THE IMPACT OF ISLAMIC FINANCIAL DEVELOPMENT AND SOCIAL ORIENTATION OF ISLAMIC BANKS ON INCOME INEQUALITY IN OIC COUNTRIES

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by

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AAOIFI	Accounting and Auditing Organization for Islamic Financial Institution
CAGR	Compound Annual Growth Rate
CORR	Corruption
CSR	Corporate social responsibility
GDPC	Gross Domestic Per Capita
ICFM	Islamic Conference of Foreign Minister
IDB	Islamic Development Bank
IE	Income inequality
IFD	Islamic financial development
IFSB	Islamic Financial Services Board
IIFM	Islamic International Financial Market
IILM	International Islamic Liquidity Management
IMF	International Monetary Fund
INF	Inflation
OECD	Organisation for Economic Co-operation and Development
OIC	Organization of Islamic Countries
UN	United Nation
ZKT	Zakat

IMPAK PEMBANGUNAN KEWANGAN ISLAM DAN ORIENTASI SOSIAL DALAM PERBANKAN ISLAM TERHADAP KETIDAKSAMAAN PENDAPATAN DI NEGARA-NEGARA PERTUBUHAN PERSIDANGAN ISLAM (OIC)

ABSTRAK

Pembangunan kewangan Islam di dunia Islam semakin baik. Tetapi, ketidaksamaan pendapatan mereka dalam keadaan membimbangkan. Trend ketidaksamaan pendapatan di majoriti negara-negara OIC adalah meningkat dan tidak tetap. Majoriti negara-negara OIC tersebut mengamalkan sistem perbankan Islam dan konvensional. Terdapat kelemahan dalam sistem perbankan konvensional. Oleh itu, pembangunan kewangan Islam dipercayai mengurangkan ketidaksamaan pendapatan. Selain pembangunan kewangan Islam, orientasi sosial dipercayai menyokong mekanisme mengurangkan ketidaksamaan pendapatan. Oleh itu, kajian ini mepunyai tiga objektif ialah untuk mengkaji kesan pembangunan kewangan Islam terhadap ketidaksamaan pendapatan; untuk mengkaji kesan zakat oleh bank Islam dalam meningkatkan keberkesanan pembangunan kewangan Islam dalam mengurangkan ketidaksamaan pendapatan dan untuk menganalisis sama ada tanggungjawab sosial korporat yang lebih aktif dan tinggi oleh bank-bank Islam meningkatkan keberkesanan pembangunan kewangan Islam dalam menurunkan ketidaksamaan pendapatan. Kajian ini menggunakan 25 negara OIC untuk tempoh 2006 hingga 2014. Hasil kajian menunjukkan bahawa pembangunan kewangan Islam mengurangkan ketidaksamaan pendapatan. Zakat dan tanggungjawab sosial korporat membantu pembangunan kewangan Islam dalam menurunkan ketidaksamaan pendapatan.

THE IMPACT OF ISLAMIC FINANCIAL DEVELOPMENT AND SOCIAL ORIENTATION OF ISLAMIC BANKS ON INCOME INEQUALITY IN OIC COUNTRIES

ABSTRACT

Islamic financial development in the Muslim world had shown tremendous improvement. But, their income inequality are in worrisome state. The income inequalities' trends of majority OIC countries are increasing and fluctuating. Majority of these OIC country practise Islamic and conventional banking system. There are shortness in the conventional banking system. Thus, Islamic financial development could be able to reduce income inequality. Apart of Islamic financial development, social orientation are believed to be supporting mechanism in reducing income inequality. Therefore, there are three objectives of this study which are to examine the effect of Islamic financial development on income inequality; to investigate the moderating effect of the zakat by Islamic banks in improving the effectiveness of Islamic financial development in reducing income inequality and to analyse whether a more active and higher corporate social responsibility by Islamic banks enhances the effectiveness of Islamic financial development in bringing down income inequality. This study uses 25 OIC countries for the period from 2006 to 2014. The result indicates that Islamic financial development reduces income inequality. Zakat and corporate social responsibility help the Islamic financial development in reducing the income inequality.

CHAPTER ONE

INTRODUCTION

1.1 Development of the Islamic Banking System.

Islamic finance had been resurgent in 1975 in the Middle East with the first Islamic commercial bank was developed which is Dubai Islamic Bank. Four years later, the Islamic insurance companies as known as Takaful had been operated in Sudan and Dubai (Bakar, 2010). In the recent years, more than 75 countries had acknowledged the practices of the 300 Islamic financial institutions inclusive non-member of Islamic Organization Countries (OIC) such as United Kingdom (Bakar, 2010; Islamic Financial Services Board, 2015a), Singapore (Bakar, 2010; Islamic Financial Services Board, 2015a), Japan, South Korea, France, Hong Kong, Australia (Bakar, 2010) Luxembourg and Mauritius (Islamic Financial Services Board, 2015a).

Iran and Sudan run 100% Sharia banking system. Seven other countries achieved systemic importance in Islamic banking system specifically Yemen, Brunei, Saudi Arabia Kuwait, Qatar, Malaysia, and the United Arab Emirates (UAE). These countries apply dual financial system. It is where the Islamic financial sector operates together with the conventional finance sector. All of these countries are classified as systemic importance because they can reach either more than 15% of total Islamic banking assets or 5% of the total global Islamic banking assets (Islamic Financial Services Board, 2015b).

Turkey, Pakistan, Bangladesh, Bahrain and Jordan are showing the upward growth of the Islamic finance market. Their growth has geared by several development initiatives and legal support from the government agencies and regulatory bodies inclusive the formulation and implementation of blueprints to achieve a broader market share for Islamic finance. Also, several countries had shown their interests in the Islamic banking that comprised of developed countries like USA, France, UK, Japan, China and Federation of Russia. As well, emerging countries like South Korea, India, Philippines together with Thailand. Then, under-developed countries, for instance, Kenya, Burkina, Niger, Nigeria and Guinea (Islamic Financial Services Board, 2015b). Figure 1.1 portrays the Islamic finance market by systemic importance.

