

# Examining the Nexus between Riba and Gharar, and Islamic Banking Products Among Zanzibar People

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## Abstract

This paper aims at examining the nexus between riba, gharar and income level, and Islamic Banking Products among Zanzibar people. The Islamic bank products such as Murabahah, Musharakah, Mudarabah, Ijarah, Hawalah, Takaful and Sukuk were considered as independent variables for this study. On the other hand, the dependent variables investigated were three (3) namely riba, gharar and income level. A total of 116 respondents consisting of Zanzibar people residing in different districts responded to the survey questionnaire via google form. The study used statistical techniques to analyse the collected data in terms of demographic, descriptive, reliability and validity analysis and presented by charts, tables and curves. The hypothesis test has been conducted using correlation analysis. Statistically, the finding revealed that, the people of Zanzibar were against Riba but in favour of Murabahah, Musharakah, Mudarabah, Ijarah, Hawalah, Takaful and Sukuk with  $p \leq 0.01$ . The result also revealed that the people of Zanzibar were against gharar with  $p \leq 0.01$ . On the other hand, income level showed a significant correlation against Mudarabah, Ijarah, Hawalah, Takaful and Sukuk as  $p \leq 0.01$ . These findings suggest that the products and services of Islamic banks have a significant relationship with Riba, Gharar and level of income for Islamic banks' shariah priority. It is also shown that riba and gharar were significantly impacted the people of Zanzibar for the influence on the acquisition of Islamic bank facilities which are vital on direct effects that attract customers and investors in which they are customised from conventional banks products. As the awareness level from these Islamic products are high, it is recommended that Islamic banks should focus in designing Islamic banks products (Murabahah, Musharakah, Mudarabah, Ijarah, Hawalah, Takaful and Sukuk) that will comply with Shariah requirement.

**Keywords:** Riba; Gharar; Bank products; Shariah; Income level; Zanzibar people.

## 1. Introduction

Muslim community in Zanzibar, Tanzania, consists of over 98 percent (International Religious Freedom Report-IRFR, 2018). However, the banking services are dominated by conventional banks. The study conducted by Omar and Yusof (2019) pointed out that, Tanzania banking industry is dominated by conventional regulations even though Islamic banking facilities are allowed to offer its products by the Central Bank of Tanzania. Under the present circumstances, the performance of Islamic banks is hindered by the inappropriateness of Shariah compliance in the day to day Islamic banks transactions (Mzee and Othman, 2020). Meanwhile, other studies have contended that the Islamic banks have the same banking products and services as to what being provided by the conventional banks; with the only exception that the former have Islamic windows banking facilities (Alfin and Md Saad, 2018; Bananuka *et al.*, 2020; Darwanto and Charir, 2019). Omar and Yusof (2019) have reported that out of 54 registered banks in Tanzania, only five (5) banks, namely PBZ, Amana, KCB, NBC and Stanbic, have opened the Islamic banks' windows with Amana Bank is the only one fully complied with Islamic bank operations. Specifically, PBZ offers various products and financing facilities for customers based on Shariah principles, KCB designated Sahl banking system for its Islamic bank customers; and NBC Bank offers La Riba Banking facilities specifically for Shari'ah-compliant bank account holders which is conveniently for Muslims (Omar *et al.*, 2017). Consistent to this view, it has been observed that, particular Islamic products are offered by these respective banks mainly different bank accounts such as Non ribaa Account (NBC and KCB), Murabaha mode of finance and other types of different accounts (Amana and PBZ) in which most People of Zanzibar have managed to open bank accounts to promote risk sharing between Islamic banks and Zanzibar people so that the user of funds (the entrepreneur) can obtain capital growth based on legitimate trade.

