
Evaluating Islamic banks' Products and Services through Product and Service Disclosure Index (PSDi)

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Abstract

Due to Shariah governance (SG), the management ensures whether or not their bank's products, services, and operations are in-line with the defined rules of Shariah. This Shariah ensurity is crucial because the concern investment and deposit making stakeholders chooses Islamic banks' products and services just because to protect their religious commitments and belief. The fundamental purpose of this project is to evaluate the prevailing Islamic banks' products and services through a self-constructed product and service disclosure index called PSDi here after. The study is inspired from the few well-reputed and highly cited prior research studies in the field of Islamic banks' disclosure. The focused is on the product and service attributes disclosed on the Islamic banks' website. PSDi would be used to compare different products and services offering by the Islamic banks. It would help both the existing and potential Islamic banks' customers in their investment decisions toward Islamic banks.

Keywords: *Islamic Banking, Products Disclosure, Services Disclosure, Shariah Compliance, Shariah Governance.*

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1. Introduction:

Islamic banking is a faith based banking system, inspired from the Islamic law of business (Ahmed, 2011). Therefore, a large number of customers choose IBIs because of the Islamicity of its products, services, operation, and all other kind of financial activities (Al-Mehmadi, 2004). Pakistan is among those countries across the globe that established on the ideology of Islam. The creation of a separate country for the Muslims of the sub-continent was to provide a space to the Muslims where they can protect their religious commitments and ideological stance. Therefore, Pakistan was created on this faith centered ideology, which means that here the Muslims citizens will be provided an environment in which they ensure their financial, social, economic, inter-personal, and religious activities according to the tenets of Shariah. In Pakistan, Islamic banking was also introduced on this approach as well (Ullah, 2014). Therefore, both the existing and potential Islamic banks' customers are keen interested in knowing the Shariah information disclosure of the IBIs, because to protect their religious commitments. That's why, to stay connect the existing customers and attract the potential customers, IBIs need to ensure full Shariah information disclosure and transparency.

In the established Islamic finance literature, a lot of work has been done concerning the disclosure framework and mechanism of the IBI. However, little concentration has been given to the Shariah information disclosure that proposed by the IBI's existing and potential customers. Therefore, the fundamental objective of the present study is to explore the attributes and information, especially related to Shariah, that need to be disclose in the IBI's annual reports and websites. Content analysis based research was conducted in order to achieve the purpose of this study. Phenomenology is a unique kind of qualitative research strategy, wherein a researcher explores the phenomena based on the individuals' lived experiences concerning that particular phenomenon. Structurally, the paper is divided into six main sections. The second explored the existing phenomena and concepts from the relevant established literature, third section framed all the existing concepts and identified space for the missing concepts, methodological approach of the study explained in section four, the

primary findings are explained in section five, while the last section concluded this research.

2. Literature Review:

There is not a standardized definition of SG and different scholars and researchers made different definition based on their personal approach, however, Hasan (2012), a prominent SG expert, viewed about SG that it is the set of rules, regulation, and organization arrangement on the basis of which IBIs ensure the Islamicity of its operations, products, and services. It is relatively an adequate definition of SG that covered almost each aspect of the governance. In the definition, organization arrangement refers to different the different SG's department, such as, Shariah supervisory board (SSB), Shariah compliance department, Shariah audit department, Shariah review department, Islamic product and services development department, etc. While the second part of the definition, that is, rules and regulations refer to the concern departments' standard operating procedures (SOPs). SG is not a separate governance structure that supplements CG within IBIs but it is an additional mandatory arrangement within the Islamic bank's CG architecture (Grais & Pellegrini, 2006b). This views is also supported by Qattan (2003) who argued that SG is a unique building block in the CG architecture of IBIs. This means that SG is the only corporate governance arrangement that differentiate Islamic from its conventional counterpart. Furthermore, SG is mandatory for IBIs and conventional banking institutions (CBIs) are free from such regulation.

