

## **Credit Evaluation Perspective of Dual-banking and Full-Fledge of Islamic Banking Approach in Malaysia: Current Practices and Issues**

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### **Abstract**

*This paper aims to explore credit evaluation perspective of dual-banking and full-fledge of Islamic banking approach in Malaysia. This study further used qualitative method of analyzing the data collected from in-depth interviews with them. The study found that credit risk management really has a great role to play because it makes financing decisions less risky, it helps the banks to have a secure system of two-dimension of credit risk management. Besides, the commencement of credit risk management is in the time of stage in before the financing decisions until when it does repayment from customers. During the time of making financing decisions, information needed, most important elements and continuous relationship within customers are both valued differently by the different banks.*

**Keywords:** Banking, Credit Evaluation, Credit Risk Management, Current Practices and Issues

### **1. Introduction**

The effective of credit risk management could be viewed by the effectiveness of the first dimension of credit evaluation process as banking institutions has set the level of this effectiveness one of the factor to achieve a good performance as well as bank's profitability (Funso et.al, 2012). Therefore, "The greater achievement of credit risk management practices is categorically worthy from the bottom line". Certainly, many researchers ascertained that banks are broadly exposed to high credit risk but different factors with different banking approach. Such for conventional banks practices, they are widely exposed to high risk in credit because of the default payment thus increase the interest rate (Apostolik et.al, 2009; Takami & Tabak, 2011; Adem et.al, 2012; Choudhry, 2012; Zeyneb Hafsa Orhan Astrom,2013). However, Islamic banks practices, they are extensively exposed to high credit risk too due to the two (2) reasons: default payment but imposed for ta'widh (penalty) and gharamah (compensation) and the other reason is due to different types of contracts used (Baumgartner, 2009). For that reason, this paper comprehensively to empirically study the different perspective of credit evaluation to mitigate credit risk of dual-banking and full-fledge of Islamic banks approach in Malaysia. To extent this further, this paper are interestingly divided this empirical study into four (4) sub-section theme of the study which comprises of:-

1. Identification of the current practices of credit evaluation process, the information needed and the important elements used in evaluation process.
2. Recognition of how dual-banking and full-fledge Islamic banking approach handle with default cases.
3. Recognition of how dual-banking and full-fledge Islamic banks approach make a good and continuous relationship with customers notwithstanding of credit activities.

4. Ascertain of their opinion regarding to the issues in current practices and how the issues may perhaps resolve to have enhanced strategies in future.

Besides, this study also would contribute some facts and information to the recent collected works/literature, body of knowledge and regulators thus tie with the research findings in this study to added-up an input to the area of interest. Furthermore, the results of from the findings will be valuable to bank managers, credit officers, banking regulators, and borrowers who seek credit from the banks. This paper is structured as follows: section 2 discusses the problem statement of the study, section three overviews the related literature, section 4 discusses the methodology, sample, and proposition to be corroborated in this paper, the results and findings are presented in section 5, the analysis will be presented in section 6, the conclusion and recommendation will be presented in section 7 and lastly is section 8 presented the future works of research in related to area of interest.

## **2. Problem Statement**

There are different types of risks that banks must be administered cautiously, but the major risk that banks faced in their operation is credit risk (Muhammad Farhan Akhtar & Khizer Ali, 2011). This happen when banks deal with a bulk of default cases with their customers. One of the factors which may lead to trouble in the banks while there is not as much of concern on effective supervision on credit risk management. It is because according to Muhammad Hanif et.al (2011) and Samuel (2014), high credit risk and catastrophe to implement worthy strategies will have emotional impact to the performance and profitability of banks as well. Carey (2000) indicates that first dimension of mitigate the credit risk is begin from the first line-credit evaluation. Besides, in a study conducted by Eva and Jaroslav (2012) and Arora (2014), they indicated that good practices of credit risk management will drive to the improvement the worth of the institutions and contribute them a viable and competitive advantage and at the same time to manage and monitor credit risk systematically.

Besides, different types of banking approach will have different strategies and techniques in credit risk management (Muhammad Farhan Akhtar & Khizer Ali, 2011). It is because Islamic banks and conventional banks counterpart are different in terms of concept, types of contracts offered, the business activities, the relationship between bank and customers and the excess of profit attained in loan/financing. Therefore, since dual-banking approach are different, it may seem that different types of banks practices face different situation of credit risk and hence, will have different kind of credit evaluation process in mitigate the credit risk as well.

Based on the above discussion of the problem statement, this paper is aimed to look at the aspect of first dimension of credit risk in four (4) folds: First, this study will look supplementary in the stage of credit evaluation before the loan/financing approval in relation to current practices of dual-banking and full-fledge Islamic banking approach and thus to identify how different types of banking approach facing and handle with default cases. Third, this study will look further how they make a good and continuous relationship with customers notwithstanding of credit activities and lastly to ascertain of their opinion regarding to the issues in current practices and how the issues may perhaps resolve to have enhanced strategies in future.

## **3. Literature Review**

The acknowledgment of credit risk management in the stage of credit evaluation process that affect the accomplishment of dual-banking and full-fledge Islamic banking approach is one of the most imperative themes of study that stir the awareness and interests of researchers in the financial field of interests where the researchers may perhaps diagnose a set of perspective and perception towards credit evaluation with different practices of banking approach in Malaysia that proposed each of them to have different perspective towards the current practices of implementation in credit evaluation, default cases, relationship with customers and issues arise in current practices and how the issues may perhaps resolve to have enhanced strategies in future.

To extent this further, various researchers conduct a study of credit risk management. Credit risk management comprises of procedures and guidelines of mitigation of credit risk, identification, measurement of risk and, monitoring and controlling risks (Bouteille & Pushner, 2012; Setiawan, 2014). According to Dermine (2014), it certainly accomplishes the value of credit management because miscarriage in managing credit risk may perhaps reduce bank financing and vice versa. Furthermore, According to Golin and Delhaise (2013), a good credit risk management is derives from the performance of credit evaluation and the determinants of it is one fragment of an essential due to the effects of good policies and procedures to keep follows plus with a good practices which in line of banking strategies on contemporary conventional versus Islamic counterpart system approach.