Theoretically, in Zanzibar, the income received by Muslims from various sources such as business, agricultural and fishery activities is supposedly deposited in the Islamic banks which in turn makes it possible for them to get Islamic loans for further investments in order boost their economic welfares and social well beings. Nonetheless, in reality, the awareness level of Zanzibar people about the Islamic banks' services and facilities is very limited, and

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this has led them to seek the conventional banking services. Given these two scenarios, this study aims to examine the nexus between Riba, Gharar and income level, and the Islamic Banking Products among Zanzibar people.

At this juncture it is worth noting that the study of Pratiwi *et al.* (2019) has highlighted the fact that the operations of Islamic banks and conventional banks are the same, whereby the non-Muslims are allowed to utilize Islamic bank products. The Islamic bank products have a lot of benefits since the facilities are obtained without interest (riba) or gharar, which are strictly prohibited in Islam Pratiwi *et al.* (2019); Bananuka *et al.* (2020); Echchabi and Olaniyi (2012). In the same vein, the study conducted by Asni and Sulong (2018) lamented that it is the time for Islamic Banks to come up with the products and services that meet the Shari'ah requirements so as to attract Muslim customers and be competitive with conventional bank products. In this regard, unfortunately, the banks in Zanzibar have not designated their products and services for Muslims even though they are aware that Islam prohibits all business transactions involving non-shariah compliance, especially riba and gharar. As such, the study recommended for Muslims to look for Shariah-based banks to fulfil their day to day transactions (Asni and Sulong, 2018). Unlike Malaysia where the Islamic banks and products have been put into practice since the 1980s, in Zanzibar the Islamic banking services were just established in 2011 (Moh'd and Abdullah, 2019; Mzee and Othman, 2020) and since then they have to struggle to survive.

### **1.1. Patronization Behaviour of Islamic Banks' Customers in Zanzibar**

Different scholars have different ways of determining the criteria of Islamic banks' priority and attributes for customer's attraction (Mukhibad and Khafid, 2018; Sobol, 2019). The service quality and convenience offered, personnel friendliness and competence of bank officers, professional knowledge and advice given by the personnel, bank location, shariah compliance and finally exceptional bank's services offered by respective banks are some of the crucial elements for customers attractions (Adalety and Dutta, 2019; Echchabi and Olaniyi, 2012; Shome *et al.*, 2018). In this context, it was reported by Adalety and Dutta (2019) in their study on some of the factors that influenced the choice of Islamic banking and finance products and services in the United Arab Emirates (UAE). Unexpectedly, their findings revealed that the Muslims were unaware of some Islamic bank products compared to conventional bank products. In this study, the existing Islamic banking transactions are attributed by customers' perception of riba, gharar, income level, service quality and convenience by banks, and personal competence and friendliness by bank officers. Another factor, namely the role of Shariah Board as recommended by Mzee and Othman (2020) should also be considered as it is expected to affect the financial and non-financial performances of Islamic banks in terms of return on assets and growth, and shariah compliance respectively. The reason for such inclusion is to confirm whether or not the studies by Mzee and Othman (2020) and Darwanto and Charir (2019) that have specified the shariah board establishment and supervision in Zanzibar and Indonesia has helped Islamic banks to perform better still hold water in the present days.

## **2. Literature Review**

The study examines the nexus between Riba and Gharar on Islamic Banking products and its impact on Zanzibar. Among the most Islamic bank products and related services are murabahah, ijarah, etc, as will be explained in detail below. They are expected to contribute significantly to improve and enhance the standard of living of the Muslim community around the globe, particularly in Zanzibar.

### **2.1. Riba**

Riba (Interest) is a very complex issue in the contemporary economy; basically, owing to its meaning, types, features, religious perspective and nature. The theory of Islamic transactions asserts that riba is very harmful for any economy. Specifically, while the Islamic theory of transactions declares that riba is harmful for an economy, the theory of conventional transactions regard interest as a crucial factor for spearheading the business transactions, especially in financing products (Ahmad *et al.*, 2019; Uddin, 2015). Muslim scholars had classified riba into two (2) types; first, riba from property exchange (Riba Al-Fadl), and second, riba which covers all transaction matters other than property exchange (Riba An-Nasiah). The Islamic financial services are based on the principles of riba prohibition and therefore Muslims are strictly obliged not to pay or receive it (Ahmad *et al.*, 2019; Cheruiyot *et al.*, 2018). Consistent with this view, (Omar and Yusof, 2019) are of the opinion that it is very difficult to differentiate between riba and profit made by Islamic banks in Zanzibar. However, since the establishment of the Amana Bank in Zanzibar in 2018, more customers are attracted to do transactions with the bank for it has become a full-fledged Islamic Bank.