The involvement of Shariah experts in the CG's activities of an Islamic bank gives rise to some unique issues, such as, independency, confidentiality, competency, consistency, and disclosure (Grais & Pellegrini, 2006a; Zainuddin & Nordin, 2016; Hasan, 2011). While, Hamid, Ubud, Djumahir, & Siti (2016) and Grassa (2013) added transparency and reputation, respectively, in the list of issues that arise due to the engagement of Shariah advisors in the Islamic bank's corporate governance system. Independency refers to the separation to dominance of SSB from board of directors (BOD) and management, confidentiality means ensuring secrecy of the bank's personal documents related to product and service, competency is about hiring competent members for SSB, consistency means that the Shariah pronouncements

made by the SSB should be consistent all time, disclosure is about communicating all the concern SG and compliance related information that are important to the concern stakeholders, transparency means true information should be disclosed, and reputation means the status of Islamic bank's SSB in the eyes of concern and potential stakeholders. There is a detailed literature established on each of these issues, however, the focus of the present study primarily on the disclosure issue.

Many researchers contributed to the disclosure discussion and framework within the IBIs. The nature of those studies varies from geography to geography, researcher to researcher, context to context, and most importantly regimes to regimes. Ramli, Majid, Muhamed, & Yaakub (2014) worked on the Shariah governance and compliance disclosure in IBIs. They make a comprehensive SG disclosure index on the basis Bank Negara Malaysia's (BNM) Shariah compliance disclosure requirements for IBIs. The geographical context of their study was Malaysia. They make comprehensive list of information which they grouped in eight different categories. Azid & Alnodel (2019) constructed a checklist of twenty Shariah disclosure items which were extracted from Accounting and Auditing Organization for Islamic Financial Institutions' (AAOIFI) governance standards. They conducted their study in Saudi Arabia, as Saudi Arabia and other Gulf countries followed AAOIFI's governance standards. Abdullah, Percy, & Stewart (2013) constructed two different information checklists, related to SSB and Zakat. Concerning SSB they make a checklist of nine attributes while a checklist of 10 attributes was made for Zakat. Both of their checklists were inspired from AAOIFI governance standards, Islamic Financial Service Board's (IFSB) guidelines, BNM's guidelines, and Bank Indonesia's (BI) disclosure requirements. The geographical context wherein they conducted their researcher was Malaysia and Indonesia. The entire attributes which they selected for their study was appropriately fit in the Malaysian and Indonesian regulatory regimes.

Majid, Sulaiman, & Ariffin (2010) conducted their research in Malaysia and constructed corporate governance disclosure index by exploring 123 disclosures attributes which then they classified into fourteen different groups. The information which they gathered in their disclosure checklist was extracted from the AAOIFI

governance standards-I, Islamic Financial Service Board's (IFSB) guidelines, and BNM's disclosure requirements. They checked their index on the annual reports of Malaysian Islamic banks for a certain period of time. Masruki, Kumar, & Hanefah (2018) also conducted their disclosure study in Malaysia and constructed Shariah disclosure index. They make a comprehensive checklist of thirty seven SSB's related attributes, categorized in five different categories. The information extracted from BNM's Shariah governance framework-2010 and Malaysian Islamic Financial Service Act-2013.

3. Conceptual Framework:

Based on the above discussion we developed the following conceptual framework, shown in Figure 3.1. The conceptual framework shows that disclosure in IBIs is a four folded phenomena in which every concern has their own requirements for information disclosure. An adequate Shariah disclosure information framework may developed by the bringing the inputs of all these four concern stakeholders. Regulators, central bank or security and exchange commission, has their own information disclosure requirements which they issued through governance framework or issued guidelines. Academicians and the foundational scholars in Islamic finance have their own requirements toward Shariah information disclosure. Different standards sitting agencies has their own standards wherein they ensure full disclosure. While, the concern and potential investment and deposits making customers have their own requirements in which they are interested. Therefore, an acceptable and ideal Shariah information disclosure framework will be one which developed by incorporating the disclosure requirements of all these four stakeholders. Furthermore, all the stakeholders' disclosure requirements are available in the established therefore they are given in gray three boxes, in the following conceptual framework. However, the Shariah disclosure requirements of the Islamic banks' existing and potential customers are given in, a different, comparatively light gray color dashes box. The reason is that, the present study will explored the Shariah information disclosure requirements by arranging experiential interviews of the IB's customers.

