The influence of legal regulatory requirements as strategic growth on Islamic banking in Kenya. A case a case of selected commercial banks in Kenya

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Abstract: In Kenya's conventional banking, Islamic banking is not a novel concept. Many banks have chosen to provide Muslim and non-Muslim customers alternate banking options. Banks, on the other hand, confront a number of issues, including social, political, and legal issues. The goal of this research was to look at the strategic elements that influence Islamic banking growth using a case study of a few Kenyan commercial banks. From a population of 16 management officers and 80 consumers, 56 participants, 16 management officials, and 40 consumers were selected. Customers were sampled using probability sampling techniques, whereas management was sampled using census sampling. In this thesis, a questionnaire was used to collect data semi quantitatively using open and closed ended questions. Data collected was extracted into excel spread sheets, and later exported to SPSS for statistical analysis. Descriptive statistics and test of normality was calculated. Inferential analysis was also done for correlation and regression analysis to determine the effect of each factor on adoption of Islamic banking. Findings showed that the respondents knew the products very well as provided by the Islamic banking manuals. Consumer protection and legal concerns affected the establishment of Islamic banks in a positive and non-significant way. Risk perception, on the other side, had a minor and insignificant impact on the expansion of Islamic banks. It was concluded that others factor other than the three factors studied are better predictors of growth of Islamic banks are expressed by the regression model. This study therefore recommends that factors other than the three determinants be explored to establish the factors with greater impact as determinants of growth for Islamic banks in Kenya.

KEY WORDS: Islamic banking, Muslim, legal regulatory

1 INTRODUCTION

Islamic banks' major purpose is to give Muslims and non-Muslims alike access to credit through financial products. Islamic banks therefore offer financial solution to the conventional financial services. The characteristics of a good financial product is that it should enable the access to finance by everybody, expand and diversify their economic activities and as also increase the access to income and improvement of the social wellbeing of users.

The fundamental objective of poverty alleviation is in line with Islamic banking beliefs. They are formed under the Shariah law, which governs financial operations, as a fundamental financial organisation. The economic objectives, among other things, ensure that their money is divided equally to as many people as possible without inflicting any harm to those who legitimately obtain the riches (Ibn Ashur, 2006).

Following its inception, Islamic banking was recognized as one of the fastest growing banks, with double-digit yearly growth for a period of nearly 30 years Despite the fact that it began as a tiny rural bank in Egypt in the early 1970s, it has expanded to offer a wide range of financial goods and services to many traditional banks. Its current worth exceeds USD 150 billion, and it is expected to continue to rise in the financial industry as more traditional banks implement Islamic banking services (Iqbal & Molyneux, 2005).

The history in Kenya goes as while back and many challenges have come up because of the growing competition from even better competing financial institutions in many aggressive markets. Even though there has been a perfect growth representation in the previous history for the past between 30-40 years of business. There is need for the industry reorganization and reorientations on both the social and economic matters of financial transaction at the Islamic banks rather than focusing on the main goal of making profits and targeting the bottom line business interests. The most important part is in the identification of the social and economic barriers that present challenges to the competitiveness of Islamic banking products in big capital cities such as Nairobi.

II Literature Review

Regulatory and compliance as strategic growth among the Islamic banks in Kenya

According to Kinyanjui (2013), the greatest barrier for Islamic banking is legal backing, because Islamic law, in its application and implementation, offers its own method of executing commercial and financial contracts and transactions. As a result, the Sharia requires the absence of financial contracts and goods, as well as a lack of transparency and disclosure procedures for clients, to ensure that the users of the services are protected. Equally, the challenge is also with the number of the legal experts of Sharia law and Islamic banking. Furthermore, there are no accounting and auditing standards have been developed for use by Islamic banks. Furthermore, there is a lack of standardisation in credit analysis criteria, which poses obstacles and possible conflicts, particularly for banks in non-Muslim nations.

It was also challenging for some of the tenets set out by many of the products which are Shari'ah compliant due to the different interpretations of acceptability from the Shari'ah perspective which made it complicated to establish the standardization measures (Hemed, 2009). Consequently, this has seen many proposals on Islamic financial instruments being accepted by one board and rejected by another Shari'ah board since the basis of interpretations are based on the Shari'ah principles (Karbhari et al., 2004). It is implied that questions of interpretation of Shari'ah principles are left to Muslim schools, and that many have diverse schools of thought owing to differences in Muslim societies' cultures.

