Banking on Ethics vs the Ethos of Banking: Ethical Values, Business Practices and the Development of the Islamic Financial Industry in the Middle East through the Fate of One of its Founding Banking Groups

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Abstract

This paper will discuss the development of Islamic banking in the GCC as a concrete industry – and not as a concept – by looking at business practices from a practitioner’s point of view. It will start by setting the context of the emergence of Islamic banking in the GCC. Through a brief case study, it will then describe the broad lines of the development of the DMI Group – the first Islamic financial company created in the MENA region that was not government-funded – from its establishment by HRH Prince Mohammed al Faisal to the corporate shift initiated at the turn of the century and finally to its eventual demise in the aftermath of the global financial crisis. The last part of the article will try to understand the mismatches between business practices and market expectations that could explain the DMI Group’s downfall, and their relevance to the development of the Islamic banking industry.

Keywords: Islamic banking, Islamic finance, GCC, Ithmaar Bank, corporate governance

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Islamic banking is a puzzling phenomenon. How was it possible to come up in the late 1970s, at the beginning of the era of high technology as well as economic and cultural globalization, with a business model based on traditional values embedded in religious principles established in the sixth century? What drove the founders of the first commercial Islamic banks to massively commit their family’s wealth in ventures whereby the business model entails tremendous potential limitations to the profitability of their organizations? A few decades later, the fact is that Islamic banking has not only proved to be a sustainable industry, but it has enjoyed since the late 1990s double digit growth rates\(^1\) to such extent that several global conventional banks developed an ‘Islamic window’ and regulators in financial centers such as London or Singapore adapted their legal framework to try and capture such growth.

The growth of Islamic banking was even more spectacular in the Middle East and North Africa region (MENA) in the aftermath of the terrorist attacks on 11 September 2001, when massive inflows of liquidity from the oil-rich countries of the Gulf Cooperation Council (GCC) triggered the region’s economic boom. Between 2002 and 2008, Islamic banking assets in the MENA region grew at an average annual rate of 72%, compared to 56% worldwide. By 2008, the MENA region accounted for half of worldwide Islamic banking assets, compared to only 29% four years before\(^2\). The GCC Islamic banking sector showed amazing resilience in the wake of the 2008 financial crisis, and was only impacted from 2009 onwards, when several banks and Islamic financial institutions suffered severe losses. Now in 2013, this industry is still poised to grow. However the damages suffered in 2009 and 2010 were not only financial, but also reputational, questioning the industry’s adherence to the ethical principles that are at the heart of its business model.

This paper will discuss the development of Islamic banking as a concrete industry – and not as a concept – by looking at business practices. More specifically, it will try to understand how such an eccentric idea in light of the economic environment of the late twentieth century has actually turned into a

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