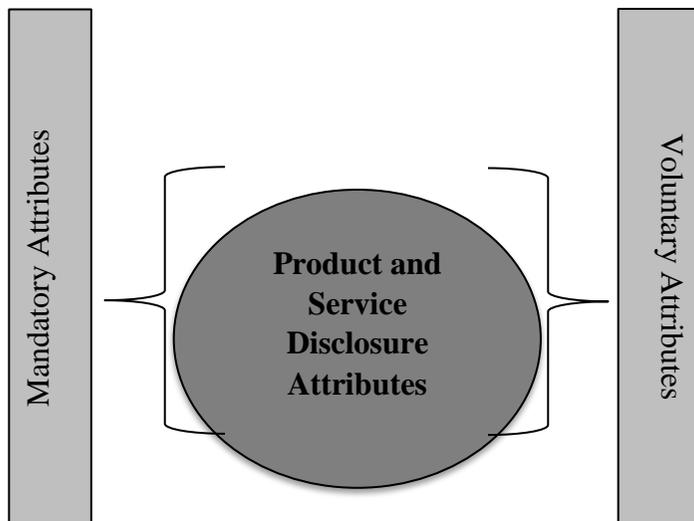


Figure 3.1: Shariah information concerning products and services

4. Methodology:

The study opted pragmatic approach both in the development and in indexing of PSDi. Wherein, disclosure attributes were extracted from the prior related studies and also from the SBP legal documents that deal implicitly and explicitly with the disclosure arrangement of the Islamic banks' products and services. We then constructed PSDi in the form of a mathematical equation. PSDi were then indexed for different Islamic banking products and services through content analysis of the concern Islamic banks' website regarding different products and services statements.

PSDi Development Process:

The following are the fundamental steps which are taken in order to construct PSDi:

Step-1: Making checklists of Product and Service disclosure attributes:

Arvidsson (2003) noted that in making disclosure index, the most important task is checklist development of all the concern attributes that supposed to be disclosed. In the development of disclosure index, the first step is gathering disclosure information, we called it disclosure attributes, from the established literature and from the prevailing statutory documents. The suggested attributes extracted from the established literature called voluntary disclosure requirements while the statutory disclosure requirements known as mandatory disclosure requirements. For voluntary

disclosure attributes we studied different prominent prior studies and make a table of the extracted attributes. Similarly, for mandatory products and services disclosure, we studied SBP issued Islamic products and services related guidelines, policy, circular, circular letter, and Shariah governance framework.

Mandatory Products and Services Attributes		Voluntary Products and Services Attributes	
1.	Name of the product/service	1.	Disclosure about how Islamic banks contributed toward Maqasid al-Shariah through their products and services
2.	Underlying Islamic mode	2.	Is the product or service environment friendly
3.	Tenors (Minimum and Maximum)	3.	Is the product or service contribute toward the social upbringing of the society
4.	Target customers	4.	Is the product or service is Islamic in substance also
5.	Type of product (Corporate, SME, Agriculture, Consumer, Commodity Financing, etc.)*	5.	Disclosure of late repayments of insolvent clients
6.	Basis for pricing/return*	6.	Investment areas wherein the product's investment employed and its proof of Islamicity
7.	Minimum and Maximum Financing Limit*	7.	Shariah appraisal of the adopted products and services
8.	Security/collateral required*	8.	Disclosure of products and services information in easy and local language
9.	Acceptable Currency**	9.	Disclosure of products and services in the local interpretation of Shariah
10.	Type of product (Saving/Current/Term/ others)**	10.	Disclosure of products purpose
11.	Minimum Balance requirement, if any**		
12.	Profit calculation (Daily product, monthly, etc.)**		
13.	Periodicity of Profit distribution (Monthly, quarterly, annual, etc.)**		
14.	Service charges leviable, if any**		
15.	Disclosure of the differences of all the Islamic bank's products offered with conventional products		
16.	Certificate/ fatwa from the Shariah Advisor		
17.	Process flow		
* Asset side products/ services, **Liability side products/ services			
Sources: State Bank of Pakistan (2007); State Bank of Pakistan (2013); State Bank of Pakistan, (2016a); State Bank of Pakistan (2016b); State Bank of Pakistan (2018);			

Step-2: Attributes weightings:

Weighting attributes means that all the attributes has no similar weight (Hossain, 2002). Following Ismail, Jan, & Ullah (2019) attributes weighting approach, weight of the mandatory attribute is 1 and weight of the voluntary attributes is 0.5.