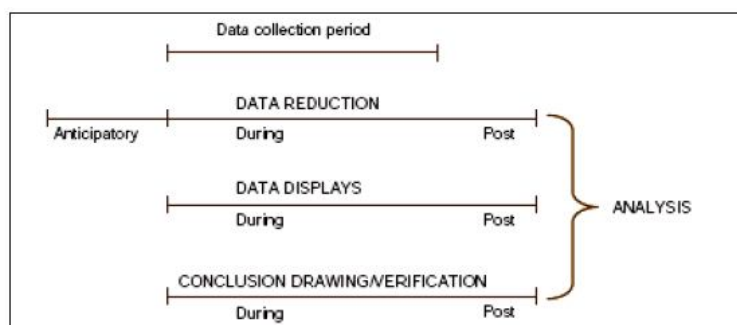
Therefore, a good policies and procedures have led to in stiff competition for different types of banking approach in well-developed financial markets. These as a reason of different types of banks practices may possibly have different practices in managing credit risk in counterpart of credit evaluation. These results in a need to determine what current practices bring forth to the good practices in evaluation process and some issues arise from the findings which of the various potential improved performance and strategies are the most important (Asantey & Tengey, 2014). Malaysia cases of reviewed of literature has showed that there are some issues pertaining credit risk within different approach of banking system which necessity to study profoundly. Soke and Nurul Izza Yusoff (2009) found that criteria of credit which consists of five C's and CAMPARI elements, credit culture, credit reminder and recuperation of loan/financing are most important things of credit risk management strategies. Study found in nearest Malaysia which is in Indonesia country, by improving the quality of credit risk management by the authority of dual-banking approach can be followed by put into words or either wise formulating the banking regulations within different system used (Chusaini & Ismal, 2013). Despite of that, Noraini Mohd Ariffin et.al (2009) stated that full-fledge of Islamic banking practices are mostly exposed to high in credit risk too those in conventional banking practices due to the different types of contracts used and the level of risk itself. They also opine that the findings stated for the issue of transparency and different level of contracts used should be comes with advance techniques and strategies in full-fledge of Islamic banks approach. These also found by Shaikh S.A and Jalbani A.A (2009) that with different types of contracts used in Islamic banks they are posing to more risks especially in credit risk, but they do found that both banking approach are profitable in loan/financing activities.

Many of researchers intricate towards credit risk affect the bank's performance. The results from Badrul Hisham Kamaruddin and Rohani Mohd (2013) justify that the Islamic banks practices in Malaysia is a worthwhile and profitable business despite Shariah restrictions that are imposed on them. They suggest that by applying of the latest technology in full-fledge of Islamic financing concept. In the light of differing Islamic financing concept and workflows, it is imperative that Shariah compliant system be evaluated and employed. Therefore, these also contribute for operational efficiency. Another study by Nabilah Rozzani and Rashidah Abdul Rahman (2013) found that performance of dual-banking approach in Malaysia is found to be self-same comparable due to the insignificant difference found among the ratings of dual-banking approach. In contrast, Hazzi and AL Kilani (2013) have different results pertaining performance which they found that different types of banks practices have different results in profitability as Islamic banks practices are less profitable. The result is same as much as the study of Abdus Samad and M. Kabir Hassan (1999), that they found that this issues arise because of banker's deficiency of knowledge evaluating risks as much as credit risk so that the outcome is a significant cause for slow growth of financing under performance.

**4. Methodology**

This study employs Primary data with qualitative analysis. The unique of this method of analysis employs with two (2) different ideas. First, this study views as a way to recognize and understand what participants certainly thought or experienced in some situation. Second, this study implements a hermeneutic perspective and perception of participants on transcripts as such of interpretation that can never be arbitrated true or false. In regards of collecting the data and process as showed in figure 1 below, this study first organize the data into concepts, then connect it to show how one concept or answers from participants may influence other participants. Afterward, validation is presented by assessing the alternative justifications, disconfirming confirmation, and penetrating for undesirable cases. Lastly, the study makes a report from the findings.

**Figure 1: Flow Model of Research Study**



To extent this further, in orders to accomplish the objectives of the study, a two-step analysis is commenced. First, development of questions was designed based on research questions. For the purpose of this study, each bank is given questions and consent form first to make them be prepared before the real of in-depth interviews, which is then compared with the different answers from different participants of dual-banking industry. The flows of the questions starts from the general questions and based on themes of study were developed into four (4) themes: current practices, default cases, relationship and issues pertaining of credit evaluation.

#### 4.1 Sample Data

The sample data comprises of five (5) of banking practices in Malaysia which consists of banks listed under Bank Negara Malaysia (BNM). Three (3) of Islamic window of finance banking practices and two (2) of full-fledge of Islamic banks practices. The sample of data is limited within out of total of banks in Malaysia because of time constraints. Five (5) of the banks practices are given a same of questions to have their point of views regarding to the credit evaluation perception towards the theme covered in this study. Table 1 below shows the banks included in this study:-

**Table 1: Lists of Participating Banks Institutions**

| No. | Name of Banks  | Types                         |
|-----|----------------|-------------------------------|
| 1   | CIMB Berhad    | Islamic window of finance     |
| 2   | BTMB Berhad    | Full-Fledge Islamic practices |
| 3   | Maybank Berhad | Islamic window of finance     |
| 4   | RHB Berhad     | Islamic window of finance     |
| 5   | Bank Rakyat    | Full-Fledge Islamic practices |

#### 4.2 Research Questions

The research questions that need to be addressed and investigated in this study are as follows:-

1. What are the current practices in credit evaluation process of dual-banking approach in Malaysia?
2. How does the different types of banks approach facing and handle with default cases?
3. How different types of banking approach make a good and continuous relationship with customers notwithstanding of credit activities.
4. To what extent the issues in current practices and how the issues may perhaps resolve to have enhanced strategies in future?

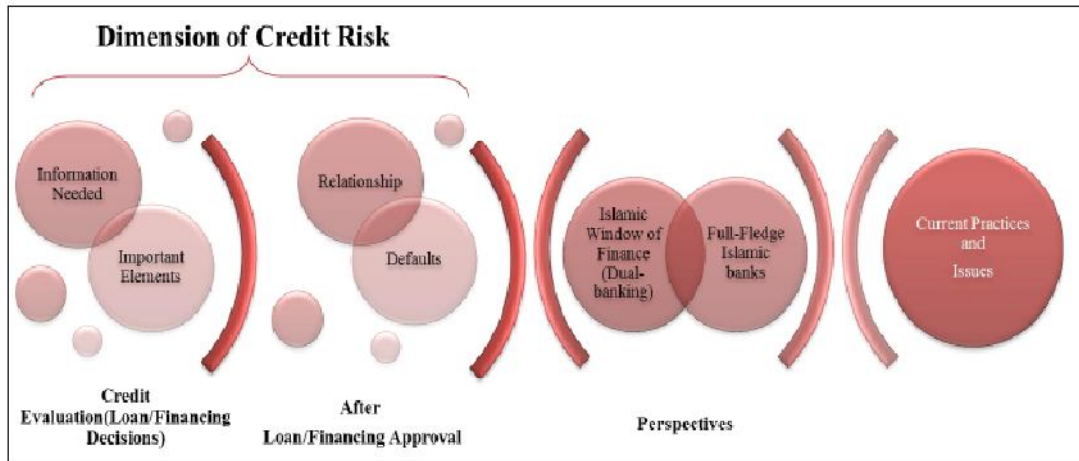
#### 4.3 Propositions

In order to answer these research questions, four (4) research propositions have been established. These research propositions are developed based on the core judgments of previous research collected works and also the unique characteristics of dual-banking practices in Malaysia. The propositions describe to views and thought of the respondents regarding to the credit risk management techniques in pre-approval stage of loan/financing. Therefore, it is proposed that:-

1. Credit risk management really has a great role to play because it makes financing decisions less risky, it helps the banks to have a secure system of two-dimension of credit risk management with different types of contracts.
2. The commencement of credit risk management is in the time of stage in before the financing decisions until when it does repayment from customers.
3. During the time of making financing decisions, information needed and most important elements collected are both valued differently by the different banks.
4. A good relationship with customers as in the business financing activity, both of them should be aligned together right from the beginning in making financing decisions, through and along the business will make it easier to identify and if possible solve problems in time before they get off hand and thus this can diminish issues beforehand, so that automatically bring a good solutions.