### **2.2. Gharar**

Gharar (uncertainty, hazards, or risk) is designated from various type of trading transactions in which Islam prohibits it as parties of traders do not know the feature of trading matters. Uddin (2015) classified Gharar into two aspects namely excess and light Gharar whereby both of them are strictly prohibited in Islam as they are part of gambling transactions. The study of Velayutham (2014) contended that the greatest Islamic principle impact on the banking system is the prohibition of payment of interest (Riba), sale of risky assets and gambling (Gharar). In this regard, the Islamic banks operating in Zanzibar will be in a position to attract more Muslim customers provided they are able to convince them of the fact that their funds deposited in the banks are free from Gharar.

### **2.3. Murabahah**

Murabaha (Cost plus profit) is another Islamic bank products whereby the sale of a good or property is done with an agreed profit against a deferred or a lump sum payment. According to [Cheruiyot et al. \(2018\)](#), the contract is between customer and bank however the bank will be responsible to purchase the commodity and then resell to customer with known specified profit. Therefore, going forward, Murabahah is referred as a sales contract between bank and its customers, mostly for trade financing whereby according to [Mzee and Othman \(2020\)](#), different products such as plant, machinery and equipment, car, surveyed plot, raw and building materials can be transacted in Zanzibar context. On the other hand, [\(Moh'd and Abdullah, 2019\)](#) reported that, the murabahah business in Zanzibar can be done and the customer can pay by instalment basis up to five years depending on the nature of the product transacted.

### **2.4. Mudarabah**

Mudarabah (profit-sharing partnership) is defined as business contract between financial institution and the borrower for the provision of funds (as capital) to establish business or boosting business transactions ([Cheruiyot et al., 2018](#)). [Bananuka et al. \(2020\)](#) pointed out that in a business contract where two business parties were involved, one contributes the capital in Shariah compliance for the sake of provision microfinance entrepreneurship, while the customer is responsible to manage the business. Subsequently, the profit is shared according to a pre-agreed ratio. This kind of transactions are vital for Zanzibar people in order to improve their financial health of day to day activities so as to create job opportunities on the establishment of SMEs. In light of the above, and based on the findings from various scholars, the profit of mudarabah business will be shared based on a pre-determined ratio, while the loss is shared by all parties equally. The existence of financial risk, if based on this Shariah guidance, makes it possible for the fund provider (the bank) to lose its funds when the business venture ends up making losses; otherwise, the bank claims part of the profit when the said business venture generates profit. Whichever case it might be, such venture satisfies the fundamental principle of Islamic banking ([Adalety and Dutta, 2019](#); [Su'un et al., 2018](#)).

### **2.5. Musharakah**

Musharakah (joint venture) is Islamic financial obligation in which two or more parties on business transactions agreed based on profit and loss sharing ([Sobol, 2019](#)). Owing to such assertions, [Moriguchi et al. \(2016\)](#) simplified Musharakah as a joint venture or partnership based on profit and loss sharing contract. Specifically, the study has pointed out an ideal financing contract in Islamic finance and it has been applied in Islamic capital market across the world where Zanzibar people in particular are benefited much from it ([Ahmad et al., 2019](#); [Mzee and Othman, 2020](#)).