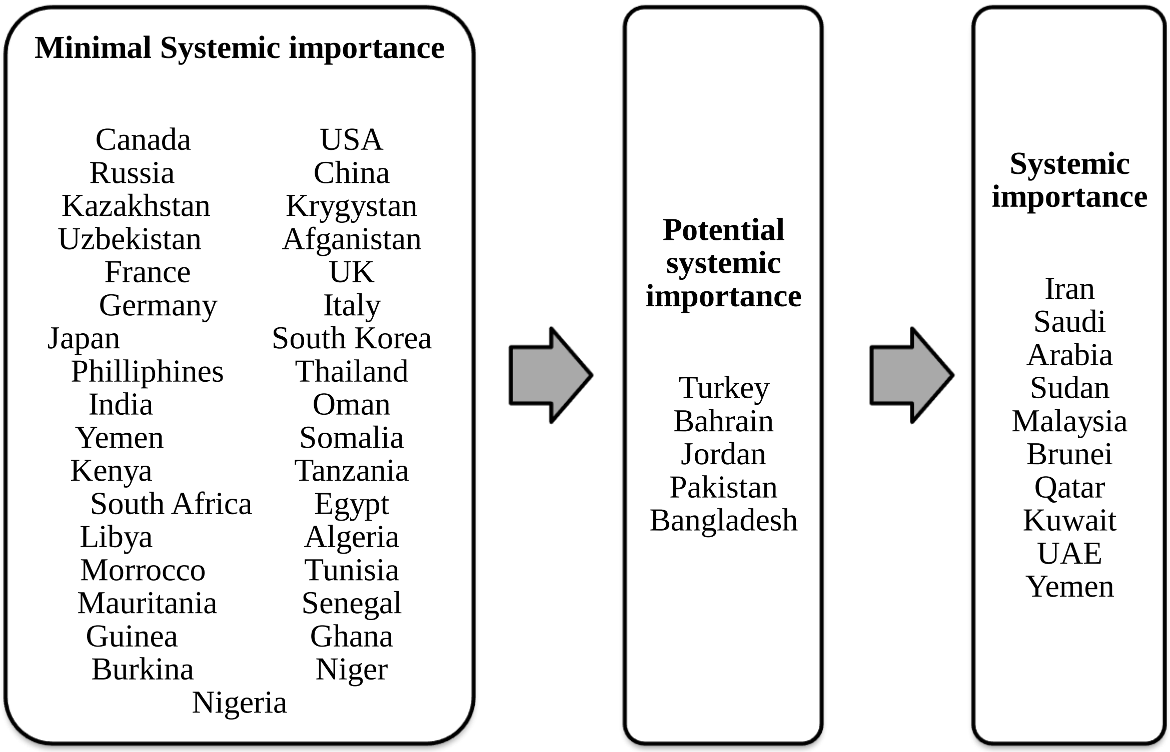


Figure 1.1 Islamic Finance Market by Systemic Importance
Source: Islamic Financial Services Boards (2015b).

As for the systemic importance of Islamic finance markets, Saudi Arabia has 51.3% of the total domestic banking assets that are equivalent to 18.6% of the global Islamic banking assets. Malaysia has 21.9% of Islamic banking assets as a proportion of total domestic banking sector which is 9.6% of the global Islamic banking assets. UAE maintains 17.4% of Islamic banking assets of its total domestic banking sector that are nearly 7.4% of the global Islamic banking assets. Islamic banking assets in Bangladesh owns 17% of its domestic banking assets. Brunei, Kuwait, Yemen and Qatar are classified systemic importance since they have 41%, 38%, 27.4% and 25.1% Islamic banking assets as a part of the total domestic banking sector respectively. Table 1.1 shows the jurisdiction of Islamic banking share in total banking assets (Islamic Financial Services Board, 2015b).

Table 1.1: Jurisdiction of Islamic banking share in the total of banking assets.

	Jurisdictions
100%	Iran, Sudan
50% -60%	Saudi
41% -50%	Kuwait, Brunei
21%-30%	Malaysia, Yemen, Qatar
11% -20%	Palestine, Bahrain, Bangladesh, Jordan, UAE
1% - 10%	Mauritius, Nigeria, United Kingdom, South Africa, Kenya, Turkey, Oman, Lebanon, Azerbaijan, Tunisia, Thailand, Indonesia, Singapore

Source: International Financial Services Board (2015b).

Islamic finance assets portray tremendous increased from USD150 billion in the mid-1990s to an approximately USD1.9 trillion as at the second quarter of the year 2014. The highest amount of the Islamic finance assets is in the Gulf Cooperation Council that worth of USD657.1 billion. Countries situated in the North Africa and the Middle East regions obtained USD602.3 billion of the Islamic financial assets while countries in Asia and Sub-Saharan Africa contribute USD420.3 billion and USD25.1 billion of the Islamic finance assets respectively. The North America and Europe contribute the smallest portion of the Islamic financial assets that amounted USD90.3 billion. Islamic banking assets are the major contributors to the overall Islamic financial assets in all regions. Figure 1.2 shows the Islamic finance assets according to the regions. Islamic finance sector also is continuingly succeeded where the compound annual growth rate (CAGR) is at 16.94% from 2009-2013 (Islamic Financial Services Board, 2015a).

