature than ever before. As a result of it, there has been a lack of institutional and legal support towards the Islamic banking. In addition, SFB (2013) concluded from the findings that Islamic banking laws are still dependent upon the conventional systems. The primary reason is the fact that the enforcement of Islamic financing & banking policies, the conventional support increases the costs & efforts.

Moreover, Hassan (2008) highlighted a very important and critical challenge that Islamic finance faces in the Swiss region. According to Hassan (2008), Switzerland is a non-Muslim region, therefore there is a weak Sharia advisory board that can control, monitor and manage the entire infrastructure. Therefore, in order to ensure growth and success, the Swiss central bank will have to develop and design the Sharia board that can work along with the central bank in strengthening and streamlining the entire infrastructure. In addition, the above Swissworld (2013) raised a very technical, but vital element by adding that conventional financing is based on accounting standards. However, when it comes to Islamic financing, some of the accounting standards are argued to be non-Sharia. As a result, it limits the Islamic banking in Switzerland to operate in a limited context.

Similarly, New Horizon (2012) explains that Swiss conventional banking system is backed up with equities and long term bonds. However, since Islamic financing is comparatively newer, Swiss security market for Islamic financing is still not well established.

Unlike above institutional challenges, Iqbal, Ahmad & Khan (1998) focused on the operational challenges within the context of Switzerland. According to Iqbal, Ahmad & Khan (1998) Switzerland is highly influenced by conventional financing. Therefore when it comes to develop a new product or service, it takes longer to get the product certified and approved by Shria board. Wilson (2000) also presented the idea that in Switzerland, the Muslim population is in minority, therefore there is always a lack of Muslim scholars. As a result, the new products and services are to be forwarded in other region, which takes longer time. Karimi (2013) on the other hand defines that as compared to conventional financing, Islamic financing is new in the market. Therefore, there has always been an issue with the research & development, training and teaching of banking personnel. However, when it comes to the Switzerland, this situation becomes more critical.

Following on, Omar & Iqbal (2011) concludes from the findings that Islamic finance is based on profit sharing, rather than interest. However, when it comes to the practice, such contract requires both parties to conduct thorough research, conduct feasibility studies as well as to conduct financial and technical evaluation of the project. In the end, there is a very high chance that one party can step back to sign the contract. When it comes to the Swiss region, which is world's most secure investment region, it restricts the Islamic finance in Switzerland to grow. Khan (2010) also defines that in Islamic finance, the defaulters are given incentives to default. The primary reason is the fact that when Sharia compliance does not allow a bank to charge extra

to the defaulters. Since Switzerland is claimed to be the secure banking region, regulators find it a threat and does not promote the Islamic finance (Swissworld, 2013).

# Chapter Three

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## **3. Research Methodologies:**

This section of the research paper provides detailed and thorough discussion regarding the methodology adopted to complete the research study. The subsequent discussion analyzes the different techniques and approaches adopted by the author to attain research objectives and answer the research questions. This chapter details how different adopted methods and techniques has worked and enabled the researcher to focus on critical elements, while reducing the probability of errors to occur. In this section author has defined adopted methods and have provided underlying reasons to leave other.

### **3.1 Research Philosophy:**

According to Crowther, & Lancaster, (2008), research philosophy guides the research by providing it different ideas, concepts, focal point, and defined values that can be used to select and chose different attributes of the research methodology. About the applicability of research philosophy, it is argued that appropriate research philosophy is attuned with research questions

and research objectives. As a result, it is quite essential to select the one which supports the overall attainment of research objectives and in answering the research questions.

Interpretive approach, on the other hand, is subject to social and business issues. It tends to argue that real environment, in business world, or social world can be studied by different perspectives. Flick, (2006) argued that since reality setting is quite complex, therefore, reality setting can be viewed differently. Hence, followers of interpretive philosophy support the idea that facts and reasons are suitable for different situations. This research paper is being constructed while having interpretive approach. Having interpretive approach basically has helped in restricting the data collection process. By this approach, it was realized that both qualitative and quantitative data has to be gathered ensuring the results that are attuned with research objectives and research questions. It has helped in studying different dimensions of Islamic banking that are discussed in the literature review.

### **3.2 Research Approach:**

According to Panneerselvam, (2004), there are two core approaches that can be used to study the identified issue, namely, deductive, and inductive. Inductive approach is observed to work with the bottom up approach. This approach works by focusing on the focal point and then starts adding different elements to it. The core motive of inductive approach is to induce from the findings and reach at a point that could be generalized to the entire population. This is the reason that it focuses on stating statements including the entire population. According to Sing, (2006), inductive approach is difficult to apply, as it requires great deal of research and insights to critical data. This is the reason that this approach was left out. In order to have inductive approach



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towards the research study, positivists approach is observed to be quite helpful. Since positivists also want to generalize findings to the entire population and so does the inductive approach.

Deductive approach, on the other hand, is the one adopted for this research paper. Deductive approach has been quite effective for this research paper, mainly because of the fact that it works in the opposite direction. It starts with the focal point, and eliminates all of the irrelevant data and stances to ensure that focal point is sharpened (Saunders, 2003). Deductive approach leads towards deduction of elements, while focusing over the study area. Using deductive approach is suitable as the author has selected interpretive philosophy. It is observed that interpretive philosophy and deductive approach works together, as both attribute of research methodology strives to ensure that appropriate conclusion is drawn while focusing over the entire research project.

The core benefit of using this approach is the fact that it has enabled the author to conclude the overall findings. It ensured that the findings and analysis are concluded while reaching at the point where it could be decided that how Islamic banking has emerged in Switzerland and what are the different factors supporting the claim. Another advantage of using this approach, as stated by Saunders et al., (2009), is the fact that it enables research to pursue the study while focusing over sample size, then concludes the research study through stating the conclusion for the similar nature of audience.

### **3.3 Qualitative or Quantitative:**

Deciding upon the nature of research project actually helps in determining the nature of data shall be collected to meet the research objectives and answer the research questions. Author has to ensure that it has selected the nature that is aligned with remaining attributes of research

methodology. Without synchronizing the attributes of methodology, it is then impossible to develop and present information with logical flow (Saunders, 2003).