With western regulators, it has also been difficult to define and define Shari'ah law for Islamic banking. As a result, several banks have established their own Islamic Shari'ah committee to assess if their activities are in accordance with Islamic Shari'ah. As a result, standardisation of Islamic finance and instrument vocabulary, pricing, and formulae for banking products has become necessary.

Murabaha, for example, refers to financing through a sale with a later payment. According to the Business Review, some banks refer to it as Al Bai Bithaman Ajil/ BBA (Deferred Payment Financing) (2004). Sharia'h should be considered as an accelerator of invention and creativity, rather than a restraint, as many others have highlighted. This calls for collaboration between Scholars of Shari'ah law, practitioners, regulators and equally, the researchers. In undertaking research and indepth studies on towards the development of Shari'ah compliant Islamic banking products (Business review, 2004). This sentiment were similarly suggested by Tahir (2004), by suggesting for the development of Shari'ah manuals, banking manuals and proven and working formulas for Islamic financial services and products by financial institutions.

III Methodology

Research Design

According to Brown et al. (2003), a research design is the "glue" that holds a research endeavour together. It provides the structure of research development and how parts of the research are linked together in addressing research questions for the study. Qualitative study according to Creswell (2014) who defines it as a process of inquiry of social or human problems used on creating a complex, holistic representation of the views held by the respondents when conducted in a natural setting. While a quantitative study is a test of the theories of variables, measures and analyzed statistically to ascertain the statements of the theory.

This thesis utilised a descriptive research approach to look at the factors that influence Islamic banking growth in Kenya. Research done by Kumar (2011) suggested that a descriptive study was the best in establishing the relationship between two or more aspects of the study. It measures the ability of the independent variable to cause a change in the dependent variable for the study. It also assesses the relationship between numerous factors in the same demographic (Leedy & Ormond, 2015).

Target Population

The whole collection of instances from which a sample can be chosen and the results generalised to the entire population is referred to as the target population (Saunders et al., 2016). It is also regarded as an aspect or person that a researcher would like to investigate (Zikmund, Babin, Carr, and Griffin, 2013). A target demographic required to be able to communicate with one another (Cooper & Schindler, 2014) This study focused on the manager of banks that offer Islamic bank products in Nairobi County. The number of banks offering Islamic banking financial services are limited, hence, Saunders et al, (2016) provides a solution, when there is no suitable list to use for a sample frame; a researcher can make their own sampling frame as a way of ensuring that the information is valid and reliable.

As a result, the study focused on males and women aged 18 and above were employees in the two Islamic banks offering Islamic banking services and the targets is the managers of the bank at various units such as Branch managers and risk managers.

Table 1 Population of the study

Study Department	Management	Customers
	Target Population	Target Population
Barclays banks	2	10
First community bank	2	10
Gulf African bank	2	10
National Bank	2	10
Dubai Bank	2	10
Kenya commercial Bank	2	10
Middle east bank Kenya	2	10
Standard chartered Bank	2	10
Total	**16**	**80**

Sampling Design

Sampling design was the strategy that is adopted in coming up with the specific target population. It involved the selection of key individuals to represent the entire population of the research (Cooper & Schindler, 2014). It was collectively used to refer to the processes of estimating the sample frame, technique and size.

Sampling Frame

That's the whole list of people from the population from whom a sample was drawn, free of any bias (Saunders et al., 2016). The findings may be extrapolated to the total population using this sample frame. The sample frame was based on the employee population share of Islamic Banks for the financial year 2013. However, as of the conclusion of the 2018 fiscal year, no specific number of Islamic bank personnel has been disclosed.

Sampling Technique

This was really a scientifically established method for selecting the elements to be investigated. Representatives from the populations chosen to apply the findings to the entire population (Saunders et al., 2016). There were two types of sampling procedures used: probability sampling and non-probability sampling (Cresswell,2014). The possibility of selection for inclusion in a sample for all individuals is equal and known for probability sampling while in the latter, selection based on personal decision-making or convenience and therefore an element of bias was unavoidable (Zikmund et al., 2013).

The investigation used a variety of sampling strategies to collect quantitative and qualitative data. Both census and probability sampling was used in the individual survey. The managers were selected using census sampling to include all the risk managers and branch managers of the banks. Probability sampling was used to include all the customers of the banks. This was a walk in and access basis. The assumption was that the customers walk into the banks randomly to seek for services. Equally, willing customers were assessed at random. In line with Kothari (2004), a sample of accessible populations can be identified using carious sampling methods. The sample size as calculated was for 16 managers and 40 customers from all the banks in Nairobi County offering Islamic banking services.