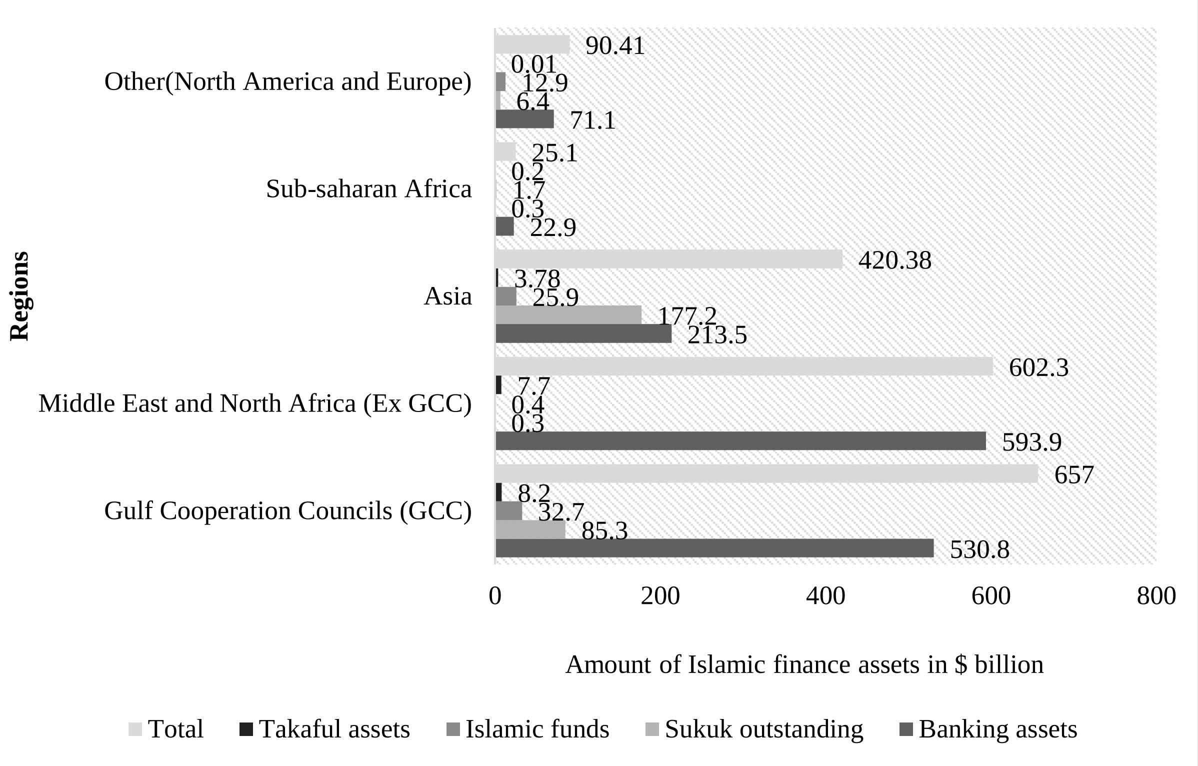


Figure 1.2: Islamic Finance Assets according to the Regions.
Source: Islamic Financial Services Board (2015b).

Islamic financial services received encouraging support from government and regulatory agencies in their respective countries. Legislative and regulatory processes are essential to make sure charities of regulations; gradual coordination in industry standards; soundness corporate governance; and accommodative legislative infrastructure. The process of enhancing the legislative and regulatory is still on-going process in the several continents such as Asia, the Middle East, Europe and sub-Saharan Africa. For instances, Malaysia enacted an act which is Islamic Financial Services Act 213 with coming into effect on 3 June 2014. This act is believed to be the first global comprehensiveness act about the Islamic finance. Despite that, the China's Legislative Council passed the Loans (Amendment) Bill 2014 to allow the government to raise money through Sukuk. The global multilateral entities like Islamic Financial Services Board (IFSB), the Asian Development Bank, the Islamic Development Bank (IDB), the International Monetary Fund (IMF) and World Bank also involve in this successful journey (Islamic Financial Services Board, 2015a).

Islamic financial institutions offered numerous products for retail and corporate customers including Sharia-compliant capital markets (equities and Sukuk or Islamic bonds); assets and funds management; and Takaful (Islamic insurance) services. Due to that, conventional banks tend to imitate the Islamic banking operations. As the Islamic finance industry offers the various portfolio of Islamic financial assets, the Islamic banking sector continues to be in the top portfolio where it contributes 79.8% share in the middle of 2014. The compound annual growth rate (CAGR) of the assets of Islamic banks and Islamic banking windows is at 17.4% between 2008 and 2013. The top-performing sector of Islamic, Sukuk, have been issued with the value more than $100 billion in the last two years and estimated to achieve more than $66.2 billion in 2014. The last sector is Takaful which estimated to contribute approximately 1.0% share of the global Islamic financial assets as of the first half of 2014. Also, the Islamic fund's sector has developed relatively faster with assets system (Islamic Financial Services Board, 2015a).

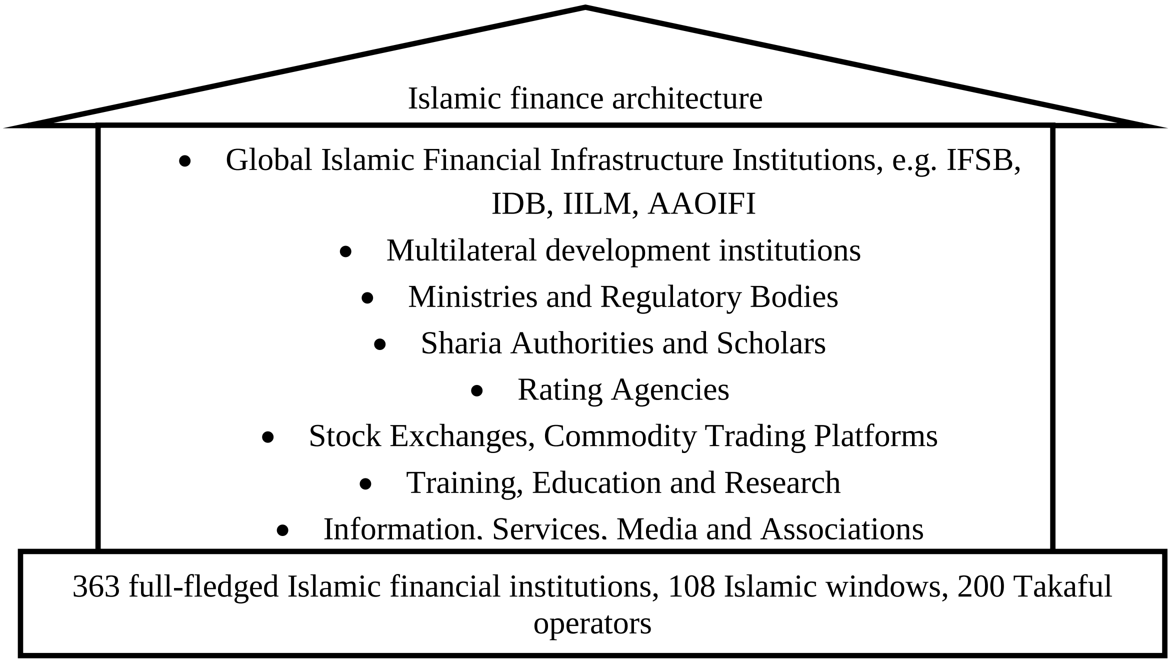


Figure 1.3: The Ecosystem of Islamic Financial Services in the Industry.
Source: Islamic Financial Services Board (2015a).