4.4 Research Framework

Figure 2: Framework of the Study



5. Results and Findings

The empirical framework in this study consists of respondents working in five (5) of the selected banking system that applying the Islamic window of finance in Malaysia and full-fledged of Islamic banking system as the purpose to distinguish their current practices in managing credit risk. These interviewees have been chosen based on their job position and experience qualifying them to give appropriate answers.

5.1 General Questions

This section is focused on the job position of the all respondents in the selected banks and shariah advisers, their working experience and their educational qualification. The choice of respondents was based on their experience both in theory and practice in the field of industry particularly with knowledge in business lending/financing coupled with longevity in service since it is widely believed that “experience is the best teacher”. Table 2 below shows the profile data of respondents:-

Table 2: Profile Data of Respondents

|                        | RESPONDENTS                               |                                   |  |  |  |
|------------------------|---|-----------------------------------|--|--|--|
|                        | A   | B                                 | C  | D  | E  |
| <b>Gender</b>          | Male                                      | Female                            | Male   | Female                                   | Male                                     |
| <b>Job Position</b>    | Business Financing Officer (CIMB Islamic) | Business Financing Officer (BIMB) | Business Financing Officer (Maybank Islamic) | Business Financing Officer (RHB Islamic) | Business Financing Officer (Bank Rakyat) |
| <b>Work Experience</b> | 2012-2015<br>4 Years                      | 2010-2015<br>6 Years              | 2012-2015<br>4 Years                         | 2010-2015<br>6 Years                     | 2010-2015<br>6 Years                     |
| <b>Education</b>       | Degree                                    | Diploma, Degree                   | Degree                                       | Degree                                   | Degree                                   |

5.2 Interview Responses

In this section, the study focused on understanding the perception of selected bank’s interview responses regarding to their current practices in managing credit risk in business loan approval as well as during the time-line of financing decisions. The other questions of interviews included focused on what are the information needed about the customer before taking a lending decision, what the respondents might think to be the case of defaults and how they handle the situation. Besides, the other questions of interviews included concentrated on if they think a good relationship with a customer is important and if the duration of this relationship has an effect on the credit evaluation process and if so, why?

### 5.2.1 Respondent A

Respondent A said that since the bank that he worked are applying dual-banking approach (Islamic window of finance), there is same techniques in evaluating business clients. The basic design of the credit approval processes consists of first; the loan department request documents from business clients, then review documents related with manager of business loan department, evaluate exposure in collateral and risk assessment aspects and lastly are approval stage. Besides, he said that information from clients is important for bank to evaluate them before taking the business financing decision. The most important information needed is company's revenues includes of their cash flow of business, yearly budgets, description of the business and customers and the business size. This information is needed for use to evaluate them but these information needed will depend on types of company too. On top of that, in terms of the using of five C's elements of credit and CAMPARI elements, the first most important elements will consider is Cash Flow element of credit process for business loan. The bank needs to be certain that the client's business generates enough cash flow to repay the loan. As a loan officer, he used "Debt Service Coverage Ratio" method to first evaluate them.

Nevertheless, his opinion regarding to the case of defaults are not all of them defaults. The defaults case are happened because of the management of the company was not good as well as the business maybe in sick situation. How customers handle the situation is by trying to work closely when the bank see that the situation is close to defaults. The case of default too affect the bank's performance because customers are unable to finish up the payment within time and these give them a tough times to wait customers to fulfill their obligation. In terms of relationship questions, he thinks that a good relationship with customer is important because it helps the customer to look at their bank like business partners. Besides, conventional banking approach in the current practices does not have continuous relationship after the commercial loan approval. This practice is done in Islamic window of finance in Musharakah financing contracts. He think that a continuous relationship with customers tend to lead to an easier credit assessment process. On top of that, he admitted that relationship with new customers make the credit evaluation process is more difficult because since the bank don't previously know them and have no identity and this makes more difficult to have go through all the procedures.

### 5.2.2 Respondent B

Respondent B said that currently the bank that she worked practices business financing which based on asset-based financing in business financing. They used Ijarah thumma al-Bay' financing (Hire purchase) practices, Ijarah (Islamic rent) financing, Bay' Bithaman Ajil (BBA) or known as sale on deferred payment basis financing, Bay' al-Istisna' (project financing) and other Islamic financing contracts offered in her bank's practices. The step-by-step used is first, the financing department use a clear and formal evaluation and approval process for new customers and extension of existing customers and allow customers to submit business proposal before the business financing officer evaluate them severely. The business financing officer makes a careful analysis by a credit analyst so that soft information and hard information can be generated for internal evaluation. The current practices are in line with rules and guidelines which provided by Bank Negara Malaysia (BNM). The step-by-step processes are used for appropriate judgments about the acceptability of the business financing. Besides, based on her experience in the industry, the most important information needed about the customer is the business profile and cash flow of business for customers who applied for business financing. The less important officer emphases are about information asymmetry and agency conflicts.

As a financing officer, regarding to the five C's and CAMPARI elements of evaluation process, the first most important element will be consider is character elements. Her department decision is based on a level of character of clients as well as physical characteristics. The characters includes of years of experience, other business partners and dress code of clients. All of these are qualitative elements that need to look up further first in the stage of business loan process. The bank want to deal only with people that they can trust to act in good faith at all times – in good times and in bad. Nevertheless, since the bank is applying the full-fledged of Islamic banking system, there is not major default case from customers. It is because the bank used Musharakah contracts, the bank appoint them to be their business partner, the profit from business is shared and bear for losses. If some of the customers are in the case of defaults in their business, which means late in making payment on time, bank do not charge for interest, but then they charge for late payment charge penalty. The bank used concepts of gharamah (penalty) and ta'widh (compensation) in handle the defaults case. The gharamah (penalty) used is channeled to specified charitable bodies. Besides, the bank used ta'widh (compensation) as income on the basis that it is imposed on the customers as compensation for the actual loss incurred by bank.

In terms of relationship questions, she think to develop a good relationship with a customer is by the first impression of character from us and from our customers. As the customers are agreed in the Musharakah financing contracts in business financing, thus both of them are borne as a business partners. But there are some issues the bank she worked faced. One of them is about the issue of knowledge. Not all of them fully understand the concept of the bank's used, since before this, majority of the customers are in line with conventional part approach. It is complicated to business financing department to explain to them. She think that, it is better to implement syura' (meeting) concept and discuss with them deeply. Gives them time to understand is better. This can reduce the default case or either they tend to be bankruptcy.

