

# *The institutional development of Islamic finance in the Middle East: a post-colonial comparative perspective*

Article

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## **THE INSTITUTIONAL DEVELOPMENT OF ISLAMIC FINANCE IN THE MIDDLE EAST: A POST-COLONIAL PERSPECTIVE**

### **Abstract**

The Islamic finance sector has experienced rapid growth since its commercialization in the 1970s. For many Muslim countries that gained independence from their colonial rulers, developing the financial industry that represented their faith and value belief systems provided the population with a sense of identity. This paper traces the historical development of the Islamic finance sector in the Middle East. We apply the post-colonial perspective and the Institutional theory lens to analyze the evolution of governance models across three Middle Eastern countries: Bahrain, Kuwait, and the UAE. We find that the foundation for the Islamic finance sector was laid soon after these countries gained independence. The governance models in these countries have evolved from a decentralized approach to a centralized system aimed at harmonizing operations in the region and globally. The paper highlights implications for theory, policy, and practice and identifies avenues for future research.

**Keywords:** the Middle East; Islamic finance; Sharia governance; post-colonial theory; institutional theory

## THE INSTITUTIONAL DEVELOPMENT OF ISLAMIC FINANCE IN THE MIDDLE EAST: A POST-COLONIAL PERSPECTIVE

### INTRODUCTION

Interest-free trade financing agreements have a long history in the Arab world and predate the advent of Islam. The religious prohibition on interest is manifested in the verses of the Qur'an, which bars the use of *riba* (loosely translated to usury or interest). While Islamic financing was introduced as early as the seventh century, its commercial implementation only commenced in the 20<sup>th</sup> century (De Jonge, 1996). The present-day revival of Islamic finance can be traced back to the end of colonial rule in many Muslim countries. The newly independent countries gravitated toward their Islamic roots as they reassessed their economic policies and legal system (Warde, 2000).

Although the sector has experienced rapid growth in the Middle East and South and Southeast Asia, Islamic banking and finance institutions face challenges in applying global standards and regulations (Iqbal & Mirakh, 2007). The lack of institutional infrastructure and national differences in the interpretation and application of the Islamic principles against operating under the existing conventional financing system poses a challenge to launching Islamic commercial banks and financial institutions. While some progress has been made in this regard, such as establishing the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) in Bahrain in 1990 (AAOIFI, 2021), the application of the standards varies across the Middle East and other countries with a Muslim majority population.

The lack of standardization results from historical decisions made about the speed at which the system would be commercialized and the limited number of experts available who could judge the financial and religious credentials of the financial products and the processes followed. This has raised concerns about the authenticity of the financial products offered, and the procedures followed to comply with the religious doctrine. As Kamla and Rammal (2013) highlight, the actions of many Islamic financial institutions do not match their stated mission, and they pay lip service to their role in promoting social justice. Therefore, the governance mechanisms followed by the financial institutions are critical to ensure the products being offered are *halal* (permissible) under *Sharia* (Islamic law) (Nienhaus, 2007).

A *Sharia* advisor assures this compliance, and their use within institutions is a more recent phenomenon.

This article presents a historical analysis and critique of the development and evolution of the institutional environment of the Islamic financing system in the Middle East, emphasizing the role of *Sharia* advisors within the country's institutional environment (Gelderblom & Trivellato, 2019). Using institutional theory and post-colonial perspectives, we draw upon a standard historiographic orientation advocated by Fleischman et al. (1996), who argue for the co-existence and mutual complementarity of differing theoretical and historiographic schools of thought and historical methodologies. We offer a narrative and interpretive study combining two theoretical lenses (Rammal and Parker, 2012) to illuminate the regulatory and accountability elements of the sector in the Middle East. Thus, this study bears the imprint of historiographic insights into the relationship between narrative, interpretive and explanatory history (Elton, 1967; Parker, 1997).

## **THEORETICAL BACKGROUND AND METHOD**

Following the religious teachings, the Islamic financial system follows the notion of returns being linked to the level of risk. The prohibition on earning and paying interest on loans means that, in theory, lenders cannot make a guaranteed return. The capital would need to be invested rather than kept in a term deposit. In contrast to the conventional financial system, money has no intrinsic value under Islamic financing. Therefore, instead of lending money, Islamic financial institutions invest in the underlying asset for which the money would usually be borrowed. For example, instead of approving a car loan for their client to purchase a car, the Islamic financial institution would buy the vehicle on behalf of their client and then use various financing options (equity-ownership, lease, etc.) for the client to use and own the vehicle. In other financing options under this system, the financial institution becomes a partner in the business venture. If the venture makes a profit, the financial institution receives a return (Rammal, 2010).