Globalisation had improved the development of overall Islamic finance architecture. Islamic Development Bank (IDB), Islamic Financial Services Board (IFSB), Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), International Islamic Financial Market (IIFM), and the International Islamic Liquidity Management (IILM) Corporation are actively involved in crafting instruments and mechanisms; enhancing awareness; and formulating basis for practical standards and Sharia governance. In developing human capital in the industry, many higher academic and training institutions offer Islamic finance academic programs. The summary on the ecosystem of Islamic financial services in the industry depicted in Figure 1.3.

Individually, the global Islamic banking assets are on upward trends from approximately $ 600 billion in 2008 to more than $1.6 trillion in the mid- the year 2014 which heavily concentrated in the Middle East region (Islamic Financial Services Board, 2015a, 2015b). Figure 1.4 shows the growth trend of Islamic banking assets.

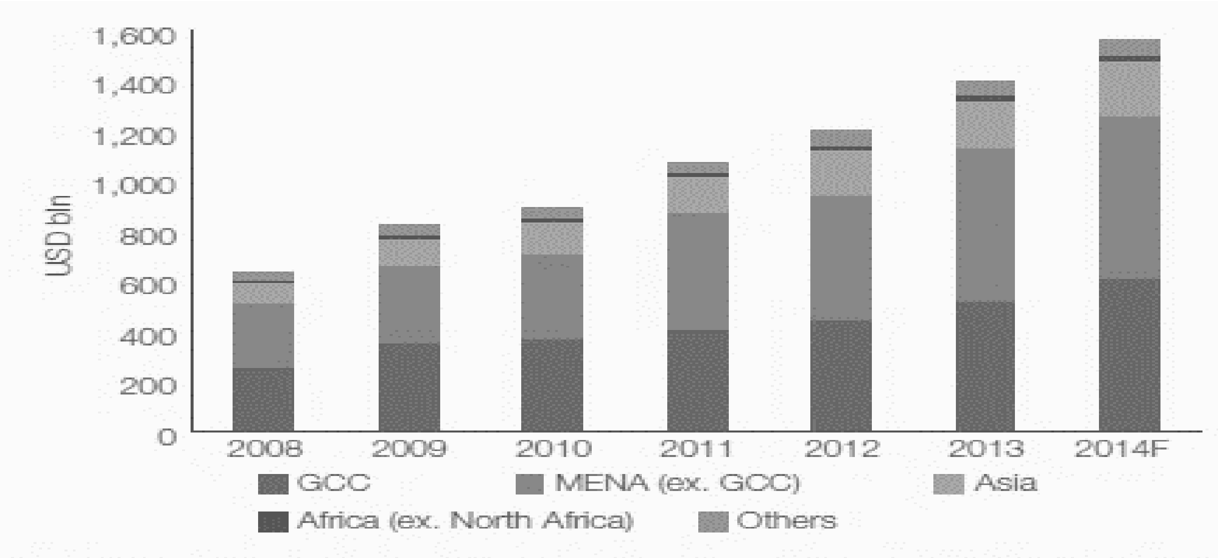


Figure 1.4: Islamic Banking Assets Growth Trends.
Source: Islamic Financial Services Board (2015a, 2015b).

1.2 Income Inequality

Income inequality is a gap of the income amidst the rich and the poor in a continent at the macro level. It exists due to the discrepancy between outcomes and opportunities even without the intervening of human's control like gender, ethnicity, family history and birth of place. To be more specific, it arises due to the incongruence between efforts and talents; and opportunities. Typically, the bigger the income, the higher the expenses will be. It gives an opportunity to have better education and healthcare access. However, the minimal level of inequality gives advantages as it gives motivation for improvement in life. Higher education level, the variation of labour earnings, innovations' incentives and entrepreneurship returns can boost the aggregation of human capital and change the economic growth (Dabla-norris et. al, 2015).

An excessive level of income inequality gives negative implications to the economy and society. Massive social costs can exist when the policymakers unable to control inequality in opportunity. It is because inequality reduces the individuals' educational and occupational choices and does not give good rewards to the suitable candidates. Consequently, they change their actions from ethical settings to the unethical misconducts (Chen & Tsai, 2012; Werfhorst & Salverda, 2012; Zagorski et. al, 2014; Dabla-norris et al., 2015). In future, public lose their respect to the institutions; wear down the social unity and mislay their confidence (Chen & Tsai, 2012; Dabla-norris et al., 2015).

Also, extreme income inequality can erode the economic growth. Prior studies proved that there are negative relationships between income inequality and economic growth. Higher inequality of the income leads to slow economic development due to lower productivity and creates economic and financial problems such as escalating leverage; elongate of credit; a reduction in mortgage-underwriting standards and permitting lobbyists to push for financial deregulation. If it is not treatable in the short and long-term growth, it can lead to the financial crises (Susanu, 2012; Dabla-norris et al., 2015; Sehrawat & Giri, 2015).