Besides, from her point of view, continuous relationships with customers tend to lead to an easier credit assessment process. It is because each type of contracts offered is halal/ permissible in Islam, both of the parties included are borne to be as a business partners, bank do not charge the interest in the business financing, bank try to make more comfortable with customers by making any promotions which allow them to do more effort to make the payment within the time-line of financing. Moreover, not at all of the bank's new customers make business financing department of credit evaluation process more difficult. It is because new and existing customers are same. The bank might evaluate them time-by-time to ensure that customers are in line with shariah. The bank also might watch-list customers regarding to the types of business. It's their business did halal business or not and so forth.

### **5.2.3 Respondent C**

Respondent C said that in making financing decision in business financing activities, first in the sales stage, the bank make acquisition to customers who apply for business financing, then make a credit review, analyze the risk assessment included, process of documentation and lastly approval stage. Furthermore, the most important information needed about the customer before taking a business financing decisions includes of the annual report for the last few years, budget for the next year, the performance of the company, collateral, experience of the management, the type and size of the company. But there is some information about the customer not known to the bank but that is the risk they take. The most important element that the bank analyzes is capital of the company. This shows how the bank incorporates the element of capital in evaluation process bad from potential creditors. The other elements are less concern, but the bank still used in analyzing process of financing decision. Each bank has their own cases of default. But in his bank practices, the most cases of default are in conventional-based practices, but minority of them used the Islamic-based approach of business financing instead of this practices are more highly issues in operational charges. These issues are still in progress to find out solutions, he hope that the issues can be minimize since each year the bank might face with a lot of default cases from customers. He thinks that the most cases of default happen because of the company's branches are fluctuating financially. Based on his expectation to handle this issue, the case of delayed payment and bankruptcy should be concern by the customers themselves. Customers must respect the repayment time. To remind them, the business loan department first calls them by phone and asks them why they failed to pay on time. Besides, the bank cut off the loan/financing by cutting the credits as well as they cannot withdraw the money from account. Besides, the bank also terminates the credit and asks them to pay the total loan/financing before the company goes bankruptcy. In terms of relationship questions, respondent C said that a good relationship with a customer is important because it helps them to have information and as soon as possible. Besides, relationship with new customers make the bank credit evaluation/assessment process more difficult because the bank needs more time to look further their character and capital of their company. It is so hard times if the customer lacks a professional management.

### **5.2.4 Respondent D**

Respondent D said that in making financing decision, first loan officer asked customers/applicant to decide which form of business is best for them, then bank will make the checklists includes of information needed by bank. Then, bank analyzes and evaluates them based on physically aspect such as five C's and CAMPARI elements. After that, bank evaluates exposure in collateral and risk assessment aspects and lastly is approval stage. On top of that, the most important information needed about the customer before taking a business financing decisions is the business plan of customers, budget planner for next year and business asset statement. Besides, the other information needed comprises of the financial performance of the business such as trading accounts, cash flow forecast and the other is the cost breakdown. The first most important elements will consider is capital of business because bank first need to analyze customers according to their financial assets then follows to the other elements.

Besides, the starting point of high credit risk occurs when bank failed in viewing and evaluating customers appropriately. Nevertheless, the high case of default happen from customers is because of the poor management and they do not have enough collateral. To handle this issue, bank charge the interest thus makes call customers to ask them to pay the financing. If not, the proceedings will continue and even goes to the court. In terms of relationship questions, a good relationship with a customer is important because it enables bank to do more businesses and activities. A bad relationship with customers makes their bad perception about bank's services thus affect the performance. Besides, a continuous relationship with customers tends to lead to an easier credit assessment process because bank already know the performance of the company. Moreover, relationship with new customers makes bank's credit evaluation/assessment process more difficult. It is because it is a risk for bank to give out loans to new customers but the point is that the analysis goes faster when bank already known the customer.

### **5.2.5 Respondent E**

Respondent E said that in making business financing decision, bank used various types of product offered for business financing such as Term financing-i, Bridging-i, Property-i, Contract-i, Hire Purchase-i, Share-i and Contract Financing-i. These are business financing in line with shariah principles. Before the financing is approved, bank makes a careful analysis by a credit analyst so that soft information and hard information can be generated for internal evaluation. Furthermore, based on his experience in the industry, the most important information needed about the customer is the business profile and cash flow of business for bank's customers who applied for business financing. Besides that, bank needs purpose of customers in doing business financing. Regarding to the five C's and CAMPARI elements of evaluation process, the first most important element will be consider is character elements. The characters includes of years of experience, other business partners and dress code of clients. The elements business financing department analyzed need to look up further first in the stage of business financing process. Bank wants to deal only with people that we can trust them at all.

On top of that, since bank is applying the full-fledged of Islamic banking system, there are not major default cases from our customers. As a business financing officer, customers are appointed to be as bank's business partner, the profit from business is shared and bear for losses. If some of them are in the case of defaults in their business, which means late in making payment on time, bank charge them gharamah (penalty) and ta'widh (compensation) in handle the defaults case. The gharamah (penalty) used is channeled to specified charitable bodies. Besides, bank used ta'widh (compensation) as income on the basis that it is imposed on the customers as compensation for the actual loss incurred by us. In terms of relationship questions, he thinks that to develop a good relationship with a customer is by the first impression of character from us and from our customers. But there are some issues bank faced. One of them is about the issue of knowledge. Not all of them fully understand the concept bank used, since before this, majority of them are in line with conventional part approach. It is complicated to bank to explain to them. Therefore, it is better to implement full-fledged of Islamic concept and discuss and re-discuss with them deeply. Gives them time to understand is better. Make them understand our Islamic financing products. This also can reduce the credit risk. From his point of view, continuous relationships with customers tend to lead to an easier credit assessment process. It is because each type of contracts offered is halal/ permissible in Islam, bank do not charge the interest, bank try to make more comfortable with customers by making any promotions which allow them to do more effort to make the payment within the time-line of financing. For new customers, they make bank's credit evaluation process more difficult. We might evaluate them time-by-time to ensure that customers are in line with shariah principles and guideline instead bank might go further to their premise/ company to make a watch-list the types of business and what types of products/ services they do.