Quantitative approach is linked with statistical data including charts, graphs, and all of the data that could be represented through tables. Qualitative approach, on the other hand, is linked with words. It includes all of the data that could not be quantified. It is mostly linked with words, concepts, ideas and thoughts. This research paper utilizes both qualitative and quantitative nature of data. Quantitative data is used to study the financial stability of Islamic banks in Switzerland (Gill and Johnson, 2010). Financial stability is studied by calculating and analyzing financial ratios. The data for this purpose is collected through annual reports, and therefore is quantitative. By this author has provided and supported the claim regarding growth of Islamic banks in Switzerland. Qualitative data, on the other hand, is used throughout the research paper. The conceptual framework is being constructed on the basis of qualitative data that has helped in studying the basics of Islamic banks (Remenyi et al, 1998).

### **3.4 Data Collection:**

It is the most crucial part for any researcher. The main reason for this is the fact that that study's entire reliability and validity depends upon the nature of data collected and used in the research study. According to Saunders (2003), data collection has remained the main step and attribute of the research methodology. It is derived from the combination of different attributes of methodology. As a result, it focuses on over gathering relevant and reliable data that could be used to overcome all of the potential issues. This research study has mainly focused on secondary data. Primary data, on the other hand, was left out because of the fact that the topic

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area was too broad, it was nearly impossible to contact personal linked with Islamic banking in Switzerland.

### **3.4.1 Secondary Data:**

Secondary data is the one that is readily available from different sources. There are different pros and cons for secondary data. First of all, it is readily available and requires less time to be searched. However, the validity and reliability of secondary data is always questioned. Saunders (2003) stated that reliability and validity of secondary data can be covered by utilizing authentic sources.

As a result, author has paid extra attention to this regard and has used authentic sources to collect secondary data. The main sources for collection of primary data were internet and libraries. From these sources, author has searched different books, published in different countries, written by different authors, journal articles, annual reports, published articles and paper from authoritative bodies (Saunders, 2003).

Since the aim of this research report was to investigate the challenges and opportunities faced by Islamic banks in Swiss industry, the secondary data was collected using the financial statements of considered banks. In addition, one of the research objectives was designed to compare the Islamic banks' performance with the conventional banks. To collect the financial data of conventional banks, author has used different financial websites to collect the available financial graphs, charts and other relevant information.

The primary reason behind the collection of secondary data only, was the fact that it is almost impossible to approach the banks in Switzerland and gather the required data. However, the primary data collection would have been helpful in improving the research validity, but since

author had its own limitations, the collection of primary data could not be made possible. Nevertheless, the secondary data using financial statements of the two Islamic banks and readily available performance charts of two conventional banks was processed in a way to reflect the financial growth of the considered banks. This approach helped the researcher a lot in investigating the current threats and challenges faced by banks as well as potential opportunities that can be availed to ensure growth and success.

### **3.5 Data Analysis:**

In order to study and analyze Islamic banks in Switzerland in the light of constructed objectives and research questions, author has integrated single analytical technique. This technique is applied to study the actual market position as well as growth of Islamic banks in Switzerland. To serve the purpose, author has used various financial ratios for considered Islamic banks from 2008 to 2012. This year span shall give the actual condition of how many Islamic banks have grown and how different factors including globalization and competition have influenced it. Following is the list of ratios that are calculated:

|                               |
|-------------------------------|
| • Current Ratio               |
| • Gross Profit to Sales Ratio |
| • Net Profit to Sales Ratio   |
| • Return on Assets Ratio      |
| • Debt Ratio                  |
| • Asset Turnover Ratio        |

Although, different other ratios could have been used, but while collecting the data, it was observed that the financial statements published by considered Islamic banks i.e. Faisal Bank and

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Habib Bank AG Zurich, were based on the limited information. Therefore, lack of information on the financial statements eventually limited the author to examine more financial aspects.

Moreover, while collecting the financial information using the financial statement of Islamic banks, the author could not find the financial statements of Faisal Bank for the years of 2011 & 2012. Therefore, Habib Bank is analyzed from 2008 – 2013, but Faisal Bank could be analyzed from 2008 – 2010.

A part from this, when it came to collect the financial information about the conventional banks, the financial performance and growth related information was explored to be readily available. Therefore, it was considered to be easier to integrate the available information, rather than using their financial statements.

### **3.6 Organization of the Study:**

In order to have practical essence of the study and practically apply the themes, concepts and ideas, it was essential to have organization of the study. However, it was realized that studying a single banking entity cannot generate desirable outcomes, as the research objectives and research questions shall not be met. As a result, it was made sure that different organizations are integrated within the study to increase the reliability and validity of the project. Moreover, as the research objectives stated that this research study needs to realize the Islamic banking industry, and as a result, following organizations are considered. The banks mentioned below are observed to operate within Switzerland. Some of them are observed to be international and some are confined to remain local.

- Habib Bank AG Zurich

- Faisal Private Bank
- UBS – AG
- Credit Suisse

The main reason to select these banks is the fact that they are quite famous and mature within the banking industry. As a result, there is a bulk of information available and they have provided with appropriate term reports that had to be used to calculate financial ratios. Another reason is the fact that these banks have captured much of the market share and are considered as important market players in the industry. Studying these banks could help in generally stating the growth and stability of Islamic banks in Switzerland.

### **3.7 Limitations:**

Despite the hard work that is embedded in this project, there are several elements that have reduced the scope for this project (Saunders, 2003). First of all, the scope of this research project could have been increased, if only primary data could be gathered and integrated. However, since it was quite difficult, therefore it is suggested that in future research, primary data can play a vital role.

This project is based on two Islamic banks & two conventional in Switzerland, but still, the findings cannot be generalized, and thus the scope of this project is limited to considered organizations for this project. Inductive approach could have provided a broader scope as compared to deductive approach.