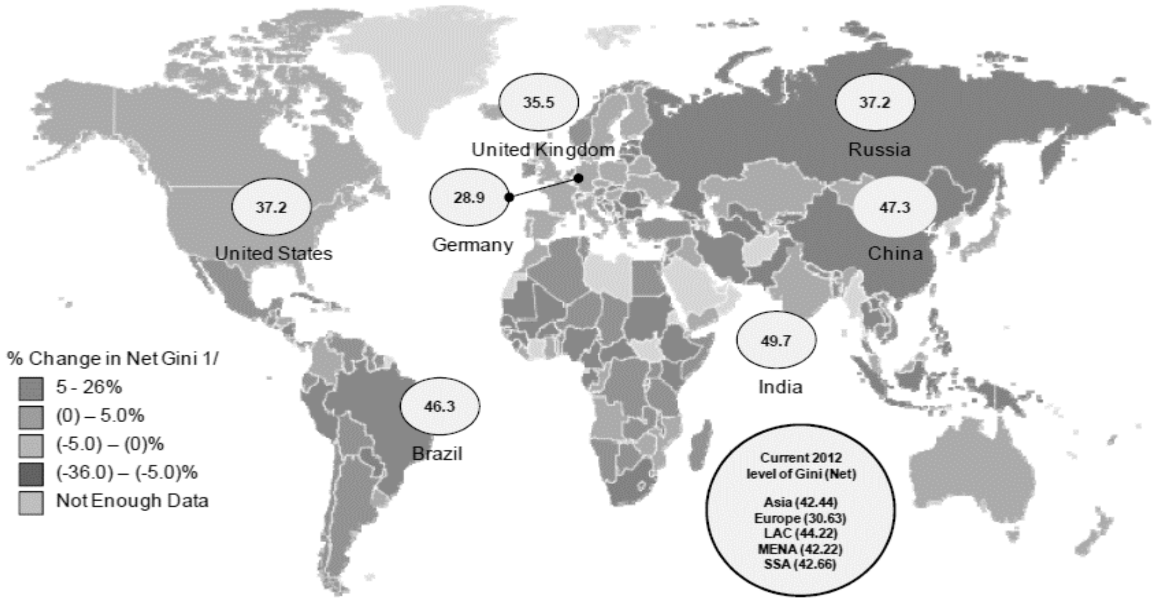
Moreover, high level of income inequality creates a global imbalance. It is because financial liberalisation produces massive external deficits and discourages the investment. It can create more conflicts and make a solution to the disputes more challenging (Dabla-norris et al., 2015). Above and beyond, uncontrollable of higher income inequality distorts the poverty reduction program due to the alteration of the efforts to the economic growth (Tiwari, Shahbaz, & Islam, 2013; Dabla-norris et al., 2015).

The issue of inequality becomes a world agenda. United Nations (UN) had set up a special conference regarding the development sustainability where they came out with a set of sustainable development goals. The sustainable development goals had been generalised with seventeen goals. Among the seventeen goals, they concentrated on the reducing the inequality within and among countries in which they set it as goals 10. By 2030, they aim to improve the regulation and monitoring of global financial markets and institutions. They are also intended to reinforce the implementation regulations and guarantee superior representation and voice for developing countries in decision-making in global international economic and financial institutions. So that, they can be efficient, credible, accountable and legitimate institutions. They had set several actions should be taken by the country's member upon upholding that aim (United Nations, 2014).

Income inequality had been measured based on Gini coefficients of gross and net income since 1990. The Gini coefficient ranges between 0% that indicates complete equality to 100% that denotes complete inequality. World Bank had set a standard of the regulation where the scale considers low when it lies between 20% up to 20.99 %. Middle when the score between 30% up to 39.99%, high when it ranges between 40% up to 40.99% and very high inequality when the score is more than 50% (Dobrea & Podgoreanu, 2014). The lesser the Gini coefficient scores, the better income inequality. It means that the small income inequality gap between the rich and the poor.

There are substantial increments in the measurement of Gini coefficient in the developed countries since 1990. Emerging market and developing countries hold relatively stable inequality on the average even though at a higher level than the developed countries. However, there are significant discrepancies across emerging market and developing countries, with Asia and Eastern Europe, are facing marked increases in inequality, and countries in Latin America exhibiting notable declines. In 2012, the level of Gini coefficient is above 40% on the average where the Latin America and the Caribbean, 44.22%; Asia, 42.44%; Europe, 30.63%: North Africa and Middle East 42.22% and Sub-Saharan Africa 42.66% (Dabla-norris et al., 2015; International Monetary Fund, 2014). Figure 1.5 indicates the variation in net Gini index from 1990 to 2012.

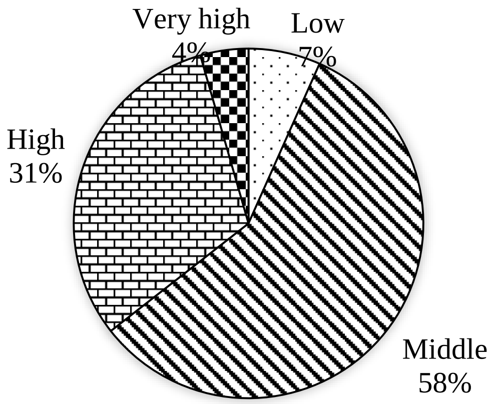
Figure 1.5: Changes in net Gini index from 1990 to 2012



Note LAC =Latin America and the Caribbean; MENA = Middle East and North Africa; and SSA = Sub-Saharan Africa. Variation in net Gini from 1990 to 2012 expresses as a percentage.
For missing values, data for the most recent year are in use.
Source: Dabla-norris et al. (2015).

Referring to the indicator from World Bank, 12 apart from 57 OIC countries that did not disclose the information regarding income inequality, majority income inequality of 45 OIC countries are unconvinced. As per Figure 1.6, only 7% of 45 OIC countries have low-income inequality. It gives good reflection since the income inequality gap is narrow. However, 58% of 45 OIC countries possess the scores between 30% to 39.99% income inequalities. It indicates having middle-income inequality. Another 31% of 45 OIC countries have high-income inequality which ranges between 40% to 49.99% income inequalities and 4% of 45 OIC countries have very high-income inequality which is above 50% income inequality.

Figure 1.6 Classification of income inequality of 45 OIC countries



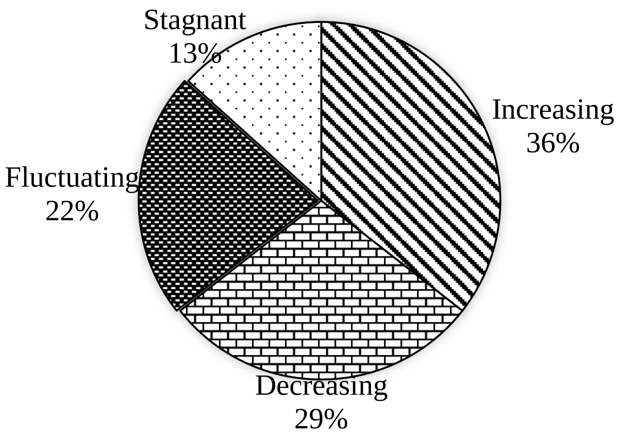
*Based on World Bank, Gini index can be classified into four main groups which are:

Gini index	Indicators of inequality
0% - 19.99%	No inequality (Equally)
20% - 29.99%	Low
30% - 39.99%	Middle
40% - 49.99%	High
More than 50%	Very High

Note: Data are not available for other 12 OIC countries.
Source: Calculated from World Bank (2014).