### **2.6. Ijarah**

Ijarah (renting or leasing) can be referred as leasing transactions. That is to say, it is an Islamic bank financing facility whereby the leasing transactions are provided for the use of particular property. Usually, the beneficiary agrees to pay sum amount on instalments basis for the agreed period and once the last instalment is made, the property ownership is transferred from Islamic bank to the respective customer ([Sobol, 2019](#)). Consistent to this view, a study conducted by [Masruki et al. \(2020\)](#) on the Shariah Accountability Practice of Malaysian Foreign-Owned Islamic Banks and Bahrain Islamic Banks revealed that, there is significant implication for policymakers on encouraging ijarah trading. As such, it is thought the Zanzibar people could also enjoy the benefits of ijarah remarkably.

### **2.7. Hawala**

Hawala (transfer of funds) is a business transaction between client and bank ([Aris et al., 2013](#)). It is reported that the funds transfer is based on revenue sharing and usually calculated ex post on a monthly basis, while the transfer of funds from the bank to the clients is based on profit sharing ([Castro et al., 2019](#); [Elliot, 2018](#)). The study also contended that, such ratios (revenue and profit sharing) and the rates vary between banks and may also vary between contracts within the same banks. Reciprocally, the conventional bank too operates funds transfer with no element of profit sharing. However, it is worth noting here that funds transmission is strictly prohibited for the purpose of safeguarding money laundering. In the context to Zanzibar, various transfer of funds that is mainly conducted by mobile and banks transfer was not based on the Islamic principles as outlined in Hawala. The existence of Islamic banks in Zanzibar may lead to the transition of funds transfers from the conventional to one that is shariah compliant so that more Muslim customers will be in position to enjoy Hawala benefits.

### **2.8. Takaful**

Takaful (Islamic Insurance) is designated to satisfy customers' investments whereby individuals and businesses are covered with insurance. The study of [Cheikh \(2013\)](#) asserted that the returns and products should be based on the Islamic principles of Takaful particularly for credit commodities whereby the market for Islamic services must be operated on the basis of equity participation. Despite significant contribution of Islamic bank products among community, the study conducted in Uganda by [Bananuka et al. \(2020\)](#) on the adoption of Islamic banking in a non-Islamic country revealed that, the banks are responsible for creating awareness on the availability of Islamic products like Takaful. Generally, the awareness on operations of this product in terms of consumer religious beliefs, values, lifestyle and banking habits is very uncommon as reported by [Kaabachi and Obeid \(2016\)](#) and [Buchari et al. \(2015\)](#).

Additionally, the study also reported that, lack of trust among clients hinder the success of Islamic banking operations specifically in Zanzibar whereby the rules, procedures and bank operations guidance are still based largely on non-sharia compliance.

## 2.9. Sukuk

Sukuk (Islamic bonds) are Shariah-compliant financial instruments of which the agreement is based on Islamic profit sharing. According to Bhuiyan *et al.* (2018), global outstanding sukuk topped USD349.1 billion. The study has clustered sukuk into four categories which are: ownership, liquidity facility, purchaser undertaking, and underlying asset whereby sukuk holders are allowed to transfer beneficial ownership (Bhuiyan *et al.*, 2018; Razak *et al.*, 2018). The study conducted in India by Islam and Rahman (2017) on awareness and willingness towards Islamic banking among Muslims revealed that, the majority of Muslims are willing to purchase Islamic banking products however, there is lack of understanding of the principles of Islamic finance. As sukuk is part of the products, it has also suggested that, the awareness of products and operations must be put in place so as to attract Muslims (Omar, 2019). In this regard, the idea of awareness and products operations by Islamic banks such as sukuk must be put in place in Zanzibar too.

## 3. Methodology

This study is distractive in nature where the data were collected among Zanzibar population with 99 percent of the people are Muslim. A random sampling technique was used to capture the representative number of respondents. Since the data used were primary, the structured questionnaire was developed and distributed online using social media, namely WhatsApp. A total of 116 responses were collected from different income level of peoples across Zanzibar. The data were analysed using SPSS software. Analysis such as demographic profile, descriptive, validity and reliability analysis were conducted to understand whether the data are valid, reliable and fit for further analysis. The study hypotheses which were to examine the nexus between Riba, Gharar and income level, and Islamic banking products such as Murabahah, Mudarabah, Musharakah, Ijarah, Hawala, Takaful and Sukuk were tested using correlation analysis.