### **3.8 Reliability and Validity:**

Despite limited scope of the project, there are some steps taken to ensure that the reliability and validity of the research study remains intact. First of all, the different attributes of methodology that are considered are aligned and attuned. This is has resulted in greater suitability and feasibility of methods supported approaches and techniques going along with procedures. In addition to this, author has used different nature of data that tends to answer the research questions. The treatment of data collected is based on deductive approach that is considered as it aligns with all of the research methodology attributes. By integrating such elements, author has ensured to increase the reliability and validity of the project.

# Chapter Four

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## **4. Data Findings and Analysis:**

This is one critical and most important section of the entire research study. The primary objective of this section is to present the research findings, about the characteristics, opportunities and challenges current being faced by Islamic Finance within the context of Swiss banking. In order to ensure the logical presentation of findings and analysis, this section is divided into two parts. The first part is purely designed to reflect the research findings through the ratio graphs and charts. Following on, the next part is designed to discuss and analyze the research findings along with the current industry facts.

However, it is important to mention here that the opportunities and challenges of Islamic Finance in Swiss banking area are linked with the past performance of two selected Islamic banks (i.e. Habib Bank AG Zurich and Faisal Bank). The fluctuation in ratios meant to reflect the challenges and opportunities that eventually influence the banks' financial performance.



## Islamic Finance in Swiss Banking Area

### 4.1 Data Findings:

Ratios are not only important but effective too, to examine and analyze the organizational performance. Numerous practitioners and theorists have supported the use of ratios to understand and evaluate the organizational financial as well as non financial performance. Similarly, it is defined that ratios are not limited to examine and analyze the organizational performance, but this technique also helps practitioners to examine the industry trends. Similar approach has been used in this research and the findings are presented below;

|      | Habib Bank | Faisal Bank |
|------|------------|-------------|
| 2008 | 0.11       | 1.51        |
| 2009 | 0.14       | 1.41        |
| 2010 | 0.14       | 1.21        |
| 2011 | 0.14       |             |
| 2012 | 0.13       |             |

The above chart and table is designed to reflect the liquidity performance of Habib Bank AG Zurich and Faisal Bank. It is noted from the above findings the liquidity performance of Habib Bank has been worst throughout the past five years. In 2008, the company had SWISS FRANC 0.11 of current assets to cover every SWISS FRANC 1 of its short term liabilities. Although in the following year, the liquidity performance of the bank improved by 27%, but since the performance in 2008 was very much critical, the growth of performance does not reflect to have positive impacts. The findings above also reflect that the Habib Bank managed to sustain its performance in the following three years, but in 2012 the liquidity performance declined again and reached to the ratio of 0.13.

However, at the other end, it when looked at the liquidity performance of Faisal Bank, it is noted that its performance has been very positive and satisfactory. In the year of 2008, the Faisal Bank's liquidity performance is noticed to be 1.51. In other words, it can be said that in 2008, Faisal Bank had 51% of more current assets as compared to its total short term liabilities and debts. In the following two years, the liquidity performance of the bank declined by 7% and 15.5%. But the performance is still satisfactory.

From the above findings, it can be deduced that as compared to Habib Bank AG Zurich, the liquidity performance of Faisal Bank has been much better.

|             | <b>Habib Bank</b> | <b>Faisal Bank</b> |
|-------------|-------------------|--------------------|
| <b>2008</b> | <b>55%</b>        | <b>-320%</b>       |
| <b>2009</b> | <b>55%</b>        | <b>-234%</b>       |
| <b>2010</b> | <b>45%</b>        | <b>-312%</b>       |
| <b>2011</b> | <b>50%</b>        |                    |
| <b>2012</b> | <b>44%</b>        |                    |

The above chart and table is designed to reflect the profitability performance of Habib Bank AG Zurich and Faisal Bank. It is noted from the above findings the profitability performance of Faisal Bank has been worst throughout the past three years. In 2008, the company recorded the gross loss of 320%. In the following year, although the ratio declined by 26.875%, but the ratio of loss still crossed the level of 230%. In 2010, the profitability performance of Faisal Bank reached to its 2010 position and it again recorded the loss of over 310%.

## Islamic Finance in Swiss Banking Area

However, at the other end, it when looked at the profitability performance of Habib Bank, it is noted that its performance has been very affirmative and adequate. In the year of 2008 & 2009, the Habib Bank recorded the gross profit of 55%. However this ratio declined by 10% in 2010, but improved by 5% in 2011. But in 2012, the gross profit margin of Habib Bank is recorded to be 44%, which clearly reflects its strong profitability performance as compared to Faisal Bank. The main reason behind the huge losses is the continuous decline of fee business income and interest income. In addition, since the products and services are limited, customer portfolio could not be improved. Eventually it effected the total revenue.

From the above findings, it can be deduced that as compared to the Faisal Bank, the gross profit performance of Habib Bank AG Zurich has been very positive for its shareholders.

|             | <b>Habib Bank</b> | <b>Faisal Bank</b> |
|-------------|-------------------|--------------------|
| <b>2008</b> | <b>2%</b>         | <b>-253%</b>       |
| <b>2009</b> | <b>17%</b>        | <b>-420%</b>       |
| <b>2010</b> | <b>11%</b>        | <b>-391%</b>       |
| <b>2011</b> | <b>20%</b>        |                    |
| <b>2012</b> | <b>14%</b>        |                    |

The above chart and table is again designed to reflect the profitability performance of Habib Bank AG Zurich and Faisal Bank. It is noted from the above findings the profitability performances of both banks are very low.

In 2008, the Faisal Bank recorded the net loss of 253% which clearly reflects the worst financial position. In the following year, the profitability performance reached to its worst ever position because the net loss was recorded to be 420%. Following year of 2010 was very similar to the past two years, because the net profit loss was still 391%.

The main reason behind the huge losses is the continuous decline of fee business income and interest income. In addition at the other end, the operating expenses of the Faisal Bank are also increasing.

However, at the other end, it when looked at the profitability performance of Habib Bank, it is noted that its performance has been better than its competitors. In the year of 2008, the net profitability ratio was noticed to be 2% which boosted in the following year to 17%. In 2010, the Habib Bank's profitability declined to 11%, but again improved by 9% in the following year. The fluctuating trend of profitability remained same in the following year of 2012, in which the ratio again declined by 6% and reached to the level of 14%.