Besides, the trends of income inequality of majority of 45 OIC countries are also unimpressed as per Figure 1.7 since 36% of 45 OIC countries are suffering increasing trends of income inequality and 22% of 45 OIC countries have fluctuating trends of income inequality. Only 29% of 45 OIC countries have decreasing trends of income inequality. 13% of OIC countries do have unchanged trends of income inequality.

Figure 1.7 Trends in income inequality of 45 OIC countries



Note: Trends are depicted based on the income inequality for nine consecutive years.
Data are not available for other 12 OIC countries.
Source: Calculated from World Bank (2014).

1.3 Organisation of Islamic Cooperation (OIC) – 2025 Programme of Action

OIC is another largest inter-governmental organisations apart from the United Nations that comprises of 57 countries' membership worldwide. OIC is a communal voice of the Muslim world. It establishes to preserve and defend the interests of the Muslims world as well as promoting the international peace's spirit and harmony amongst human in this universe. The primary function of OIC is to be a unified body that actively represented more than 1.5 billion Muslims in the world. The organisation has consultative and cooperation relations with the UN and other inter-governmental organisation which aims to shield the interests of Muslims and to settle conflicts involving the Member States.

The organisation comes out with a blueprint that is Ten-Year Program of Action (2016-2025) in 2015. It had named as OIC-2025 Program of Action. Inside that, the Organization mentions on the need to formulate a comprehensive multi-dimensional approach that aims to raise the problem of poverty in the organisations. It should include the targeted government policies and actions, and contribution of other financial means, such as efficient utilisation of Islamic social finance at national and intra-OIC level (Organization of Islamic Cooperation (OIC), 2016b).

The organisation also mentions on the significance of the Islamic social finances like zakah and awqaf to be implemented in the OIC development agenda. Islamic social finance is an efficient mechanism for mobilising funds. It addresses the problem of financial sanction within poverty alleviation initiatives' frameworks (Organization of Islamic Cooperation (OIC), 2016b). The organisation sets four goals for the investment, trade and finance priority areas. Apart from the four, the Organization mentions on the aims to develop reliable and well-regulated Islamic financial system and related practical institutions; to ensure the systematic development of the Islamic finance; and to create and encourage Islamic financial products for advancement in the socio-economic development in the OIC Member States (Organization of Islamic Cooperation (OIC), 2016b). Due to that, the Islamic financial development is believed to contribute to the reduction of the income inequality that could lead to the improvement of well-being.

1.4 Statement of the Problem

Income inequality is a gap of the income between rich and the poor. It occurs due to the discrepancy between outcomes and opportunities even without the intervening of human's control (International Monetary Fund, 2014). Income inequality can lead to the human illness (Zagorski et al., 2014) and can impair the community's condition (Werfhorst & Salverda, 2012). According to the statistics, the global income inequality, measured by the Gini coefficient, is between 25% to 50%. Income inequality is an essential issue to the economists and governmental authorities in the world (International Monetary Fund, 2014). World Bank had set a standard of the regulation where the scale is considered low when it lies between 20% to 29.99%, middle when the score between 30% to 39.99%, high when it ranges between 40% to 49.99% and very high inequality when the score is more than 50% as per Table 1.1. The lower the Gini index, the better the inequality (Dobrea & Podgoreanu, 2014) .

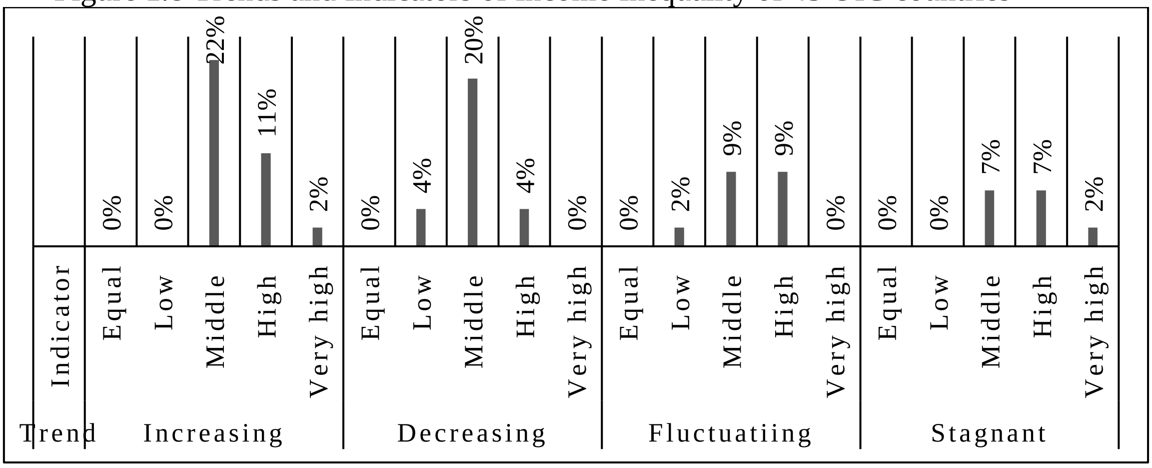
Table 1.2 Classification of Gini index

Gini index	Indicators of inequality
0% - 19.99%	No inequality (Equally)
20% - 29.99%	Low
30% - 39.99%	Middle
40% - 49.99%	High
More than 50%	Very High

Source: Dobrea & Podgoreanu (2014)

In the Muslim world, income inequality is not convincing as per Figure 1.8. It is because 35 % of the 45 OIC countries are experiencing the increasing trends of income inequality. Meanwhile, 29% of 45 OIC countries are suffering the fluctuating trends of income inequality and 16% of 45 OIC countries are having stagnant trends of income inequality Only, 28% of 45 OIC countries are experiencing declining trends of income inequality. To be precise, 96% of the 45 OIC countries are in the worrisome state. Their income inequality trends are increasing and fluctuating. Though, there are some of the countries are facing decreasing and stagnant trends but the scores are still in nuisance. Majority of scores lies in the middle, high and very high of income inequality. If the corrective plans not executed, it could lead to the increment and deteriorate trends shortly. Only 4% of 45 of OIC countries can be considered safe and are in the stable state of income inequality.