## **6. Analysis**

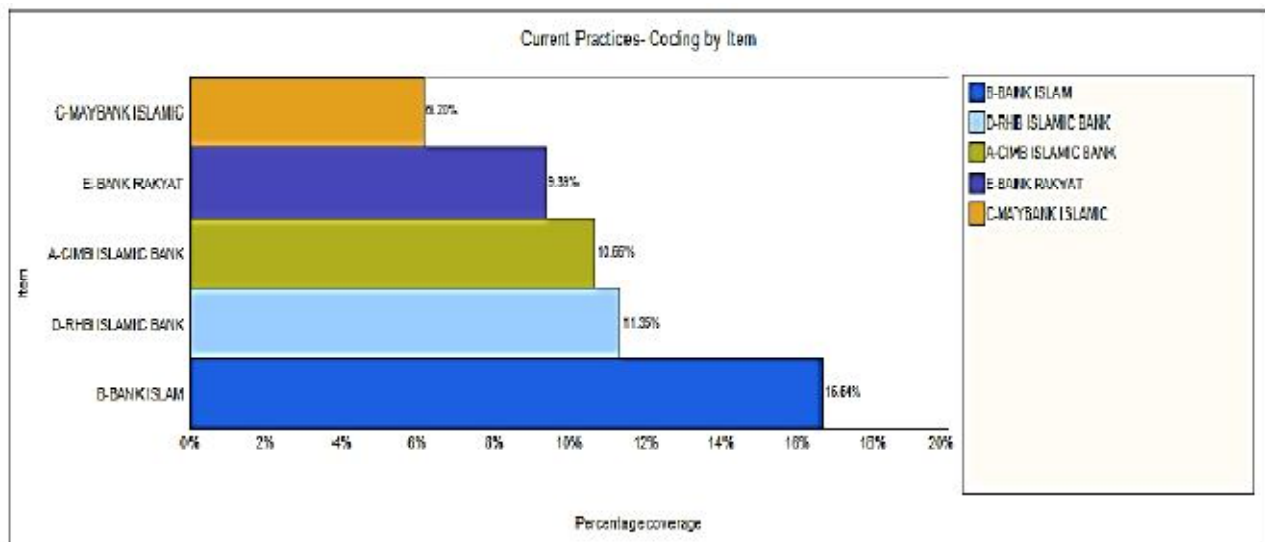
In this section of analysis of selected banks interview responses, the study tried to explore the perception of business financing officer regarding to the current practices in managing credit risk in business loan approval, the information needed, the default cases and relationship with the customers. Besides this section will divided into five (5) themes of study that will be analyze further based on the interview responses which includes of theme of current practices, information needed, important elements in credit evaluation process, default cases, Islamic elements in evaluation process and lastly is theme of relationship with customers.



**6.1 Current Practices**

Based on the interview responses, the highest percentage with coding by item is respondent B with a total of 16.64 percent. Respondent B stressed the business financing product used and the step-by-step of evaluation and approval process. Besides, Respondent B stressed the Bank Negara requirements in evaluation process for full-fledge of Islamic banking practices. The second highest percentage with coding by item is respondent D with a total of 11.35 percent. Respondent D stressed the important of credit risk management in making financing decision by making the checklists includes of information needed by bank and looking for physically aspect such as five C's and CAMPARI elements. Besides that, respondent D stressed the need of collateral and aspects in risk assessment before the financing is approved. The results of least of the respondents (respondent A, E and C) were low with a total of 10.66 percent, 10.39 percent and 6.20 percent respectively. The results shows in the figure 3 below:-

**Figure 3: Coding by Item for Current Practices**



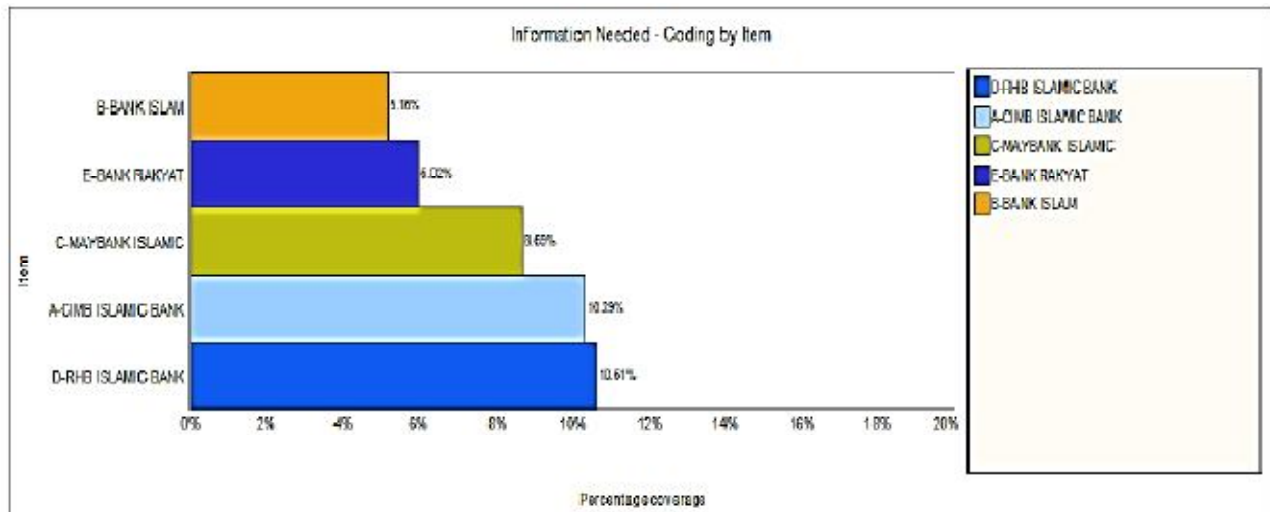
The result shows that all five (5) respondents stressed the important of credit risk management in making financing decision with followed out the elements of evaluating their customers although they did so in different ways. All of them followed strictly explained their current practices in making financing decision. Regarding to the highest percentage of coding by item (respondents), the full-fledge of Islamic banking approach stressed the important of analyzing and evaluating customers based on business financing product offered. Not all of them concentrated on business financing product offered unless for full-fledge of Islamic banking practices, they do also discussing the current practices with the product offered such the interview responses for respondent B and E respectively. The study agree with this only to a certain extend because the study think that a good credit risk management also affect the business financing products used in the contracts thus affect the evaluation stage of the customers. It is for the reason that the good evaluation process is strongly put on the customer's knowledge and expectation to the business financing product offered simply because they are one part of the business partners and not as borrowers and thus are expected not just to pay back the financing, but both banks and customers in doing ikhtiar (effort) as both of them are in the business partners. Besides, it is also said that business activities of business financing regarding to the interview responses are the highest word frequency recorded with a total of 6.45 percent frequency of word count. Majority of the respondents stressed out the term of 'activities' which means business financing activities. The less word count frequency is 'applicant' in this theme of question in the study. It is because the question straight forward with the current practices in making financing decision in the side of bank perspectives and all of them discussed on the way of making financing decision.

**6.2 Information Needed**

In this section the study addressed the information needed by banks from customers. A bank can't just give the financing to customer without submitting the information needed that they are going to have their money back. Besides, the bank attempts to know of the guarantee/collateral by considering into the credit worthiness of the company in question and this is done by using certain information about the business/company.