From the above findings, it can be deduced that as compared to the Faisal Bank, the net profit performance of Habib Bank AG Zurich has been very positive for its shareholders and investors. In addition, it can also be said that the potentiality of Islamic finance and its growth does exist, but it totally depends on the approach and strategy of the banks. The reason is the fact that Habib Bank has been positing the profits (although low), but still positive and reflect the strong potentiality of the Islamic finance within the context of Swiss context.

## Islamic Finance in Swiss Banking Area

Even though, Faisal Bank is observed to be making huge losses, but the main objective behind its existence in this industry is claimed to be the growth of overall Islamic Banking industry in Swiss area. Likewise, explained in the literature review that Islamic finance is one growing area for the industry, therefore Faisal Bank has also claimed to have implemented the Holding strategy with the anticipation of growth in industry in nearest future.

|             | <b>Habib Bank</b> | <b>Faisal Bank</b> |
|-------------|-------------------|--------------------|
| <b>2008</b> | <b>0%</b>         | <b>-5%</b>         |
| <b>2009</b> | <b>66%</b>        | <b>-16%</b>        |
| <b>2010</b> | <b>36%</b>        | <b>12%</b>         |
| <b>2011</b> | <b>74%</b>        |                    |
| <b>2012</b> | <b>51%</b>        |                    |

The above chart and table is constructed to reflect the asset performance of Habib Bank AG Zurich and Faisal Bank. It is noted from the above findings the asset utilization performances of Habib Bank has been very effective as compared to the Faisal Bank.

From the findings, it is noticed that the total value of net profit of Habib Bank was only 0.09% as compared to the total values of assets. It leads to understand that the utilization of total assets did not really generate the positive results in terms of profitability. However, in the following year of 2009, the asset performance utilization of the Habib Bank's assets improved which eventually reflected the ratio of 66%. However, in the following year, the bank could not utilize its assets as effectively as in 2009. Bu again in 2011 and 2012, the performance reflected the growth of return on assets by 74% and 51% respectively.

At the other end, the Faisal Bank's performance to generate return on assets has been very critical, even negative. In 2008, the organization recorded the loss with 5% and 16% even in the following year. However, in 2010, Faisal Bank also posted the return of 12% on its asset utilization.

From the above findings, it can be deduced that as compared to the Faisal Bank, the return on asset of Habib Bank AG Zurich has been very positive for its shareholders and investors. It can also be said that Habib Bank is more effective and efficient in utilizing its assets to generate profit, as compared to Faisal Bank that generated on 12% in the last three years and only in 2010.

|             | <b>Habib Bank</b> | <b>Faisal Bank</b> |
|-------------|-------------------|--------------------|
| <b>2008</b> | <b>4%</b>         | <b>2%</b>          |
| <b>2009</b> | <b>4%</b>         | <b>4%</b>          |
| <b>2010</b> | <b>3%</b>         | <b>3%</b>          |
| <b>2011</b> | <b>4%</b>         |                    |
| <b>2012</b> | <b>4%</b>         |                    |

The above chart and table is constructed to reflect the asset utilization performance of Habib Bank AG Zurich and Faisal Bank. It is noted from the above findings the asset utilization performances of both banks has been equal.

From the findings, it is noticed that the total value of net revenue of Habib Bank was only 4% as compared to the total values of assets. It leads to understand that the utilization of total assets did not really generate the positive results in terms of sales. Similar trend is noticed in the following year, in which the asset turnover ratio is observed to be remained same as previous year.

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However, in the following year, the bank could not utilize its assets as effectively as in 2009. But again in 2011 and 2012, the performance reflected the growth of return on assets by 4%.

At the other end, the Faisal Bank's performance to generate return on assets has been very similar to the Habib Bank. In 2009, the organization recorded the asset turn over by 2% which increased to 4% in the following year. However, in 2010, Faisal Bank posted the return of 3% on its asset utilization.

From the above findings, it can be deduced the asset turnover ratio of Islamic Banks in Swiss banking sector is between 3%-5%. Therefore, it can be said that both banks have performed effectively and efficiently and up to the industry standards (Standard & Poor's Financial Services, 2012).

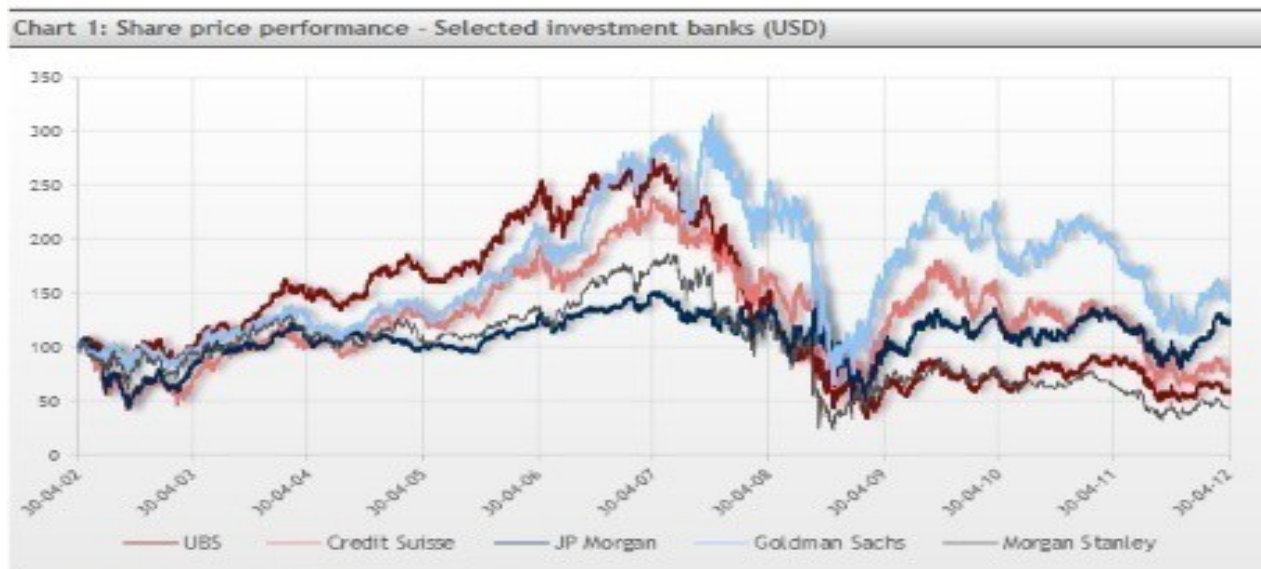
|      | Habib Bank | Faisal Bank |
|------|------------|-------------|
| 2008 | 94%        | 68%         |
| 2009 | 94%        | 69%         |
| 2010 | 94%        | 81%         |
| 2011 | 94%        |             |
| 2012 | 94%        |             |