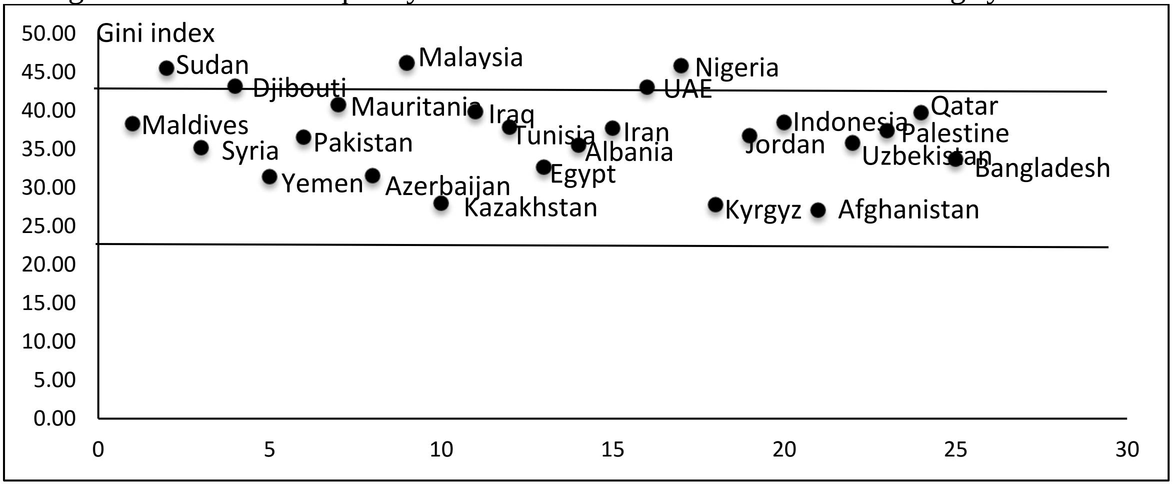
Figure 1.8 Trends and Indicators of Income Inequality of 45 OIC countries



Note: Data are not available for other 12 OIC countries.
Source: Calculated from World Bank (2014).

Out of these OIC countries, only 25 countries practise dual banking system where conventional and Islamic banking is running together. The income inequality of these countries lay between 25% up to below 50% of the Gini index as per Figure 1.9. Majority of the countries are having middle to high income inequality. Only Kazakhstan, Kyrgyz Republic and Afghanistan have low income inequality where their scores are below 30% percent of Gini index.

Figure 1.9: Income inequality of OIC countries that have a dual banking system.



Note: Data are not available for Brunei, Oman, Algeria, Bahrain, Benin, Kuwait, Lebanon, Senegal, Somalia, Turkmenistan, and Uganda.

Source: Calculated from World Bank (2014).

This situation happens because current conventional banking system promotes inequitable distribution. In the present setup, only wealthy can ask for the loan due to furnishing of collateral is the primary criterion for obtaining money (Fasih, 2012; Shaban et. al, 2014) while the losses are shared by all class of savers including rich and poor during bank's liquidation process (Fasih, 2012). The conventional banking also prevents the entrepreneurial ability and discourages innovation of small enterprises from getting new methods of production and trainings. Conventional banks tend to confine their lending to the well-established big companies as they are more concerned on the ability to pay to depositors and safe return of the principal loan (Fasih, 2012; Shaban et. al,2014). During the financial crises, many banks in the conventional banking system are unable to execute their lending activities resulted to the economic slowdown. It is because they did not have a sufficient financial back-up to absorb the losses from the massive loan defaults. The capital growth of the banks fell far below the growth of total credit and overall riskiness of the assets (Karim et. al, 2014).

As the alternative, the development of Islamic financial development is assumed to give substantial impact on the income inequality. There are limited studies on the influence of Islamic financial development on the income inequality. That is why this study would like to examine the impact of Islamic financial development on the income inequality in the OIC countries.

Those who do not have any means of income are unable to utilize the services of the financial institutions. It is because they do not possess anything in order to obtain the financing services. Due to that, Islamic financial development can enhance its effectiveness in reducing the income inequality through the payment of zakat by the Islamic banks. However, limited studies discussed on the impact of zakat from Islamic banks on the income inequality. Thus, this study intends to see whether the zakat paid by Islamic banks could increase the effectiveness of Islamic financial development in reducing income inequality.

Zakat is only 2.5% of the Islamic banks' net income. It is a small amount of money, and it could not give more significant impact to the society. That is why corporate social responsibility could help the effectiveness of Islamic financial development in reducing income inequality. At the best of knowledge of the researcher, there are limited studies on the effect of corporate social responsibility on the effectiveness of Islamic banks in kerbing the income inequality. Hence, this study would like to analyse whether the higher social contribution by Islamic banks contribute to the effectiveness of Islamic financial development in reducing income inequality.

1.5 Research Questions

In line with the statement of the problem of this study, the primary research question is “does the Islamic financial development help in reducing the income inequality in Organization of Islamic Cooperation (OIC) countries”. Specifically, this study has the following sub-questions:

a) What is the effect of the Islamic financial development on income inequality in OIC countries?

b) Will zakat by Islamic banks enhance the effectiveness of Islamic financial development in decreasing the income inequality in OIC countries?

c) Will higher corporate social responsibility by Islamic banks improve the effectiveness of Islamic financial development in narrowing income gap in OIC countries?

1.6 Research Objectives

The objective of this study is to examine the effect of Islamic financial development on income inequality in OIC countries. In achieving this objective, this study has the following sub-objectives:

a) To examine the effect of Islamic financial development on income inequality in OIC countries.

b) To investigate the moderating effect of the zakat by Islamic banks in improving the effectiveness of Islamic financial development in reducing income inequality in OIC countries.

c) To analyse whether a more active and higher corporate social responsibility by Islamic banks enhances the effectiveness of Islamic financial development in bringing down income inequality.

1.7 Significance of Study

This research would like to contribute to the enrichment of the knowledge and alignment the way forward of the Islamic banks. Due to that, the contributions will discuss in two perspectives which are a theoretical contribution and practical contribution.

1.7.1 Theoretical contribution

This comprehensive review of relevant literature has the potential to make a significant contribution in three areas.