The different banks may rank the importance of this information differently and there is continually some concealed information about the customer that is unidentified to the bank (asymmetric information). To extent this further, all the respondents admitted that the needed information is very important because that have to be sure that the business of the applicant which means the customers will be able to pay back the financing. Based on the result from the interviewed respondents, the information needed for analysis of evaluation process of business financing is the same however varies according to the type and size of the company/ business. In addition, the sources correspondingly are almost same although the classification of the important are varies. This information encompassed of the cash flows, yearly budgets, annual reports as well as the revenue for the past years, the types of business, business plan, ability of the management and so forth. According to the analysis of the coding by items, it is shows that the highest coding by items is respondent D with a total of 10.61 percent coverage. This followed by respondent A, C, E and B 10.29 percent, 8.69 percent, 6.02 percent and 5.16 percent coverage respectively. Figure 4 below shows the coding by item for information needed:-

**Figure 4: Coding by Item for Information Needed**



Back to the previous section in empirical findings, respondent D said that the most important information is related mostly with numbers which means description of the profits. Most of them are discussed about the accounts and the cash flow although everything is important. Only respondent B acknowledges information asymmetry. None of them acknowledge the company's history as being the most important as most of them are said it is hard to evaluate the information required. Besides, it is also said that the word of information needed during the evaluation process with regard to the interview responses are the highest word frequency recorded with a total of 8.10 percent frequency of word count. Majority of the respondents stressed out the term of information which means regarding to the cash flows, yearly budgets, annual reports as well as the revenue for the past years, the types of business, business plan, ability of the management and so forth. The less word count frequency is 'use' either wise the similar term is 'take' or 'purpose' in this theme of question in the study. The reason is the question is straightforward with the current practices in making financing decision in the side of bank perspectives and all of them discussed on the way of making financing decision with the used of information needed.

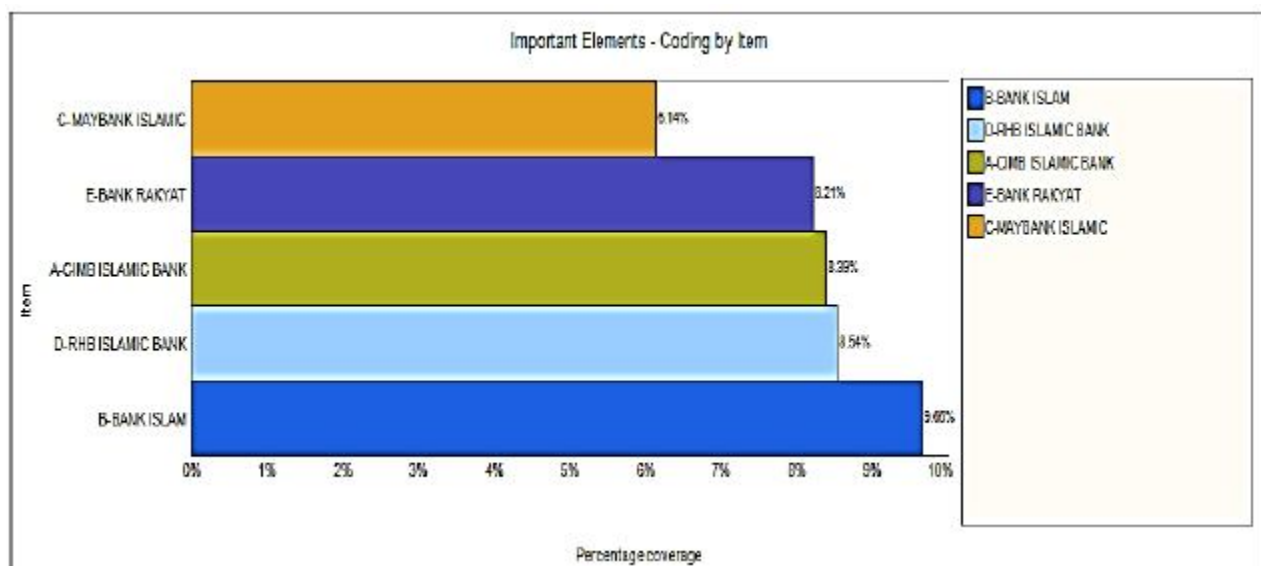
The answers to this section of theme knotted-well enough with the theory as for which information is needed when taking business financing decisions. The fact of which the study tried to discover out in this part which is contradictory to the study is the fact that both theory and interviewees believed of the same information as being needed for analysis however the classification of the importance differs. The question with regard to this theme of section is "what is the most important information needed about the customer before taking a business financing decisions?" The study straightforward to ask so for the reason that from the study point of view and understanding, the most important information needed that can be taken to be less important might be in some cases be the massive cause of problem. To extent this further, once taking the information needed, do the banks take questions associated to the elements of five C's and CAMPARI of each business applicant of financing, or do they use the credit scoring? Even though if they do, are they sure that if another bank uses the similar information to carrying out the scoring, will the outcomes from the results be the same?

The study hope that even though some information is classified as less important, once it comes to decision taking of business financing, nothing should be minimized based on the fact that it is considered less important. Furthermore, the analysis of the information is vital too before any financing decision can be taken and for sure they can't just do the task of gathering information since they know is a pre-requisite for business credit granting without good analysis is attempted. In regard if they do so, no matter the good information they may get, unscrupulous analysis can also indicate to erroneous conclusion and of course difficulties will arise at the end of the business financing activities because they may give more and more business financing as well as business credits to companies which they are not supposed to and the collection phase will not go thoroughly. Moreover, proficient management of the company is very important too and it does not matter whether they have good information of it to deliberate business financing. Even if the information collected is good but of which the management is bad, it means that the company cannot function well and as a result there is no affirmation of good repayment of business financing.

**6.3 Important Elements**

In this section, the study addressed the first most important elements that will be considered in evaluation process via using five C's and CAMPARI elements. Reviewing the answers from the respondents for questions allied to first most important elements, all of them acknowledge its importance on the other hand this comes in the second place during assessment process using the information needed as earlier mentioned. This is because the first most important elements gives a good assumption in making financing decisions instead of the analysis of information needed, the five C's and CAMPARI elements of analysis is vital as an assurance which how bank deliberate each of the elements before the business financing is approved. When asked what is the most important element that will be considered in evaluation process, most of the respondents consider capital and character elements as the most important elements used except for respondent A as dual banking approach answered cash flow element is the first most important element. Character element answered by full-fledge of Islamic Banking approach by respondent B and E, instead for capital element answered by respondent C and D who applying dual banking approach. In addition to this, the study makes the coding by item according to the responses of the interviewed questions regarding to the theme of important elements and the results shows that the highest percentage of coding by item is respondent B with a total of 9.66 percent of coverage. This followed by respondent D, A, E and C with a total of 8.54 percent, 8.39 percent, 8.21 percent and 6.14 percent respectively. The figure 5 below shows the important elements as coding by item:-

