An Evaluation on Project Financing under Islamic Banking

Sugunadevi Arjunan

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Sugunadevi Arjunan

Bachelor of Social Science
University Sains Malaysia

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ABSTRACT

Although Islamic banking has been in operation for more than a decade in Malaysia, it's market share and growth seem to be quite limited and fall far short of earlier projection. This study attempts to investigate one type of Islamic banking product, that is project financing.

The objectives of the study are to assess the current level of Islamic project financing and its associated growth, to identify problems faced in the implementation of Islamic project financing under the Mudharabah and Musyarakah concepts and to demonstrate with a real life case study the costs of financing under Islamic banking as compared to conventional banking under conditions of high and low interest rates.

The research methodology is of exploratory type based on primary data and secondary data. The research objectives were addressed using primary data which was gathered by way of interviews using structured questionnaires.

Shortage of qualified and experienced personnel, lack of quality entrepreneurs and lack of formal guidelines on Islamic banking aspects in the form of legal framework or Bank Negara guidelines are the main problems experienced in the implementation of Mudharabah and Musyarakah form of financing. The study revealed that Islamic form of banking is still at infancy stage in Malaysia as it only contributed approximately 2.6% of the total loans under broad property sector as at 31 December 1999. It was also found that Islamic banking is in favour of debt based financing over equity based financing. Long term financing activities have been financed by deferred sale instruments such as BBA, Al- Ijarah and Al- Istisnaa. The study also found that the cost of borrowing under Islamic banking is more expensive as compared to Conventional banking. Islamic banking uses fixed rate lending which lacks flexibility to revise interest rate to reflect prevailing market rate as opposed to Conventional banking which is more flexible as it is based on floating rate lending.

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