## 4. Findings and Analysis

### 4.1. Reliability Test

The Cronbach's alpha test has been used to test the reliability of the data collected for this study. Table 1 shows the Cronbach's alpha is 0.93 which is higher than the minimum of 0.70 (Taber, 2018) and therefore, it is concluded that the data are reliable and acceptable for further analysis.

Table-1. Reliability test.

Test	Result
Cronbach's Alpha	0.93
Number of Items	10

### 4.2. Demographics

Table 2 shows the demographics of the respondents such as gender, age group and highest education level. Male represents 59.5 percent and female makes up 40.5 percent of the total respondents. The respondents in the age group of 20-30 years represents 44 percent, 31-40 years is 36.2 percent, 41-50 years is 12.9 percent while those above 50 years are only 6.9 percent. The respondents with degree level of education are 49.1 percent followed by master degree and diploma both recorded 19.8 percent, Certificate education Level (5.2 percent), Secondary education (4.3 percent) and PhD (1.7 percent). The results also show that, 47.4 percent of respondents are employed, 38.8 percent are self-employed and 13.8 are students. Based on working experience, respondents with 1-5 years are 34.5 higher followed by less than 1 year (29.3 percent), 6-10 years (14.7 percent), over 15 years respondents (12.1 per cent) and those between 11-15 years are 9.5 percent. Income level wise, out of 116 respondents, 43.7 percent received salary, 25 percent received income from business profit, those received allowances are 17.2 percent, 6.9 percent received commission and 3.4 percent sourced their income from wages.

Table-2. Demographic Characteristics

Gender	Frequency	Percent
Male	69	59.5
Female	47	40.5
<b>Total</b>	<b>116</b>	<b>100</b>
<b>AGE</b>		
20-30 Years	51	44
31-40 Years	42	36.2
40-50 Years	15	12.9
Over 50 Years	8	6.9
<b>Total</b>	<b>116</b>	<b>100</b>
<b>Educational Level</b>		
Secondary	5	4.3

Certificate	6	5.2
Diploma	23	19.8
Degree	57	49.1
Master	23	19.8
PhD	2	1.7
<b>Total</b>	<b>116</b>	<b>100</b>
<b>Occupation</b>		
Employed	55	47.4
Self-Employed	45	38.8
Student	16	13.8
<b>Total</b>	<b>116</b>	<b>100</b>
<b>Experience</b>		
0-1 Year	34	29.3
1-5 Years	40	34.5
6-10 Years	17	14.7
11-15 Years	11	9.5
Over 15 Years	14	12.1
<b>Total</b>	<b>116</b>	<b>100</b>
<b>Source of Income</b>		
Salary	55	47.4
Wages	4	3.4
Commission	8	6.9
Allowances	20	17.2
Business Profit	29	25
<b>Total</b>	<b>116</b>	<b>100</b>
<b>Bank account</b>		
Islamic Bank	61	52.6
Conventional Bank	55	47.4
<b>Total</b>	<b>116</b>	<b>100</b>
<b>Income collection</b>		
In Islamic Account	42	36.2
In non-Islamic Account	37	31.9
By Cash	23	19.8
Mobile Money	14	12.1
<b>Total</b>	<b>116</b>	<b>100</b>

### 4.3. Descriptive Analysis

Table 3 presents the results of descriptive analysis of the variables used in this study. It is quite obvious from the table that the respondents are more interested in the Interest-based (Riba) and Gharar-based against Islamic banking operations. The average responses on Riba and Gharar were 12.49 and 10.54 respectively which are the highest compared to Islamic banking products. This validates the real circumstance in Zanzibar where more than 98 percent of the people are Muslims (International Religious Freedom Report- IRFR, 2018). Generally, Islamic banking products received moderate attention among people in Zanzibar except Musharakah which recorded the average response of 10.47. The Skewness and Kurtosis also were used to assess the normality of data which is referred as z value. According to Kline (2016), the z value for Skewness must be  $\leq 3$  and the z value for Kurtosis must be  $\leq 7$  for the data to be said significantly normal distributed. All results shown in Table 3 satisfied the criteria.