**Figure 5: Important Elements as Coding by Item**



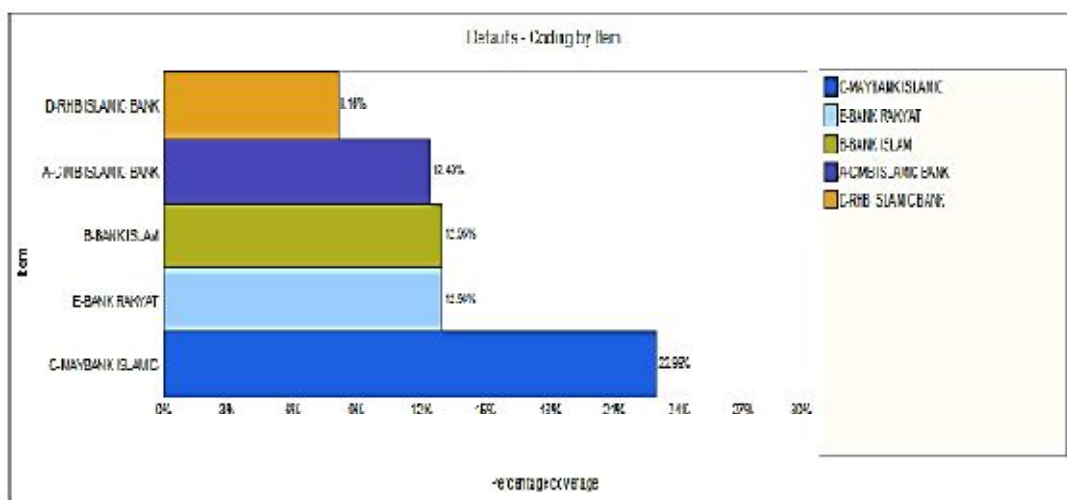
By means of the highest percentage coverage resulted from respondent B, the answered from the interviewee was interesting and full with explanation statement. As such, respondent B said that the decision process is based on a level of character of clients as well as their physical characteristics. Moreover, respondent B answered deeply in terms of character element which includes of years of experience, other business partners and dress code of clients.

What surprising responses from this respondent, the interviewee said that “we want to deal only with people that we can trust to act in good faith at all times – in good times and in bad”. By means of the lowest percentage coverage resulted from respondent C, the answered was quite short but straightforward statement. As such, respondent C said instead of capital element is the first most important element considered, this shows how the bank incorporates the element of capital in evaluation process bad from potential creditors. The other elements are less concern, but the bank still used in analyzing process of financing decision. As for analysis word frequency query, the highest weighted percentage in this section is the word of ‘act’ with a total of 9.42 percent. The word of ‘act’ is refer to the act of the bank in considering the first most important element as such act in making evaluation decision, act of method used in five C’s and CAPARI elements, act of process decision making, act of how can the customer repay the financing within time obligated, act of defend the risks occurs and so forth. All of these are included in similar word used in this theme of section. Besides, the lowest weighted percentage is refer to the word of ‘shows’ with a total of 0.55 percent as this word refer to the banks as how they shows the consideration of the first most important elements. As such, all of the respondents stood on the point that each elements are important but the first most important is more important before move to the other points of elements in assessment process. The study agrees too since the first most important elements in making business financing decision stands as a “pre-approval stage of credit risk management”. A good credit risk management comes from the good analysis in pre-approval stage. If the bank falls in this pit and does so when at the end the company unable to pay back the business financing, it obviously lead to greater problems because the bank will going through a lot of stress to cover up the money by selling the collateral or affect to the guarantee. Correspondingly collateral made accessible at a point in time can be something which has a good market at then on the other hand, what if at the time of possibility of default in case the changing environment in which we live, the bank can’t discover a good market for the collateral? Possibly It will visibly encounter huge problems as well to the guarantee if the guarantor unable at the time to make guarantee on behalf the company. Therefore, a good credit risk management in pre-approval stage may lead to a good credit risk management in post-approval stage.

**6.4 Defaults**

Regarding to this section, the study addressed problems on defaults asking the respondents what they consider possibility cause a customer to be in default and how they handle such a situation. In answering these questions, all the respondents acknowledged to have come across defaults because they can’t avoid it otherwise they don’t grant financing. As such the highest percentage coverage of defaults as coding by item is respondent C with a total of 22.99 percent coverage and followed by respondent E, B, A and D with a total of 12.98 percent, 12.95 percent, 12.40 percent and 8.16 percent respectively as shown in figure 6 below:-

**Figure 6: Defaults as Coding by Item**



As for analysis word frequency query, the highest weighted percentage in this section is the word of ‘defaults’ with a total of 4.08 percent. Besides, the lowest weighted percentage is refer to the word of ‘wait’ with a total of 0.23 percent as this word refer to the banks as how they wait their customers at the phase of business financing collection. Nevertheless, regarding to the highest percentage of coverage, the study shows that respondent C share his experiences and answered deeply.

He noticed that the most cases of default are in conventional-based practices, but minority of them used the Islamic-based approach of business financing instead of this practices are more highly issues in operational charges. These issues are still in progress to find out solutions, He hope that the issues can be minimize since each year bank might face with a lot of default cases from customers. He thinks that the most cases of default happen because of the company's branches are fluctuating financially. Based on his expectation to handle this issue, the case of delayed payment and bankruptcy should be concern by the customers themselves. Customers must respect the repayment time. To remind them, bank first call them by phone and ask them why they failed to pay on time. Besides, bank cut off the loan/financing by cutting the credits as well as they cannot withdraw the money from account. Besides, bank also terminate the credit and ask them to pay the total loan/financing before the company goes bankruptcy.

Besides, as the lowest percentage of coverage in this section is goes to respondent D as she answered shortly but aligned with question asked. As she said that the high case of default happen from customers is because of the poor management and they do not have enough collateral. To handle this issue, bank charge the interest thus makes call customers to ask them to pay the financing. If not, the proceedings will continue and even goes to the court. Thus, both of the highest and lowest percentage coverage is tend to banks which conducted dual banking approach. Meanwhile, the average percentage of coverage goes to full-fledge of Islamic banking approach (respondent B) as she noticed that there is not major default case from customers because they used Musharakah contracts, bank appoint them to be their business partner, the profit from business is shared and bear for losses. If some of them are in the case of defaults in their business, bank charge for late payment charge penalty. They used concepts of gharamah (penalty) and ta'widh (compensation) in handle the defaults case. The gharamah (penalty) used is channeled to specified charitable bodies. Besides, bank used ta'widh (compensation) as income on the basis that it is imposed on the customers as compensation for the actual loss incurred by bank. Most interestingly from the responses within the respondents, different banking approach has their own techniques and strategies in handling issues on defaults in the phase of business financing collection. However, what the study perceived here from the results of the interviews is that there is a bit different from the theory noticed. Some of the respondents believed of calling the customer via phone to discussed further and ask what the problem was.