However, if the venture is unsuccessful, then the institution makes a loss. Since the system does not burden the borrower to make fixed interest repayments when the venture is unsuccessful, it is also seen as an ethical form of financing that promotes social justice, entrepreneurship, and financial inclusion.

Despite the ethical nature and emphasis on social justice, there are questions raised about the ethicality of the system when it comes to its implementation. The lack of relevant rules, guidelines, and governance structures led to the belief, which in some cases was true, that organizations claiming to provide Islamic financial products are merely changing the terminology and offering conventional, interest-based financing products. The use of 'mark-up' in transactions by Islamic financial institutions seems like 'interest' in conventional finance.

Addressing the issue of compliance with Islamic laws in their true spirit was initially a challenge for financial institutions. Being educated in the Western curriculum and working in the interest-based economy meant that many professionals developing Islamic financing products were not proficient in understanding the religious expectations and obligations for commercial service offerings. As a result, the governance model of the Islamic financial institutions underwent further development. All Islamic financial institutions now engage at least one *Sharia* advisor or a group of individuals who are well-versed in Islamic jurisprudence and prudential regulations as part of the *Sharia* supervisory board. These advisors are hired by the financial institutions and act as an internal control body in the organization, therefore enhancing the credibility of the bank in the eyes of its customers and bolstering its Islamic credentials (Algaoud and Lewis 1997

These *Sharia* advisors undertake several roles, including providing advice on new product offerings, validating decisions made by the financial institutions' management committee, auditing financial transactions, and verifying operational compliance following *Sharia* (Karim, 1990). Hence, advisors play a critical role in the operations of Islamic financial institutions.

However, critics have raised questions about the independence of these advisors and the depth of knowledge in understanding both religion and finance. There are also concerns about inconsistencies in opinions, with some financing products being approved by one *Sharia* advisor as legitimate and *halal*. At the same time, the same offering may be deemed by another advisor to be against the teachings of Islam.

These inconsistencies highlight the disjointed efforts by the Islamic States and institutions to have unified rules and policies across the Islamic world. Faced with these challenges, the

Islamic countries combined their efforts to create formal institutions that would help develop global standards for Islamic financial institutions and provide legitimacy to the sector's operations. These institutions include the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), established in Bahrain in 1990, and the Islamic Financial Services Board (IFSB), established in Malaysia in 2002 (IFSB, 2022). Both institutions guide supervision and suggest the number of advisors on *Sharia* boards (AAOIFI, 1997; Karim, 2001). However, the adoption of these governance structures and auditing standards is voluntary, and it is the central bank of each country that decides the standards that financial institutions should follow.

Studying the evolution of the *Sharia* governance models in the Middle East allows us to identify the role institutions and advisors play in the sector's governance and how operational legitimacy can be enhanced. The lessons from the region help explain how organizations and institutions underwent isomorphism, be it coercive, normative, or mimetic (DiMaggio & Powell, 1983), and are a model for other Islamic countries and financial institutions inside and outside of the region.

Data for the study was collected from books, articles from academic journals and professional magazines, policy documents, reports by consulting firms, the websites of central banks, AAOIFI, IFSB, and select Islamic financial institutions in the Middle East. The data includes information about the launch of the Islamic finance sector in the region, the development of the institutions, the growth of the leading Islamic banks in the country, and the evolution of the *Sharia* governance models. To illustrate these issues, we cover the historical development of institutions and *Sharia* governance in Islamic financial institutions in three Middle Eastern countries of Bahrain, Kuwait, and the United Arab Emirates.

We chose the three countries because they rank as one of the top economies on the Islamic Finance Country Index in the Middle East, and the leading countries for Islamic banking assets worldwide (Statista, 2019). The three countries also share similarities, with all gaining independence from British rule and developing the Islamic financial system in their territories. The three countries also followed an informal and unregulated *Sharia* governance system, which in the last decade has been formalized. Although they represent two of the most prominent Islamic financial markets, we did not include Iran and Saudi Arabia in our study as they are both theocracies. The growth and percentage of Islamic banking assets

reflect the religious policies of the respective regimes rather than the consumer preference for the products.