The above chart and table is constructed to reflect the balance between total assets and total utilization. In other words, the above chart is designed to reflect the debt management performance of both banks and understand the industry trend.

From the findings, it is noticed that the level of liabilities i.e. debts, are always lower than the total assets. In the case of Habib Bank, the debts of 2008 were 94% as compared to the 100% of assets. The same trend of Habib Bank has been noticed in the following four years.

At the other end, the Faisal Bank's performance to balance the debt and asset level is also noticed to be stronger than Habib Bank. In 2008, the debts of Faisal Bank were of 68% as compared to the total assets. However, in the following two years, the performance declined and reached to the level of 81%, but still better than Habib Bank.

Moreover, when viewed the performance of conventional banks in Swiss financial industry, it is observed that UBS and Credit Suisse are the two industry leaders that are putting their all efforts in improving their market shares. Below charts are included to reflect their financial performance to evaluate the challenges and opportunities they are currently facing.



Source: Saxo Bank and Factset Research Data

The above chart reflects the stock market performance of two Swiss conventional banks i.e. UBS & Credit Suisse along with their key competitors. From the above chart, it is apparent that the



## Islamic Finance in Swiss Banking Area

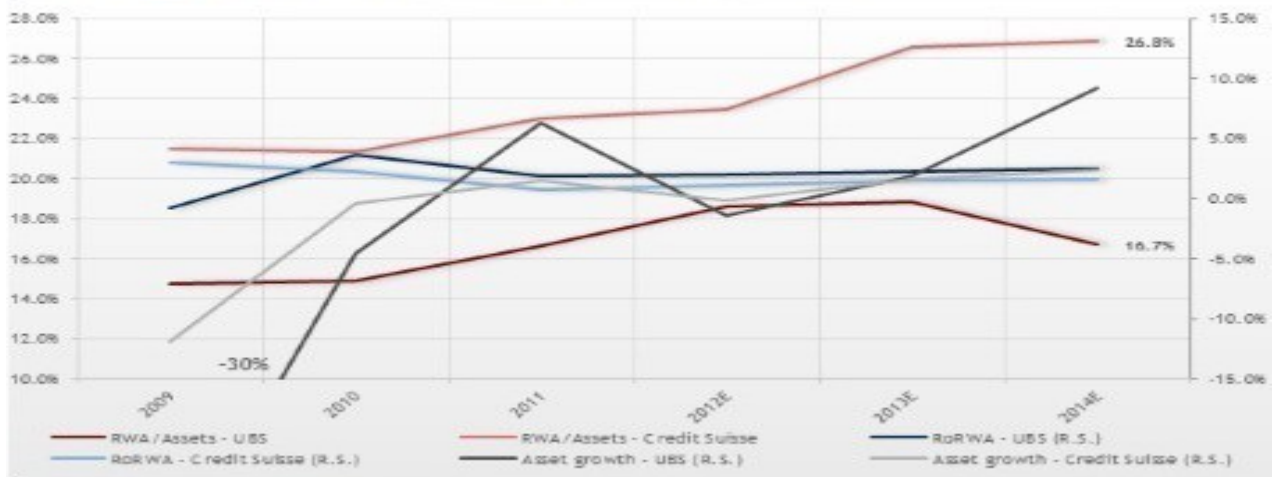
stock price performance of the conventional banks declined quite significantly in 2009, but again improved from the following financial period. Although since 2010, the stock price performances of all the conventional banks are fluctuating, but the trend leads to learn that there has been positive growth.



Source: Saxo Bank and Factset Research Data

Moreover, the above chart is presented to reflect the trading & fee and commission income of the Credit Suisse and UBS banks. According to the above chart, 2008 was the worst year in terms of income for the considered banks. However, after the global economic and financial crisis, both of the banks managed to improve their income performance and sustained at one level. It leads to learn that the profitability and income performance of the conventional banks are managed effectively because the Swiss conventional banking industry is still potential.

Chart 3: Credit Suisse and UBS - RWA weights, RoRWA and Asset Growth



Source: Saxo Bank and Factset Research Data

Lastly, when examined the RWA weights, RoRWA and Asset growth of the two considered conventional banks, it is noted that the performance, as compared to 2009, has improved quite significantly. The chart above leads to understand that both of the banks have managed to grow their asset portfolio which eventually reflects the strong growth within the Swiss conventional banking industry.

## 4.2 Discussion & Analysis:

From the above findings, it is observed that the growth of Islamic banking within the context of Swiss banking sector has not been very positive and/or effective. Before claiming the above statement, when looked at the facts and perceptions of practitioners within the industry, similar thoughts are explored. Throughout the recent research studies as well as the discussion among the practitioners are also observed to be accepting the fact that Islamic finance in Swiss region has been experiencing critical situations (Swissinfo, 2008). Similar findings are reflected from the above findings that lead to learn that whether it is liquidity management and/or debt management, Islamic banks in Swiss banking sector are limited and restricted.