Sample Size

A subset of the population is specified as the sample size (Creswell, 2014). The sample size is important to the principal researcher because, when calculated correctly, it removes bias in a study (Kumar, 2011). Moreover, a smaller sample size may not be preferred since it may not achieve the key study objectives. On the contrary, a very large one may cause unnecessary financial cost and resources (Zikmund et al., 2013). Consequently, use of the right scientific methods is recommended. A larger sample size is often preferred since the likelihood of committing an error is minimal since it lowers the variation in the distribution of the data collected, therefore, can be generalized to the entire population.

In this research all eight (8) Islamic banks operating in Kenya were investigated. They covered both Islamic banking and conventional banks offering Islamic banking services and products.

The sample size determination technique of Fischer et al (2006) was used to achieve the appropriate sample size. Because the fraction of the population engaged in Islamic banking is unknown as of 2019, 0.5 (50%) is estimated as P. (Proportion of population of interest). The confidence interval is set at 95%, while the minimal error is set at 5%..

$$n = \frac{z^2 * P * q}{d^2}$$

Where:

n = sample size

z = confidence level of 1.96

p = proportion of variable of interest in the population not known

q = 1- p

d = precision (0.05 per cent)

Because Kenya's target population of conventional and Islamic bank staff is under 100,000.

Sample size is determined using the formula Fisher et al (1998).

$$n = \frac{Z^2 pq}{d^2}$$

q= (1- p)

Where: ***n*** = Sample size

Z = Z score statistics for the level of confidence 95%: Z value =1.96

p = expected prevalence or proportion (in proportion of one; if 50%, (*P* = 0.5)

d = degree of accuracy which is 0.05

$$n = \frac{1.96^2 \times 0.5(1-0.5)}{0.05} \; 324.16$$

The target population is 324.

Since the target population was less than 10,000 the sample size was adjusted using the following formula.

$$nf = \frac{n}{1+\frac{n}{N}}$$

Where nf= desired sample size (when population is less than 10,000)

n = sample size calculated as 324.

N = Minimum number of employees required at any given time in a bank due to COVID 19 pandemic regulation as advised by business operations manager of both banks.

Thus. $nf = \frac{n}{1+\frac{n}{N}}$

$$nf = \frac{324}{1+\frac{324}{65}}$$

nf = 324/1+$\frac{324}{65}$

nf = 324/5.98

nf = 54

54 respondents were considered.

Hence, 54 was divided into an equal number of customers from all eight (8) banks identified for the study.

Table 2 Population of the study

Study Department	Management Target Population	Customers Target Population	Sample size	
			Management	Customers
Barclays banks	2	10	2	5
First community bank	2	10	2	5
Gulf African bank	2	10	2	5
National Bank	2	10	2	5
Dubai Bank	2	10	2	5
Kenya commercial Bank	2	10	2	5
Middle east bank Kenya	2	10	2	5
Standard chartered Bank	2	10	2	5
Total	**16**	**80**	**16**	**40**

Data Collection Methods

The data was gathered from the sample group using a semi-structured questionnaire administered using drop and pick method. Christensen, Johnson, and Turner (2014) defended the use of questionnaires, claiming that they were prevalent because they allow researchers to save time and money. It's also convenient since a researcher can collect a lot of data from a big group of people. The author does warn, however, that surveys should be brief and may be prone to non-response for certain questions. In this study, the questionnaire was broken into several sections to gather data for the various aims and research components. The responses in the questionnaire were measured using a scale informed by the five-level Likert scale. This scale was collecting data with from 1 to 5, with an interval of one and reflected the different strengths of different strengths.

Respondents were requested to give their informed consent and were given a questionnaire if they agreed to participate in the study. For easier answer collecting, the responder was needed to answer to the questions by checking on the proper section of the boxes supplied in the likert type table This was done to make it easy for the respondents to provide their responses within the shortest time possible without compromising the quality of the feedback provided.

IV Data Analysis Methods

Data Preparation

Inconsistencies, incompleteness, misclassification, and gaps in the information gathered from the respondents were searcher for, identified and removed from the data gathered (Kumar, 2011). Missing data were altogether verified in the data that was collected: Data that was found to have been invalid due to data collection mistakes was omitted from the final data analysis activities. This was; data that was incomplete; data that was depicting signs of inconsistent; and data that was wrong due to fabrication (Cooper & Schindler, 2014).