We chose the post-colonial perspective and institutional theory as two analytical lenses to study the historical development of the Islamic financial services sector and *Sharia* governance in the Middle East. The use of the post-colonial lens (Verma & Abdelrehim, 2017) allows us to analyze the rapid growth of the Islamic finance sector at the end of colonial rule across the Islamic world. The sector's evolution can be seen as part of the valorization of cultural heritage in many Muslim countries in the post-colonial era. The British colonies were introduced to the Western governance model and legal systems, and foundations were laid for developing institutions that followed the bureaucratic norms and processes employed in Great Britain.

Thus, the institutional theory allows us to analyze how the formal and informal institutions helped lay the foundation for the commercialization of the Islamic finance sector in the Middle East. Central to this idea is the acknowledgment of institutional voids in these newly independent states, where the existing Western institutions were incompatible with the socio-economic beliefs and systems of the local population. As we discuss further in this paper, developing appropriate institutions and institutional structures posed a challenge. Countries had to determine whether such a development should be left to the organizations in the sector, by the State, or through a joint mutual effort.

Previous studies have highlighted that when institutional development and rules are forced through by the State, such as in Pakistan, Sudan, and Iran, the sector has generally struggled in adopting the new ways of doing things, and this, in turn, has slowed organizational growth (Rammal & Parker, 2012).

## **EVOLUTION OF ISLAMIC FINANCE IN THE POST-COLONIAL ERA**

In the ninth century, the Islamic empire stretched from Asia to northern Africa and parts of Europe, including Spain. The empire's success was credited to its advances in science, arts, and mathematics, which gave it economic, intellectual, and political supremacy (Husain, 2003). However, the empire's influence eroded with colonial powers taking over several Muslim countries' rule and control of resources. The abolishment of the Ottoman Empire, the last bastion of an Islamic state, in 1922 marked the end of this once-mighty empire. The loss

of identity and control in the Islamic world led to the renewed push by Muslims to revive the Islamic values and principles in their economic and social activities. The partition of the Indian subcontinent in 1947 resulted from this social movement, with Pakistan being created as a homeland for the Muslims of India. This period also marked the revival of the interest-free *Sharia*-compliant financing or Islamic financing system.

Preceding the formal commercial beginning of Islamic financing in the 1970s, small-scale, limited scope interest-free institutions were unsuccessfully tried in Malaysia and Pakistan between the mid-1940s and 1960s (Gafoor, 1996). The philosophy of these institutions was based on initiatives to achieve social goals (Maali, Casson and Napier, 2006). Similar moves were made by many Indian subcontinent loan cooperatives influenced by European mutual loan experiments and religious ideals (Warde, 2000). In Malaysia, the Muslim Pilgrims Savings Corporation was set up in 1963 to help pilgrims save for the expenses associated with performing *haj* (religious pilgrimage) (Wilson, 1995).

The first commercial application of Islamic finance was undertaken in 1963 by Egypt's Mit Ghamr Savings Bank, which earned its income from engaging in trade and profit-sharing investments (Lewis and Algaoud, 2001). While Mit Ghamr's charter did not explicitly refer to Islam or *Sharia*, the bank did not pay nor charge interest.

The end of the colonial rule in the Middle East, coupled with the growing economic power of the oil-producing countries in the region, provided the impetus for Islamic financing options to be made available commercially. The institutional development for the sector occurred concurrently. In 1973 the conference of foreign ministers of Muslim countries agreed to establish the Islamic Development Bank to foster economic growth and social progress of Muslim countries following *Sharia* principles (Saeed 1996). The first commercial Islamic bank, the Dubai Islamic Bank, was launched in 1975, marking the formal launch of the Islamic banking and finance sector.

The Middle East is a significant contributor to the Islamic finance sector. While the most populated Muslim countries like Indonesia, Pakistan, and Bangladesh are located outside the region, the Middle East is home to most global Islamic finance assets. According to 2019 data on the distribution of Islamic financial assets value, Iran (\$698 billion), Saudi Arabia (\$629 billion), Malaysia (\$570 billion), the UAE (\$234 billion), Qatar (\$144 billion), Kuwait

(\$132 billion), Indonesia (\$99 billion), and Bahrain (\$96 billion) are the leading economies (Statista, 2020). This suggests that the global consumer base tends to have a higher level of trust and confidence in the Middle East's institutional environment than the assets held by institutions in other regions, such as South and Southeast Asia, with a significant Muslim population. We discuss the development of the Islamic finance sector and the *Sharia* governance models in three leading economies: Bahrain, Kuwait, and the UAE.