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It may be due to the fact of cultural difference, if not the stronger financial as well as economic context. As noted from the above literature, Hussain (2011) that Islamic finance is claimed to be more secure and appropriate in order to avoid the financial and banking crisis. Numerous researchers as well as practitioners have supported the above stance by adding that Islamic finance is based on different rules, and if implemented effectively, are most likely to generate the positive results and outcomes. However, in the case of Swiss banking sector, the trend of Islamic finance and products and services are noticed to be very unclear.

However, when looked at the gross and net profit margin of the above considered banks, the performances of the both banks are seen to be non-satisfactory. 17% has been the highest net profit margin of Habib Bank in 2009, whereas Faisal Bank has been making losses continuously. Off course, these banks are owned by the shareholders, and the demand of shareholders and investors is to gain the highest return, not losses. The primary reason behind the low profit and even huge losses may be due to the consumers' demands because low demand leads towards low sales and eventually towards the low profit. Theorists i.e. Claessens and Enricho (2007) also agree on this element and added that just few years ago, financial entities as well as international banks in Switzerland accepted the regulations and procedures of Islamic bank and considered it to be the biggest potential of financial sector. Numerous investors were rubbing their hands to penetrate in the Islamic finance. The primary reason was the fact that significant percentage of target market was about to become mature. As a result, various Swiss banks showed their interest in joining the party. Even, Credit Suisse and UBS launched the mutual investment funds to serve the potential customers through offering Sharia complaint services and products (Breggren, 2012).

However, when looked at the current market and industry trend, it is noticed that the level and volume of complexities have reached to their peak. For instance, in the case of liquidity management, the performance of both Habib Bank is observed to be very weak. Although, Habib Bank claims to be one of the largest and leading Islamic banks in Swiss market, but when it comes to the practices, it is even unable to balance its liquidity. Not only one year, but throughout the past five years, the Habib Bank's liquidity performance has been very weak which clearly reflects the weak market. From the practical point of view, it can be argued that Swiss market is not developed yet, therefore has high numbers of threats to deal with. It leads to learn that Islamic finance in Swiss has to deal with the consumer demand and respond them adequately to change their perception and behaviour (Claessens and Enricho, 2007). Off course, it is one of the most critical and biggest challenges for the practitioners. Especially, when it comes to the region in which the conventional banking is claimed and observed to be very much mature, there are very fewer opportunities for growth, but high numbers of threats to deal with.

Similarly, researchers argue that due to weak demand, numerous banks decided not to carry on with Islamic finance and products, therefore the Islamic finance euphoria fell down. Eventually, it leads the Islamic finance unit to experience weak growth due to low demand as well as low supply (England, 2008).

Today, the major and leading Swiss banks (i.e. HSBC) are no longer offering the Islamic finance services and products. Those banks rather offer tailored products and services that can meet the customers' demands and expectations. However, even some theorists and practitioners are found to be arguing that these customers have preferences to buy from the external suppliers and providers. Le Martin newspaper explored from research that likewise UBS, Credit Suisse also indicated itself as a niche market service provider.

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In addition to the above, experts elaborated the entire situation from different perspective by viewing different element. Stefan Leins, an expert of Islamic finance presented two key reasons behind the lack of interest from customers as well as banks. The first reason is defined to be the fact that global economic and financial crisis restricted the banks to inject more capital and increase the demand (Breggren, 2012). As a result, Islamic banks are left with limited capital to play with. The second key reason is defined to be the fact that even before the economic crisis, the expectation of Islamic finance success could not be fulfilled. As a result, the level of interest and motivation from the banks as well as shareholders and interest has declined.

However, some practitioners (i.e. Hearn et al, 2011) and industry experts are observed to be arguing that the banks that initially moved into Islamic finance viewed it as a golden goose and could not wait little more to enjoy the success. As a result, the Islamic finance could not attain of what was initially expected. Therefore the similar trend of weak performance, low growth and even failure kept continuing after the global economic and financial crisis.

The findings also reflect the similar trend that due to the lack of capital and investment, the debt ratio remained same in 2012, as it was in 2008, a part from minor growth. It leads to learn that since 2008, the Islamic banks in Switzerland remained at the same level in the following five years. It can therefore be argued that due to the weak interest, lack of capital and low demand from customers, threats from external business environment have increased. Banks are therefore noticed to be sustaining their existence, rather than focusing on the growth, as it seems to be almost impossible (Breggren, 2012).

However, the findings also reflect that UBS Bank in Switzerland has been having strong interaction with its customers and has reflected the positive growth in the past few years.

Practitioners and scholars therefore argue that Swiss environment is similarly potential today as it was few years ago. Even some are noticed to be claiming the Islamic finance industry has great and high potential for growth, but it is just that practitioners have over expected (Hussain, 2011). Considering the above fact and comparing it with the findings of research that asset turnover ratios has been positive of both banks. Although, the profitability and liquidity performances are noticed to be weak, but since assets are being utilized effective, the chances of success are higher and should be taken into consideration.

Further investigation also reflects that In Egypt and Tunisia have designed and executed new legal frameworks specifically for the Islamic finance. These initiatives are taken to strengthen the Islamic finance sector and ensure the positive results in future. It can therefore be argued that Swiss banking industry is much stronger than the other regions, and if there is potentiality of Islamic finance growth in other regions, logically it should work more effectively for the Swiss region too (Khalil & Shafii, 2012).

The above discussion leads to understand that although there are numerous challenges and issues that are influencing the growth, sustainability as well as success of Islamic finance in Swiss region, but since some banks have proved themselves to be successful, there seems to be enough potentiality and opportunities too (Breggren, 2012).

However, at the other end, when examined the Swiss conventional banking industry, it is observed that the performance of the conventional banks are not only stable, but moving towards the strong growth. Although during the global credit crunch and banking crisis, the Swiss conventional banks also experienced critical challenges that resulted in weak income and profitability, significant decline in stock price performance as well as slow asset growth.

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However, after the global crisis, Swiss conventional banking industry managed to improve its performance to sustain its earlier position (Pollard & Samers, 2013).