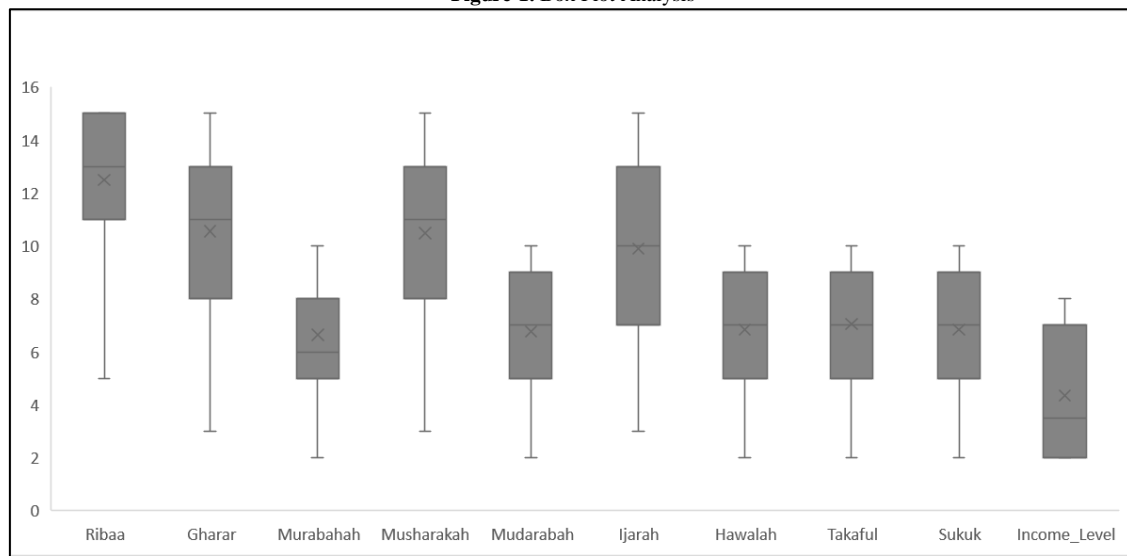
Table-3. Results of Descriptive Analysis

Descriptive Statistics	Minimum	Maximum	Mean	Std. Deviation	Skewness	Kurtosis
Interest (Riba)	5	15	12.49	2.86	-0.96	-0.22
Uncertainty & Risk (Gharar)	3	15	10.54	3.10	-0.32	-0.82
Murabahah (Cost Plus Finance)	2	10	6.64	2.30	-0.14	-0.80
Musharakah (Profit&Loss Joint venture)	3	15	10.47	3.26	-0.36	-0.75
Mudarabah (Profit & Loss Partnership)	2	10	6.77	2.29	-0.27	-0.76
Ijarah (Leasing Financing)	3	15	9.89	3.25	-0.06	-0.93
Hawalah (Transfers)	2	10	6.84	2.35	-0.18	-1.12
Takaful (Insurance)	2	10	7.04	2.44	-0.32	-1.11
Sukuk (Bonds)	2	10	6.83	2.36	-0.22	-0.96
Income Level	2	8	4.35	2.32	0.14	-1.82



Also, it can be observed that the data are symmetrical as the Skewness of all variables approaching to zero. Likewise, no outliers were found as all the value of Kurtosis are within the range. Also, no response appeared outside when box plot analysis conducted as the shown in Figure 1.