## **DEVELOPMENT OF THE SHARIA GOVERNANCE SYSTEM IN THE MIDDLE EAST**

A common theme observed across the three countries in the Middle East and globally is that the governance mechanism in the Islamic finance sector evolved informally for the first couple of decades (Wilson, 1983). This resulted in inconsistencies across the operations of the financial institutions. Saeed's (1996) study on the Middle East found that there was only one *Sharia* consultant in some Islamic financial institutions, whereas, in other financial institutions, *Sharia* boards consisted of up to five members. In the last few years, there has been a focus on formalizing the institutional oversight of the operations of Islamic financial institutions, with a stronger emphasis on the role of *Sharia* advisors as members of the *Sharia* supervisory board.

The British rule over Bahrain ended in August 1971, and the first Islamic bank in the country, the Bahrain Islamic Bank, was established in 1979 (Bahrain Islamic Bank 2021). Being the home of the first Islamic finance-related institution, AAOIFI, the Central Bank of Bahrain's (CBB) legislative and regulatory framework closely resembles the AAOIFI standards. Initially, CBB required all Islamic financial institutions to establish an independent *Sharia* supervision committee that complied with AAOIFI's governance standards for Islamic Financial Institutions. The National *Sharia* Board of the CBB verified the compliance of its products only, and other financial institutions were expected to be self-regulated. Due to the limited number of qualified experts, there was no restriction on the members of the National *Sharia* Board serving on boards of any financial institution, nor was there a limitation on *Sharia* advisors serving on multiple boards of organizations (Bakar, 2002).

In 2017, Bahrain attempted to move towards a more centralized approach to *Sharia* supervision. This included the approval for new products to be undertaken centrally and Islamic financial institutions to demonstrate four elements in their governance structure: a

*Sharia* supervisory board, a *Sharia* coordination and implementation function, an internal *Sharia* audit function, and external independent *Sharia*-compliance audit (Oxford Business Group, 2018). The potential limitation of this directive lies in the limited guidance about who would qualify as an external auditor and what role will CBB play in this process.

Kuwait gained independence at the end of the British protectorate in June 1961. Kuwait is classified as a small country in terms of land size and population. Despite the limited scope of its domestic market, Kuwait's success in developing the Islamic finance sector can be gauged by the fact that it is home to Kuwait Finance House (KFH), the world's 2<sup>nd</sup> largest Islamic bank (Hussain & Marafi, 2005). The foundations of the Islamic finance sector in the country were laid in 1977, when KFH was established. Today the bank employs over 15,000 people and has 516 branches in Kuwait and worldwide locations, including Bahrain, Malaysia, Saudi Arabia, Turkey, and Germany (Kuwait Finance House, 2022).

Kuwait's *Sharia* governance development can be best described as informal, and *Sharia* observations and audits in financial institutions as decentralized. While AAOIFI standards provided a guide for financial institutions, the formal institutional efforts have been recent. In 2016, the Central Bank of Kuwait issued instructions on the "Sharia Supervisory Governance for Kuwait Islamic Banks," emphasizing *Sharia* audits (Islamic Markets, 2017). Further efforts have been made to formalize and centralize the governance system in the last few years. For example, in 2020, the Kuwait parliament approved a proposal to set up a *Sharia* board to regulate its banking sector and ensure consistency in its operations. To further enhance the governance mechanism, the Central Bank of Kuwait in October 2020 approved the establishment of a 'Higher Committee of Sharia Supervision' to modernize the *Sharia* supervision based on international best practices (Zawya, 2020).

Finally, we describe the development of the sector in the UAE. The UAE gained independence from the British protectorate in December 1971 and is home to the Dubai Islamic Bank (DIB), the world's first commercial Islamic bank, which was established in 1975. DIB has undertaken large-scale financing projects, including purchasing aircraft for Emirates using the Islamic financial system (Dubai Islamic Bank, 2021). Despite being the oldest commercial Islamic bank globally, DIB's *Sharia* supervisory board was established in 1989.

The Central Bank of the UAE requires Islamic banks to undertake internal *Sharia* audits and annual external *Sharia* audits. It also mandates that the *Sharia* committee have at least five members, with at least a third of the committee members being Emirati. In April 2020, the Central Bank issued standards regarding *Sharia* governance in Islamic financial institutions, which specify the requirements for internal and external *Sharia* audits, and the responsibilities of the *Sharia* committee members (Central Bank of the UAE 2020).

Among the three countries that we research in this study, the UAE followed a decentralized structure, where financial institutions self-regulated and informed the Central bank of their activities (Zarrouk, El Ghak & Abu Al Haija, 2017). In 2016, the UAE Cabinet approved the establishment of a central *Sharia* board that would attempt to centralize some of the governance activities (Oxford Business Group, 2018).