Descriptive Statistics

Descriptive statistics are characteristics that show where the distribution's center (location), spread (variability), and shape are. They are crucial data description screening tools. They summarise the data's key summary qualities, organise it, and summarise it in a straightforward manner (Cooper & Schindler, 2014; Peck & Devore, 2012). For easier visual explanation, descriptive statistics may be used to create patterns in the form of figure (graphs, charts) as well as tables. Measurement of central tendency and dispersion are instances of descriptive statistics (Saunders et al., 2016). This study employed quantitative analysis to in analysis to give out descriptive statistics which summarised all the properties of the research items of interest.

Inferential Statistics

Inferential statistical analysis are statistical approaches for drawing conclusions or making decisions based on facts. This enables the generalization of information from the sample to the general population of the study. Depending on the number of variables, inferential analysis can be univariate (one), bivariate (two) or multivariate (more than two) variables when testing for the objectives of the study (Zikmund et al., 2013). In this study, factors analysis was done to measure how each item fits into the constructs of the study followed by correlation analysis. Test of Normality of data was performed to evaluate the suitability for use of regression analysis. If the data is normal, then linear regression model would be used to regression analysis to determine the special relationships respectively between the social-cultural factors and consumer protection factors, legal requirements and risk perception factors as strategic factors for growth of Islamic banking in Kenya. 3.8 Ethical Considerations

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Researchers' behaviour in respect to the rights of persons who become the topic of a research thesis, or who are impacted by it, is governed by ethics (Saunders et al., 2016; Zikmund et al., 2013). Three key topics of ethics are society's relationship with science, professional difficulties, and the treatment of study subjects. Professional ethics and misbehaviour must, nevertheless, be observed in business research. A case of fabrication, falsification, or plagiarism in proposing, performing, or reviewing research is an example of research misconduct (Christensen et al., 2014).

Legal Factors Summary responses

Most of the respondents agree 63.5% (33) while 17 (32.7) strongly agree that there are different interpretations and acceptability of various products from a Shariah perspective. In addition, most of the respondents strongly agree 33 (61.5%) and 15 (28.8%) that the Sharia manuals are very useful and comprehensive as provided by the bank, the others 5 (9.6%) were neutral. Nonetheless, many respondents (33(63.5%) strongly disagreed while 9 (17.3%) disputed that there is no Shariah-compliant legislative structure for interest-free banking in Kenya that would make it permissible. In response to this question, an equal number of 9 (17.3 percent) were neutral, while just 1 (1.9 percent) agreed with the statement. The issue stating there is a lack of accounting and auditing standards relevant to Islamic banking in Kenya was endorsed by all respondents, with 41 (78.8 percent) agreeing and 11 (21.2) strongly agreeing. Similarly, 37 (71.2 percent) and 10 (19.2 percent) strongly agreed that there is transparency and disclosure to the public in order to provide consumer protection. The respondents also strongly agreed 32 (61.5%) Islamic banking products are not different from products and services provided by the conventional banks. Equally, a good number of respondents strongly agree 27 (51.9%) and 16 (30.8%) agree that introduction of Islamic banking is as a result of global trends in banking. Only 4 (7.7%) were neutral and the remaining disagreed and strongly disagreed (3 (5.8%) and 2 (3.8%) respectively.

It was also notable from the responses that many of them strongly agree 29 (55.8%) and 6 (11.5%) agree to perceptions of Islamic banks not adhering ti the guidelines leading to low uptake of Islamic banking services. This was countered by 7 (13.5%) who disagree and 4 (7.7%) strongly disagree. Moreover, many of the respondents indicate that they were not convinced that Sharia compliant banks are fully fledged Islamic banks in Kenya (28 (53.8%), while a similar proportion of respondents 8 (15.4%) agree and disagree while 4 (7.7%) strongly agree and disagree respectively. It was now agreeable for 19 (36.5%) and 8 (15.4%) of the respondents that Islamic banks provide information for their products while an almost equal number of respondents remained neutral on the question 18 (34.6%). It was also agreed that Islamic bank and their products remain largely unknown by 27 (51.9%) and strongly agreed by 14 (26.9%) of the respondents, however, only 6 (11.5%) and 5 (9.6%) of the respondents disagree and strongly disagree respectively. Moreover, it was also agreed by 21 (40.4%) and strongly agreed by 13 (25%) that they do not have complete item to item alternative for all kinds of banking services. While 10 (19.2%) were neutral, 5 (9.6) disagree and 3 (5.8) strongly disagree with the statement. Albeit, 17 (32.7%) agree and 6 (11.5%) strongly agree to the statement that Islamic banks have limited products ranges, while 14 (26.9%) remained neutral, 10 (19.2%) disagree and 5 (9.6%) strongly disagreed to the statement.