The above presented charts of the two considered banks i.e. UBS & Credit Suisse, when compared with the Islamic banks, it is noted that conventional banks are much stronger as compared to the Islamic banks. It may be due to the fact that conventional banks have fully penetrated in the market and have strong understanding about the potential threats and opportunities. Therefore, the financial strategies designed by conventional banks are much effective in generating positive results than Islamic banks. However, since Islamic finance is comparatively new area in Swiss banking industry, the practitioners have much more to learn, understand and invest to ensure positive growth, success as well as long term sustainability.

# Chapter Five

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## **5. Conclusion & Recommendations:**

### **5.1 Conclusion:**

The primary focus of this research study was made to determine, investigate and analyze the performance of Swiss Islamic banking industry. In order to do so, this research is primarily based on the financial information of the considered four banks (i.e. Islamic Banks – Faisal Bank & Habib Bank AG Zurich; Conventional Banks – UBS AG & Credit Suisse).

The findings of the research study reflects that as compared to the conventional banks, the Islamic banks are experiencing more critical issues and have fewer opportunities for growth, success as well as long term sustainability. When examined the short term financial performance, it is noted from the findings that after the global banking and financial crisis, the Islamic banks have been experiencing short of working capital in managing their operations. The primary



## **Islamic Finance in Swiss Banking Area**

reason behind the weak performance is the fact that investors have become more reluctant than ever before. Therefore, the primary focus of the investors has been to focus on the secure and safe investment options, rather than taking risks. Since Islamic banking is comparatively new market context, it already had fewer investors to back up its operations. Although it was considered to be the biggest opportunity by the practitioners within the banking industry, but the global banking crisis de-motivated the potential investors. Although, banking crisis has been overcome by the Swiss banking industry, but eventually it has affected the growth and success of the Islamic banks. It can therefore be deduced from the findings that Islamic banks, as compared to the conventional banks are facing critical issues in managing their working capital requirements.

Moreover, when examined the profitability performance of the Islamic banks, it is observed that the gross profit of the Habib Bank has been fluctuating at the significant rate. At the other end, the gross profitability performance of the Faisal Bank is even worst because it has been reporting the losses of over 300% in the past three years. Similar is the finding with net profitability which reflects that Faisal Bank is experiencing critical issues in improving its revenue and controls its expenses. In 2008, Faisal Bank reported the loss of 253% which kept increasing and reached at the level of nearly 400%. However, at the other end, Habib Bank managed to improve its profitability from 2% in 2008 to 14% in 2012.

The findings of the conventional banks also reflect that although during the global banking crisis, the profitability performance of the two considered and leading banks declined by significant rate. But in the following years, both of the considered conventional banks have managed to improve and sustain their profitability.

These findings clearly reflect that there is a positive growth opportunity for both banking sectors i.e. Islamic and Finance. Although Faisal Bank has recorded huge losses in the past three years, but Habib Bank, being in the same position managed to improve its profitability performance. Similarly, both of the considered conventional banks are also noticed to have performed positive. It leads to conclude that the Islamic finance has great growth opportunity within the context of Swiss Banking Area. The only concerning and critical element that is restricting the Islamic finance to grow is its own weaknesses in terms of strategic initiatives.

Moreover, it is also observed from the findings that since Islamic finance is comparatively new context for the practitioners, there has been lack of professionals and practitioners with strong knowledge and interest. It may be due to the fact that Islamic Banking is based on Sharia principles. Therefore there has always been a lack of professional guidance that can help Islamic banks to utilize them adequately. As a result the entire Islamic banking system, control and monitoring is based on the traditional methods. Eventually, it restricts the Islamic banks to improve their strategic decision making.

However, the above research also reflected that Islamic banking system, if integrates the strong monitoring and controlling measures can improve the performance of entire banking industry. As a result, other international Islamic banks will be interested in investing in the Swiss banking area. Consequently, it will lead towards the growth and success of Islamic banking with the Swiss region.

In addition, the above findings also lead to understand that when it comes to the resources utilization, the Islamic banks in Swiss banking area have shown weak performance. However, at the other end, the considered conventional banks performance is observed to be at the growing

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stage. Again, it is primarily due to the lack of professional interest that restricts the Islamic banking to grow and achieve its objectives within the Swiss banking area.

Furthermore, the findings reflect that the debt management performance of the Islamic banks have not been very effective. The primary reason is the fact that almost 50% of the capital is financed by debts. Investors consider it as an important element, and prefer to invest in those organizations that are rather dependant. However, in the case of Islamic banks, the capital structure is rather weak and inappropriate. Therefore, due to lack of investment, the growth investments cannot be made.

At the other end, when examined the share price chart of the conventional banks, it is observed that the performance has been improving. Although during global banking crisis, the conventional banks in Swiss area also experienced the decline in share price performance, but again managed to improve.

These findings lead to conclude that Islamic banking has been experiencing two major challenges to operate and succeed in Swiss banking area. The first major issue is the lack of investment and capital that eventually limits the Islamic banks in taking risks & making more investments, diversify its business operations and expand its portfolio. As a result, the Islamic banking is observed to be limited in terms of its operations and portfolio.

Another major issue that is deduced from the findings is the fact that Islamic banks need to improve their strategic performance. At current, lack of leadership, controlling, monitoring and clear objectives have made the Islamic banks restricted. There seems to be no innovation and creativity in terms of product, services as well as operations. The primary reason behind is the fact that Islamic Banks were required to wait a little longer, but they failed to do so and chose for

the exit as best option. However, the profitability performance of Habib Bank leads to understand that there is a huge demand of Islamic banking in Swiss region. The only requirement is to stay focused and positive. However, there has been lack of interest from investors as well as practitioners. The Islamic banking industry is therefore facing the lack of professional skills and expertise as one critical challenge to deal with.

Regardless the fact of current challenges faced by Islamic banking area, this context is still noticed to be very potential. The collaboration and integration of different international banks can strengthen the performance of Islamic banking within the Swiss context. Although, it is likely to take time, efforts and resources, but eventually it will become the key & potential context of the entire Swiss banking area.