We also note that despite the AAOIFI regulations requiring three *Sharia* supervisors in organizations, all three banks we studied had availed the services of five supervisors. Table 1 summarizes the key dates and information regarding the Islamic finance sector in the three countries.

**Table 1:** Overview of the Islamic finance sector in selected countries

Country	Population (2020 est.)	Year of Independence	First Islamic Bank and Year of Establishment
Bahrain	1.702 million	1971	Bahrain Islamic Bank - 1979
Kuwait	4.271 million	1961	Kuwait Finance House - 1977
United Arab Emirates	9.89 million	1971	Dubai Islamic Bank - 1975

Source: World Bank 2022

## DISCUSSION

The evolution of the *Sharia* governance models in the three Middle Eastern countries shows a gradual move towards formalization of governance and emphasis on developing best practices. Comparing the three models, we find that the Bahrain governance model centers around implementing the AAOIFI standards. At the turn of the century, when AAOIFI lacked enforcement abilities and relied on the voluntary adoption of the standards by financial service providers (Haniffa and Hudaib 2002), Bahrain made it an official requirement for all Islamic

financial institutions in its jurisdiction to adopt standards released by AAOIFI (Bakar 2002). The Central Bank of Bahrain recently decided to move towards a more centralized approach to *Sharia* governance to maintain more robust control.

Kuwait has also followed a similar path, where Islamic financial institutions have moved from self-regulation to a centralized approach to governance. This includes plans to establish a central *Sharia* board to regulate the country's banking sector and plans to modernize the *Sharia* supervision practices. The UAE is the only country in our sample of three that continues to decentralize the *Sharia* supervision and audit and lays the onus on the organizations to implement the standards and guidelines issued by the Central Bank of the UAE. Financial institutions are responsible for ensuring that international *Sharia* audit committees are formed, and audits are undertaken periodically.

Regardless of the jurisdiction, the countries' central banks specify that the education and knowledge standards of the *Sharia* board members should be sufficient to make informed decisions about the religious and financial aspects of the products and transactions. From the institutional theory perspective, we see elements of coercive-mimetic isomorphism in the case of Bahrain and Kuwait and a more normative-mimetic isomorphism in the UAE.

The rapid growth of the sector reflects the demand of the local population for culturally relevant products and services. The freedom of choice that the end of colonialism provided to the people resulted in an unprecedented demand for *halal* financial products. Seeing the opportunities, financial service providers attempted to fill the gap without the appropriate regulatory infrastructure. This resulted in the informal institutional development of products that did not have consensus by jurists on meeting the religious obligations and expectations. The long-term effects of this rapid growth can still be observed, with many mark-up-based Islamic financing products being made available to consumers, even though there are questions raised about their similarity to the interest-based products. The other challenge is related to talent and knowledge development and management.

The initiatives of recruiting talented individuals for *Sharia* boards and ensuring board independence will bring more professionalism and enhance the legitimacy of the financial institutions. However, implementing these initiatives will be challenging. Historically, the sector has struggled with the shortage of qualified *Sharia* advisors globally (Abbas, 2008).

This has resulted in few qualified scholars serving on multiple *Sharia* audit boards. Hence, the governments need to invest heavily in training programs to address this shortage and ensure that there is enough mass of talented and knowledgeable individuals whose services can be availed by the financial institutions.

Looking beyond the region, we see some similarities and many differences with the evolution of and features of the *Sharia* governance models used in the Islamic finance sector in other countries. Pakistan and Malaysia are two countries that were former colonies of Great Britain and established and developed the industry in their respective territories and follow unique *Sharia* governance models.

Pakistan is a significant player in the Islamic finance sector. Pakistan was the first country to declare itself an Islamic Republic and the first country to attempt complete Islamization of the economy in the late 1970s, with the stated goal of eliminating conventional financing options (Ahmad, 1995; Khan, 2008). However, these decisions were politically motivated and not a result of a planned approach to growing the sector. With no institutional development, the country's banks and other financial service providers took an ad-hoc approach to product development and offerings (Khan & Bhatti, 2006). It was not until 2003 that the State Bank of Pakistan (the country's central bank) established the Islamic Banking Department to centralize the activities of the Islamic financial institutions. The State Bank proposed the *Sharia* governance model and established criteria for *Sharia* audits in 2008. The central bank's *Sharia* board must verify the introduction of new products (State Bank of Pakistan, 2008).