Firstly, this research considers the existence and development of Islamic banks and its role in reducing the income inequality. To our knowledge, most of the researcher and theory building literature are focused on the development of conventional banks. For example, Prete (2013) looked at the impact of financial development on the income inequality that covered for 30 countries. Due to that, that particular research has a small number of data collection in which it cannot be used to generalise the impact of financial development on the income inequality in the world. Also, the data also does not split between the countries that applied a single banking system and dual banking system. It is not appropriate to state that the Islamic banking system works similar to the conventional banking systems since the nature of both banking system differs from one to another. In conjunction with that, this study would like to enrich the studies of the income inequality by providing the empirical evidence on the impact of Islamic financial development towards reducing the income inequality.

Secondly, this study enhances the importance of not only on having the Islamic banking but also that eventually fit with the objectives of Sharia the well-being of the nations. For instances, Ahmed (2010), who elaborated the factors contributing to the rapid evolvement of the Islamic finance, argued that the Islamic finance can help in mitigating the worseness of the global financial crisis. He also suggested that the Islamic financial institutions focus more on the program that enhancing the growth of the economy as well as safeguard the stability and healthiness of the global financial institutions. However, this researcher did not provide the discussion on the current condition of the Islamic financial institutions toward the welfare of the nation. Consequently, this study would like to provide the empirical evidence on the effect of having the Islamic financial development in dipping the income gap between the rich and the poor.

Thirdly, this study considers the integration of the knowledge by integrating between the economic theories like Kuznets inequality theory and Greenwood and Jovanovic hypotheses and Islamic principles such as Islamic accountability theory and Maqasid al-Sharia. Theories in the Islamic banking is commonly borrowing from or based on the conventional banking theories which later on will blend with the Sharia or Islamic rules. At the best of our knowledge, none of the literature discussed on the income inequality from the Islamic perspective. By having this research, the researcher can contribute a unified theory that comprehends the views on the income inequality from the Islamic banking perspective.

1.7.2 Practical contribution

Enriching the program on the reduction of income inequality by involving the banking sectors.

United Nations (UN) had set up a special conference regarding the development sustainability. They formulated a set of sustainable development goals that can comprise of the seventeen goals. Among the seventeen goals, they concentrated on the reducing the inequality within and among countries in which they set it as goals 10. It aims to have gradual improvement and increment in the income which is above the national average for the bottom of the 40 percent population by allowing and encouraging the free interference regardless social, economic and political status by 2030. In conjunction, they set several actions taken by the country's member upon upholding their aim. However, they only suggested that the government should increase the rule and monitor the worldwide financial markets and institutions. They also need committedly enforce that particular law (United Nations, 2014).

Also, International Monetary Fund (IMF) via the IMF policy paper discussed on the government economic and income inequality. They stated that tax and expenditure policies need clearly to design so that they can achieve distributional and efficiency objectives (International Monetary Fund, January 23, 2014). They ignored the financial markets contributions toward correcting the vast differences in the income without realising that the financial market is a pivotal player to the economic growth of the country.

In conjunction with that, several studies conducted by Sehrawat and Giri (2015); Arora (2012), Batabyal and Chowdhury (2015); Prete (2013); Chen and Tsai (2012) and Li and Yu (2014) had proved that the financial development could decrease the income inequality. However, they are a focus on the general financial development rather than the banking sector per say. They also ignore the existence of the Islamic financial markets. Therefore, it is essential to conduct a study in proving the role of banking mainly Islamic banks in the reducing the income inequality. So that, the banking sector can innovate programs and products that can reduce the income inequality as well as gain profits.

Aligning the Islamic banking operations from profit-oriented to social-oriented mechanisms.

Islamic bank is the most stable banking systems as compared to the conventional bank. It is because Islamic banks are more money-making, liquid and capitalised and lower credit risk (Khediri, Charfeddine, & Youssef, 2015). Also, Islamic banks outperformed to conventional banks about returning on assets indicators during and after of financial crisis (Bourkhis & Nabi, 2013).

In fact, the world leading accounting and auditing firm, Ernst and Young (EY) had surveyed 70 Islamic banks and 44 conventional banks worldwide and prepared a comprehensive report to entitle " World Islamic Banking Competitiveness Report 2014 -2015". From that report, they found that the leading Islamic participation banks have three advantages. Their advantages are digitisation, customer engagement and impact banking. Improvement of the digitisation can easily do through digital payment that can provide more comprehensive the opportunities to expand the products, capture a large number of transaction and enhance the customer experience. Customer engagement can conduct through social media that can gauge the client's expectations, satisfaction level and perceptions to relevant banks. Impact banking can achieve by focusing on the socially responsible banking. It is because the emergence of the halal ecosystem and preferential investments in entrepreneurship, education, health and public infrastructure are set to create a refreshed identity (Ernst & Young, 2014).

Besides, Islamic banking can reduce poverty through providing either means for economic growth or reduction of unnecessary consumption. It can be by involving in financial inclusion and investment. It can ensure the production of more wealth by utilising the investments. It will also reduce the consumption which is encouraged by the dividend-based system (Fasih, 2012).

In conjunction with that, this study would like to be a pioneer study since it is aimed to assess the impact of the development of Islamic banks on the social aspect, which is income inequality. Rather than providing the banking and investments services only, the Islamic banks can appreciate the importance of their existence towards the society. It enables them to create products and services that meet the social needs as well as gain profits.

1.8 Scope of Study

This study utilises the data from 25 countries which join the OIC for the period from 1996 to 2014. These countries are chosen due to long practices of Islamic finance in the countries through the income inequality levels in those countries are increasing. 46% of the OIC countries are experiencing the increasing and fluctuating trends of income inequality. If these trends are not corrected, it could lead to the high scores in the future. Also, it is not parallel to the UN agenda in reducing income inequality. UN agenda set the aim to strengthen the global financial markets and institutions so that the global financial market and institutions are more efficient, trustworthy, responsible and authentic institutions. Also, OIC also focuses on the developing the Islamic social finance through the OIC-2025 Program of Action where it aims to develop and endorse Islamic financial products to advance socio-economic development in OIC. Moreover, the availability of the data also contributes to the selection of these countries.

1.9 Organisation of Study

The first chapter starts with the introduction and the issue, the root of this research. Then, problem statement states the direction of the research that helps in building the research question. The research objective is being placed after research questions to make this research more organised. Inside this chapter, the importance of this study and the scope covered.