Step-3: Scoring attributes:

Binary scoring approach is frequently used in prior studies in *Shariah* governance performance (Neifar & Jarboui, 2018; Haniffa & Cooke, 2005; Haniffa & Hudaib, 2007; Grais & Pellegrini, 2006). In scoring the communicated items through the annual reports Al-Razeen & Karbhari (2004) divided annual report's information into two group and scored it differently. The first group includes those information which covered only a single item, such as SSB members, and they scored this type of information by 1. The second group of information is those which are associated with multiple sub-information existence of SSB. In IFIs, SSB is connected to multiple related information, such as: SSB's member, SSB's meetings, SSB's fatawa, SSB's remuneration, and SSB's duties etc. They scored such items 0.25 of the concern primary item. I will also use binary scoring approach wherein I will score mandatory attributes 1 if it is disclosed or otherwise 0. Similarly, we scored voluntary attributes 0.5 if disclosed or otherwise 0.

After extracting both voluntary and mandatory disclosure attributes from the established literature and statutory documents, we then scored each attributes. Each mandatory attributes scored '1' and voluntary attributes scored '0.5'. This scoring technique is inspired from the prior index studies and from the importance each attributes as well. The total score of mandatory attributes is 17 while the total score of voluntary attributes is 5. The ideal product or service would be expected to secure 23 score (17+5).

Step-4: Calculating PSDi:

Calculating the total score of each attributes is the forth step of PSDi. We followed the same formula used by Abdullah et al. (2013); Haniffa & Hudaib, (2007); Ismail, Jan, & Ullah (2019). The following is the formula:

$$PSDi_{(bn)P} = \frac{\sum AMDA + \sum AVDA}{\sum EMDA + \sum EVDA} \times 100$$

Where

- $\sum AMDA =$ Sum of actual mandatory disclosed attributes
- $\sum AVDA =$ Sum of actual voluntary disclosed attributes

- \sum EMDA = Sum of expected mandatory disclosed attributes
- \sum EVDA = Sum of expected voluntary disclosed attributes
- bn = Bank name
- P= Product name

Higher the PSDi value represents higher Shariah compliant and vice versa.

Step-5: Classification of PSDi result:

The final score of each Islamic bank under PSDi are then classified in very poor \ practices, weak practices, 1 star (indicating good practices), 2 stars (indicating better practices), 3 stars (indicating best practices), 4 stars (indicating outstanding practices), and 5 stars (indicating ideal practices) as suggested by Meutia & Adam (2019).

Table 3.1 Islamic banks classification based on ISGDI		
ISGDI Score	Islamic Bank Classification	Indicates
1%-20%		Very poor practices
21%-30		Weak practices
31%-44%	★	Good practices
46%-60%	★ ★	Better practices
61%-80%	★ ★ ★	Best practices
81%-90%	★ ★ ★ ★	Outstanding practices
91%-100	★ ★ ★ ★ ★	Ideal practices

5. Calculating PSDi for adopted Islamic banks' products and services:

Calculating PSDi for each Islamic bank's product and service, we developed the following two checklists. PSDi calculated for Meezan Bank's Islamic Investment Certificate. Details of the product are taken from the Meezan bank's website. The product document is also given in ANNEXURE-I.

$$PSDi_{(bn)P} = \frac{\sum AMDA + \sum AVDA}{\sum EMDA + \sum EVDA} \times 100$$

$$PSDi = 9 + 1.5 \times \frac{11 + 5}{11 + 5}$$

$$PSDi = 65.62\%$$

Conclusion:

The paper concluded that disclosure, especially Shariah disclosure, in Islamic banking institutions is a two folded phenomena. In an ideal Shariah disclosure framework, the information's inputs comes from two different sides, such as, mandatory disclosure requirements of the regulators and voluntary disclosure requirements from the Islamic

finance academicians and scholars, international standard sitting agencies, and disclosure requirements from the existing and potential customers. Therefore, the present study focused on the Shariah information disclosure recommended by the IBI's existing and potential customers. The study explored 27 different information disclosures, in which the IBI's customers are keen interested, which then categorized into two different dimensions i.e. mandatory and voluntary. The study developed an evaluation index in order to evaluate the compliance of Islamic banks products and services with Shariah and stakeholders' disclosure demands. The index is also used in order to compare two products of same nature that offering by two or more different Islamic banks.