In contrast, Malaysia's approach to *Sharia* governance of the financial institutions has been planned and centralized (Wilson, 1995). In 1997, Bank Negara Malaysia (Malaysia's central bank) established the "Shariah Advisory Council on Islamic Banking" (SAC) as the foremost authority on Islamic finance in Malaysia (State Bank of Pakistan 2008). The SAC validates Islamic financial products to ensure their compatibility with *Sharia* principles (Bakar, 2002). The Malaysian model allows for variation in the number of *Sharia* advisors employed by Islamic financial institutions. The establishment of the IFSB in Malaysia can be seen as a recognition of the country as the regional hub of Islamic finance. The strong institutional environment has attracted investment in Malaysia's Islamic finance sector by leading global financial services firms.

Contrasting the experience of the Middle Eastern countries covered in this paper with Pakistan and Malaysia, we see that the three countries did not centralize the implementation of *Sharia* audits and permitted self-regulation. While the approach taken by these countries in developing the *Sharia* governance systems in the financing sector was more structured than what was observed in Pakistan, it was not as organized as the Malaysian model.

As the countries in the Middle East move toward a centralized approach to *Sharia* governance, the institutions in countries like Kuwait have expressed a desire to follow international best practices. This mimetic behavior may help them replicate models like those followed by Malaysia, aiming to adapt and follow these practices in their institutions. However, in the long-run merely replicating best practices will not provide these institutions with a sustainable competitive advantage. Instead, these Central banks should encourage and support the development of innovative practices that can be a model for other countries outside of the region to follow.

## **CONCLUSION AND FUTURE STUDIES**

Our review of the historical development of the Islamic financial system in the Middle East highlights how the countries in the region shed their colonial baggage and overcame challenges in attempting to develop the sector. The relatively smaller population but the large market share of the total Islamic finance assets held by the Middle Eastern countries shows that planning over a long period and implementing a gradual process of moving from informal to the formal development of institutions and regulations have given these countries a competitive advantage.

There are many lessons to be learned from the Middle East. The colonial legacy of imposing their cultural norms and controlling the form of knowledge that was shared has left many countries lacking the appropriate knowledge required for these financial institutions to operate. The shortage of qualified advisors is a result of this knowledge gap, which can take years to be filled. However, taking a long-term view, countries should invest in the development of relevant training centers along with the regulatory institutions.

While the example of the Middle East can be a model for other post-colonial Islamic countries attempting to develop their Islamic financial sector, we also find limitations to this

approach and lessons that can be learned from history. The effectiveness of Malaysia's governance model is acknowledged universally. The model is built on the notion of formal institutions such as the central bank working closely with the organizations in the sector to understand their needs and responding accordingly via relevant standards, policies, and support. Malaysia has not only invested heavily to promote the sector but has also invested in training and educational infrastructure that helps provide the best talent to these organizations.

Our study makes contributions to and has implications for theory, policy, and practice. From a theoretical perspective, we find that the application of the post-colonial theory to study Islamic finance remains limited. As we demonstrate in this study, the development of the finance sector in post-colonial Muslim countries is best understood when the analysis captures how the traditional societal values are suppressed during the colonization period. The end of the colonization provides the locals with the opportunity to revive their activities and determine the way they seek to manage their social and economic affairs.

From a policy perspective, we demonstrate that the lack of centralized formal institutional efforts resulted in inconsistencies, which threatened the legitimacy of the Islamic finance sector. Comparing the three Middle East countries with Pakistan and Malaysia allowed us to see the value of a more regulated and centralized governance structure (as practiced in Malaysia), which can help address the issue of inconsistencies in operations across organizations.

Finally, from a practice perspective, we highlighted the importance of investing in talented individuals with sufficient knowledge to cover Islamic jurisprudence and finance. As institutions formalize and centralize the governance requirements, the demand for individuals who can undertake internal *Sharia* audits will rise. Hence, investing in recruitment and training programs will help create a strong base of knowledge within the organization.

Our study focused on identifying the historical events that led to the development and growth of the Islamic finance sector in the Middle East and the challenges organizations and institutions faced in making their sector competitive. Future studies could investigate why the sector's development has been less successful in countries with large Muslim

populations, like Bangladesh, Indonesia, and Pakistan. These countries have much in common with Malaysia and some of the countries in the Middle East covered in this study, such as being former colonies and being proactive in developing their Islamic finance sector. Other studies could look at the implications of the commercialization of Islamic banking on small informal interest-free lending arrangements that were active in the period immediately after the end of the colonial era.

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