Table 3 Legal factors summary responses

Statement	1	2	3	4	5
a) Different interpretations of the acceptability of various products from a Sharia perspective	0 (0.0)	1 (1.9)	1 (1.9)	33 (63.5)	17 (32.7)
b) The banks Shari'ah manuals are useful and comprehensive	0 (0.0)	0 (0)	5 (9.6)	15 (28.8)	32 (61.5)
c) There is no Sharia'h compliant legal framework needed to make interest-free banking acceptable	33 (63.5)	9 (17.3)	9 (17.3)	1 (1.9)	0 (0.0)
d) There is absence of accounting and auditing standards pertinent to Islamic Banks,	0 (0.0)	0 (0.0)	0 (0.0)	41 (78.8)	11 (21.2)
e) There is transparency and disclosure to the public in order to ensure consumer protection	0 (0.0)	2 (3.8)	3 (5.8)	10 (19.2)	37 (71.2)
f) Islamic banks products are not different from products and services provided by conventional banks.	6 (11.5)	8 (15.4)	4 (7.7)	2 (3.8)	32 (61.5)
g) The introduction of Islamic banking was a result of global trends in banking	2 (3.8)	3 (5.8)	4 (7.7)	16 (30.8)	27 (61.9)
h) The perception that the Islamic Banks do not fully adhere to Sharia guidelines leads to low uptake	4 (7.7)	7 (13.5)	6 (11.5)	6 (11.5)	29 (55.8)
i) Not all Muslims are convinced that Sharia Compliant Banks in Kenya are truly fully-fledged Islamic banks.	4 (7.7)	8 (15.4)	28 (53.8)	8 (15.4)	4 (7.7)
j) Islamic bank provide information for their products	2 (3.8)	5 (9.6)	18 (34.6)	19 (36.5)	8 (15.4)
k) Islamic Banks and Islamic Banking products remain largely unknown and misunderstood in the Kenyan Market	2 (3.8)	3 (5.8)	6 (11.5)	27 (51.9)	14 (26.9)

l) Islamic financial institutions do not have complete item alternatives for all kinds of traditional financial solutions	3 (5.8)	5 (9.6)	10 (19.2)	21 (40.4)	13 (25)
m) Islamic banks have limited product rang	5 (9.6)	10 (19.2)	14 (26.9)	17 (32.7)	6 (11.5)

Source: Researcher's data (2020)

CONCLUSION

Findings on influence legal factors and growth of Islamic banking in Kenya

It was found that financial legal factors highly affect growth of Islamic banking in Kenya, where despite some indicators of financial legal factors showing low effect on growth of Islamic banking in Kenya, most of them high affect the financial performance. It was found that at 0.05 level of significance, the financial legal factors have a moderate positive significant ($r = 0.398$, $p = 0.002$) effect on growth of Islamic banking in Kenya. The study established that there are different interpretations and acceptability of various products from a Shariah perspective. Sharia manuals are very useful and comprehensive as provided by the bank. Meanwhile there are issues of lack of accounting and auditing standards relevant to Islamic banking in Kenya despite there being transparency and disclosure to the public in order to provide consumer protection. Islamic banking products are not different from products and services provided by the conventional banks and introduction of Islamic banking is as a result of global trends in banking. However, Islamic banks not adhering to the guidelines leading to low uptake of Islamic banking services and Sharia compliant banks are fully fledged Islamic banks in Kenya but these banks provide information for their products while Islamic bank and their products remain largely unknown. These banks do not have complete item to item alternative for all kinds of banking services and Islamic banks have limited products ranges.

RECOMMENDATIONS

The study recommends that the Islamic banks in Kenya should enc=hance their growth through the following the considerations and strategies. The banks should build strong customer loyally though product awareness campaigns. These campaigns should creating awareness of Islamic banking and ensure that the prospective and existing acquire sufficient knowledge of Islamic banking which make then change their attitude to products and services

Secondly, the back should ensure effective and total consumer protection reviewing the Government regulation on Islamic banking as well as their agency regulation in addition to branching regulation. These banks should make their Islamic banking regulation are customer friendly.

The study recommends that Islamic banking in Kenya should review their legal factors including their, acceptance of Sharia'h law and Sharia'h legal frameworks to make there more transparent to non-Muslims. They should always esnure Sharia'h manual availability in addition to availability of information. Their accounts and audit frameworks should be transparently clear.

Lastly the study recommends for allaying the risk perception Islamic banking in Kenya through effective **s**trategic marketing, customer service quality, corporate governance and developing innovative product portfolio.

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