## **5.2 Recommendations:**

**Recommendations for Practitioners:** Based on the above findings and analysis, it is observed that despite the fact of huge losses, Islamic banks still have many opportunities to ensure positive performance, growth as well as sustainability. Below are the recommendations that practitioners must consider;

- The first and most important area that must be focused by the Islamic banking in Swiss area is to ensure the attraction of potential investors. From the findings it is observed that majority of investors have withdrawn their investments. In addition, various banks have also shut down their Islamic operations. Although, it was the individual bank's strategy, but it eventually led the Islamic banking industry towards the lack of capital. Islamic banks are therefore strongly suggested to inject more capital through attracting international banks. At one end, it will allow Islamic banks to diversify their

## **Islamic Finance in Swiss Banking Area**

business operations and at the other end, it will allow the practitioners to attract and serve more and more customers.

- The second recommendation for the Islamic bank is to improve their organizational performance through hiring expatriates from other countries. At current, there seems to be lack of Islamic guidance and controlling bodies that can guide the existing Islamic banks. As a result, the Islamic banks in Swiss area are operating independently and within the best interest of their organizations. However, there is an urgent need of regulatory body and association that can control the Islamic finance and banking industry. This will allow the Islamic banks to re-design their strategic initiatives, follow the developed benchmark and ensure that all the efforts and resources are utilized within the best interest of entire Islamic industry, rather than the bank alone.
- Last, but not the least, practitioners within the Swiss Islamic banking area is also suggested to focus on the long term sustainability through improving and enhancing their short term financial performance. The improvement of working capital management, asset utilization and appropriate design of capital structure are the key concerning areas that must be focused by the practitioners.

**Recommendations for Researchers:** It is a fact that there are various limiting factors that are associated with this research study. Potential researchers are therefore suggested to focus on the following areas;

- This research study is based on the secondary research i.e. financial reports and financial data of the four considered banks. However, this research study could have been improved through collecting the primary data to get more insights

about the Islamic banks in Swiss area. But due to the limited resources, time and knowledge, it was suggested to focus on the secondary data only. However, this has limited the author is depending upon the available data.

- Researchers are therefore advised to focus on the mixture of primary and secondary data collection. This will allow them to explore key hindering factors that are influencing the Islamic banking in Swiss region through unfolding different areas and elements.
- Moreover, this research study is conducted through focusing on two Islamic banks. Author conducted a lot of research, but found out only two banks i.e. Faisal Bank and Habib Bank AG Zurich with their financial statements. Therefore, it influenced the validity and reliability of the entire research report.
  - Researchers are also recommended to collect the data of at least 15 Islamic banks to evaluate the larger context and picture. Eventually the findings and results will be more realistic.
- Last, but not the least, the purpose of this research study was to investigate and examine the key challenges and opportunities associated with Islamic banks in Swiss region. This topic is very broad and cannot be studied within the limited time frame and limited resources.
  - Researchers are therefore suggested to focus on one area associated with Islamic banking, rather than considering the entire industry and its growth as whole.

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# Appendix:

|   |                | Habib Bank          |                 | Faisal Private Bank |               |               |         |         |
|---|----------------|---------------------|-----------------|---------------------|---------------|---------------|---------|---------|
| RATIO ANALYSIS FOR THE YEAR:                |                | 2008                | 2009            | 2011                | 2012          | 2010          | 2009    | 2008    |
| Note: All figures are in SWISS FRANC 000's' |                |                     |                 |                     |               |               |         |         |
| <u>Liquidity Ratios:</u>                    |                |                     |                 |                     |               |               |         |         |
| 1   | Current Ratio: | Current Assets      | 57<br>9,024,404 | 775,429,688         | 783,019,355   | 686,937,459   | 104,063 | 153,913 |
|   |                | Current Liabilities | 5,207,335,972   | 5,700,730,083       | 5,434,521,060 | 5,407,989,253 | 73,830  | 101,867 |
|   |                |                     | 0.11            | 0.14                | 0.14          | 0.13          | 1.41    | 1.51    |

Profitability Ratios

2

GP to Sales

Gross Profit 0,725,194<sup>17</sup> 174,900,875 116,977,639 126,520,206

(10,243)

Net Sales

8,364,000<sup>30</sup> 316,123,397 258,600,791 286,432,229

(3,378)

55.36%

55.33%

45.23%

44.17%

(-234.07%) 320.17%

3

Net Profit to Sales

Net Income 6,307,253 54,971,923 29,057,538 40,379,281

(12,823)

Net Sales

8,364,000<sup>30</sup> 316,123,397 258,600,791 286,432,229

(3,378)

|   |  |              |               |               |               |               |           |         |
|---|--|--------------|---------------|---------------|---------------|---------------|-----------|---------|
|   |  |              | 2.05%         | 17.39%        | 11.24%        | 14.10%        | -         | -       |
|   |  |              |               |               |               |               | 3         | -       |
|   |  |              |               |               |               |               | 9         |         |
|   |  |              |               |               |               |               | 1         |         |
|   |  |              |               |               |               |               | ·         |         |
|   |  |              |               |               |               |               | 1         |         |
|   |  |              |               |               |               |               | 8         |         |
|   |  |              |               |               |               |               | %         |         |
| 4 | Return on Assets                                   | Net Income   | 6,307,253     | 54,971,923    | 29,057,538    | 40,379,281    | (112,823) | (8,525) |
|   |  | Total Assets | 7,352,361,433 | 8,384,394,907 | 8,031,939,680 | 7,850,421,968 | 107,118   | 157,359 |
|   |  |              | 0.09%         | 0.66%         | 0.36%         | 0.51%         | -         | -       |
|   |  |              |               |               |               |               | 1         |         |
|   |  |              |               |               |               |               | 2         |         |
|   |  |              |               |               |               |               | ·         |         |
|   |  |              |               |               |               |               | 1         |         |
|   |  |              |               |               |               |               | 7         |         |
|   |  |              |               |               |               |               | %         |         |
|   | <u>Asset Management Ratios / Efficiency Ratios</u> |              |               |               |               |               |           |         |
| 5 | Asset Turnover                                     | Net Sales    | 308,364,000   | 316,123,397   | 258,600,791   | 286,432,229   | 3,968     | 3,371   |