Figure-1. Box Plot Analysis



#### 4.4. Hypothesis Testing

The correlation analysis was used to examine the nexus between Riba, Gharar and Income level, and Islamic banking products among Zanzibar people with different products offered as shown in the Table 4.

Table-4. Correlation Analysis

Correlation	Income Level	Ribaa	Gharar	Murabaha	Musharaka	Mudaraba	Ijara	Hawala	Takaful	Sukuk
Income Level	1.00									
Riba	0.03	1.00								
Gharar	0.05	.65**	1.00							
Murabahah	0.12	.53**	.72**	1.00						
Musharakah	0.17	.63**	.76**	.66**	1.00					
Mudarabah	.21*	.61**	.72**	.73**	.75**	1.00				
Ijarah	.25**	.53**	.75**	.62**	.79**	.77**	1.00			
Hawalah	.25**	.46**	.66**	.51**	.73**	.68**	.77**	1.00		
Takaful	0.15	.42**	.54**	.43**	.69**	.62**	.74**	.71**	1.00	
Sukuk	.27**	.49**	.63**	.65**	.73**	.74**	.71**	.65**	.57**	1.00

\* Correlation is significant at the 0.05 level (2-tailed).

\*\* Correlation is significant at the 0.01 level (2-tailed).

The correlation of Riba against Murabahah, Musharakah, Mudarabah, Ijarah, Hawalah, Takaful and Sukuk is substantial and significant at  $p \leq 0.01$ . Table 4 shows that Gharar against all Islamic bank products were significantly correlated at  $p \leq 0.01$ . On the other hand, Income level shows that there is a significant correlation against Mudarabah, Ijarah, Hawalah, Takaful and Sukuk as  $p \leq 0.01$ .

#### 5. Conclusion and Recommendation

First, the results of this study suggested that the products and services of Islamic banks have a positive relationship with Riba, Gharar and level of Income as Riba was vital on Islamic Bank products among Zanzibar people. Second, it is found that the relationship between Gharar and Islamic products and services was positive and significant. Third, the findings revealed that the products like Murabahah, Musharakah, Mudarabah, Ijarah, Hawalah, Takaful, and Sukuk are significantly attracted and impacted by Riba and Gharar against their income level. This implies that Muslim customers in Zanzibar are aware of interest (riba) effects which had lessened their attractiveness towards banking products and consistent with findings of Alam and Seifzadeh (2020), Kaabachi and Obeid (2016) and Cheteni (2014). To put it differently, the findings signify that a vast majority of Zanzibar people are fully aware of the existence of the non-sharial compliance of the products and services rendered by the banks. Fourth, most Zanzibar people are supportive of the policy to have more full-fledged Islamic banks where religious issues are considered trivial as long as the economic and financial welfare of Muslim community across Zanzibar are well-taken care off, especially the poor with entrepreneurial mind-set. By so doing, it is hope that the standard of living of the Muslim people in Zanzibar will improve in the not too distant future. For this to materialize, it is recommended for the relevant authorities to establish more in terms of number of Islamic banks that is full-fledged Shariah-

compliant in Zanzibar as majority of people are Muslim. As reported from various countries operating Islamic bank products without fees and other costs (Maybank in Malaysia, Bank Islam Indonesia, Commercial Bank in India), these (NBC, KCB, PBZ and Amana) banks are charging customers (TZS 500-12,000) in the form of monthly maintenance fees, ATM withdrawal fees, transfer fees, balance inquiry fees, etc which are out of Islamic point of view. These banks must look forward the other means of bolstering income through bond and treasury bills in order to increase their income instead of charging the customers from deposited their funds. As Sukuk, Murabahah and Wakalah Financing appears very healthy in Indonesia, UAE, Ivory Coast and Qatar, the growing populations and Islamic Banking industry are essential for the government of Zanzibar on the efforts so as to develop and bolster needed Islamic banking operations. Finally, the respective banks offering the Shariah-compliant products and services must in turn apply various awareness programs on marketing so as to promote more customers for the available Islamic bank products.

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