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Annexure-I

No.	Check/ Uncheck	Product/ service mandatory disclosure attributes	Score availed
MDA-1	<input checked="" type="checkbox"/>	Name of the product/service	1
MDA-2	<input checked="" type="checkbox"/>	Underlying Islamic mode	1
MDA-3	<input checked="" type="checkbox"/>	Tenors (Minimum and Maximum)	1
MDA-4	<input checked="" type="checkbox"/>	Target customers	1
MDA-5	<input checked="" type="checkbox"/>	Type of product (Corporate, SME, Agriculture, Consumer, Commodity Financing, etc.)	1

MDA-6	<input checked="" type="checkbox"/>	Basis for pricing/return	1
MDA-7	<input checked="" type="checkbox"/>	Minimum and Maximum Financing Limit	1
MDA-8	<input type="checkbox"/>	Security/collateral required	0
MDA-9	<input type="checkbox"/>	Disclosure of the differences of all the Islamic bank's products offered with conventional products	0
MDA-10	<input checked="" type="checkbox"/>	Certificate/ fatwa from the Shariah Advisor	1
MDA-11	<input checked="" type="checkbox"/>	Process flow	1
Total score avail by the product/ service			9

No.	Check/ Uncheck	Product/ service voluntary disclosure attributes	Score availed
VDA-1	<input type="checkbox"/>	Disclosure about how Islamic banks contributed toward Maqasid al-Shariah through their products and services	0
VDA-2	<input type="checkbox"/>	Disclosure that the product or service is environment friendly	0
VDA-3	<input type="checkbox"/>	Disclosure that the product or service contribute toward the social upbringing of the society	0
VDA-4	<input type="checkbox"/>	Disclosure that the product or service is Islamic in substance also	0
VDA-5	<input type="checkbox"/>	Disclosure of late repayments of insolvent clients	0
VDA-6	<input checked="" type="checkbox"/>	Disclosure of the Investment areas wherein the product's investment employed and its proof of Islamicity	0.5
VDA-7	<input checked="" type="checkbox"/>	Shariah appraisal of the adopted products and services	0.5
VDA-8	<input type="checkbox"/>	Disclosure of products and services information in easy and local language (in Urdu)	0
VDA-9	<input checked="" type="checkbox"/>	Disclosure of products and services in the local interpretation of Shariah	0.5
VDA-10	<input type="checkbox"/>	Disclosure of products purpose	0
Total score avail by the product/ service			1.5

Annexure-II

ABC Islamic Bank Ltd

Certificate of Islamic Investment MDA-1

Truly Halal and Absolutely Riba-Free!

The Certificate of Islamic Investment (COII) is a Mudarabah-based deposit MDA-2
MDA-5 product through which you can invest your savings for periods ranging from 3 MDA-4
MDA-3 months to 5 years and earn Halal profit on a periodic basis.

Investment Periods

Investment can be made for 3 months, 6 months, 1 year, 1.5 years, 2 years, 3 years and 5 years. MDA-3

Minimum Investment

Minimum investment is Rs. 50,000/- MDA-7

How the Certificate of Islamic Investment Works

Profit Sharing and Distribution Method MDA-8

The Distributable income of the deposit pool is distributed among the bank (Mudarib) and customers (Rab ul Maal) on the basis of a pre-determined profit sharing ratio and weightages which shall be announced 3 days before beginning of every month and shall not be changed during the month. According to the spirit of Mudarabah, the profit rates are calculated and announced up to seven days of the subsequent month from the monthly income of the trade activities of the pool. MDA-6

Conversely, in case of the loss as per the rule of Mudarabah, the Rab ul Maal shall bear the loss in the ratio of their investment.

Fatwa on Deposit Products MDA-10

DOWNLOAD FATWA (HTTPS://WWW.MEEZANBANK.COM/WP-CONTENT/THEMES/MBL/DOWNLOADS/E-DEPOSIT-PRODUCTS-FATWA-08.JPG)

Invest in an Islamic Investment Certificate MDA-11

Fill out the form below and you'll be guided about how you can invest with us.