To extent this further, what was the study concern of regarding to the issue arise as why should they authorize things to reach defaults before all these actions are taken? Another issue arises as the possibility if they have a tight relationship of continuously being in contact earlier with the customers, is it could be conceivable is some cases not to arrive at this phase? Are the banks in fact confirming that if their implementation was carried out soundly or if the policy was followed thoroughly as highlighted in the theory? Some of the customers may hide some information, thus the question is do they sure that observing the customers via phone can reduce the issue of asymmetric information? The study think that the banks should make an improvement and go further extra mile apart from using via phones such as make a visit to the business/company or spend time to discussed together on how to solve the problems.

### **6.5 Relationship**

In this section, the study explored the reason of the respondents regarding to the good relationship with customers in doing business financing, the opinion of does a continuous relationship with customers tend to lead to an easier credit assessment process and the reason and lastly is their opinion regarding to relationship with new customers. As results from coding by item within this section, the highest percentage of coverage is respondent E with a total of 27.32 percent, followed by respondent B, D, A and C with a total of 26.11 percent, 17.33 percent, 17.26 percent and 13.29 percent of coverage. This section consists of five (5) sources from the interviewed responses and fifteen (15) references as each sources consist of three (3) references coded in the questions. The chart of the percentage coverage can be seen as figure 7 and figure 8 below:-

Figure 7: Relationship Elements as Coding by Item

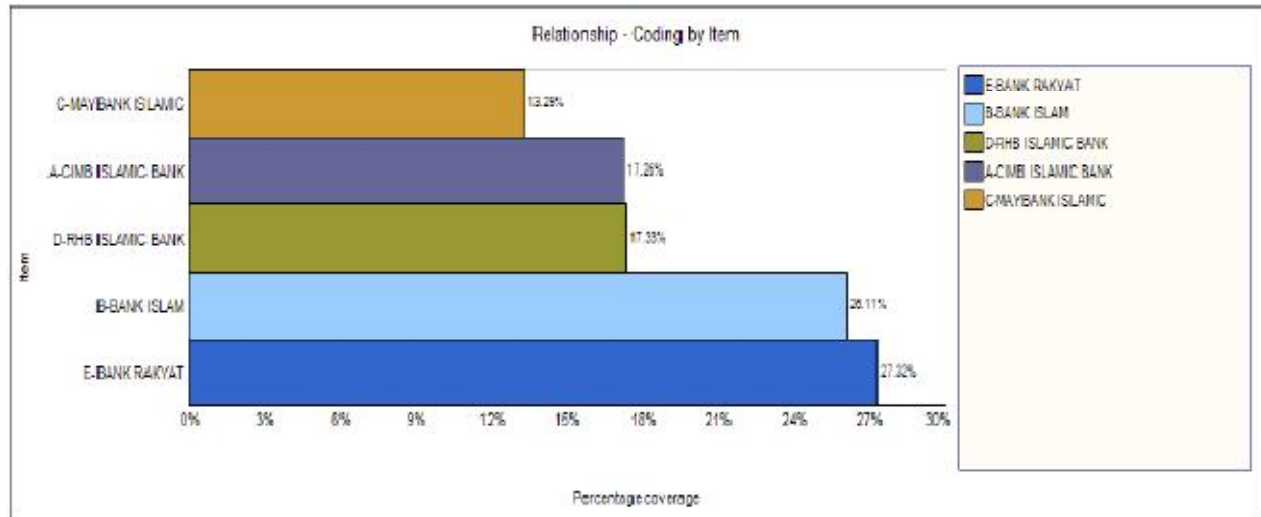


Figure 8: Sources and References as Coded by Theme

| Name  | Sources | References | Created On         | Created By | Modified On        | Modified By |
|---|---------|------------|--------------------|------------|--------------------|-------------|
| CURRENT PRACTICES   | 5       | 5          | 2/26/2015 11:53 PM | AMIRA      | 2/26/2015 11:58 PM | AMIRA       |
| DEFAULTS  | 5       | 5          | 3/3/2015 1:40 AM   | AMIRA      | 3/3/2015 1:43 AM   | AMIRA       |
| IMPORTANT ELEMENTS  | 5       | 5          | 3/3/2015 12:38 AM  | AMIRA      | 3/3/2015 12:41 AM  | AMIRA       |
| INFORMATION NEEDED  | 5       | 5          | 2/27/2015 12:37 AM | AMIRA      | 3/2/2015 2:00 PM   | AMIRA       |
| INTERVIEW/QUESTIONS BANKS                                 | 0       | 0          | 2/26/2015 11:18 PM | AMIRA      | 2/26/2015 11:18 PM | AMIRA       |
| Interviewer "Can you explain your current practices in im | 5       | 5          | 2/26/2015 11:18 PM | AMIRA      | 2/26/2015 11:23 PM | AMIRA       |
| Interviewer "Do you agree that the elements of 'adl (fair | 5       | 5          | 2/26/2015 11:18 PM | AMIRA      | 2/26/2015 11:25 PM | AMIRA       |
| Interviewer "Does a continuous relationship with custo    | 5       | 5          | 2/26/2015 11:18 PM | AMIRA      | 2/26/2015 11:26 PM | AMIRA       |
| Interviewer "Does your relationship with new customer     | 5       | 5          | 2/26/2015 11:18 PM | AMIRA      | 2/26/2015 11:26 PM | AMIRA       |
| Interviewer "In terms of the using of five Cs elements o  | 5       | 5          | 2/26/2015 11:18 PM | AMIRA      | 2/26/2015 11:25 PM | AMIRA       |
| Interviewer "What are you might think to be the case of   | 5       | 5          | 2/26/2015 11:18 PM | AMIRA      | 2/26/2015 11:25 PM | AMIRA       |
| Interviewer "What is the most important information ne    | 5       | 5          | 2/26/2015 11:18 PM | AMIRA      | 2/26/2015 11:26 PM | AMIRA       |
| Interviewer "Why do you think a good relationship with    | 5       | 5          | 2/26/2015 11:18 PM | AMIRA      | 2/26/2015 11:26 PM | AMIRA       |
| ISLAMIC ELEMENTS  | 5       | 5          | 3/3/2015 1:51 AM   | AMIRA      | 3/3/2015 1:54 AM   | AMIRA       |
| RELATIONSHIP  | 5       | 15         | 3/3/2015 2:07 AM   | AMIRA      | 3/3/2015 2:11 AM   | AMIRA       |

As for analysis word frequency query, the highest weighted percentage in this section is the word of ‘customers’ with a total of 7.92 percent. The word of ‘customers’ in this section refers to business partners in business financing contracts as this section which also stated in the question as the respondent answered frequently. Besides, the lowest weighted percentage is refer to the word of ‘like’/ ‘such as’ with a total of 0.15 percent as this word refer to the respondent A answered at the reference one (1) coding by item as means of how a good relationship helps the customer to look at bank’s side as like as business partners. In response to this question, respondent E is practicing the full-fledge of Islamic banking approach with three (3) reference coded as in reference one (1) he noticed that to develop a good relationship with a customer is by the first impression of character from bank and from customers. However there are some issues faced. One of them is about the issue of knowledge. Not all of them fully understand the concept bank used, since before this, majority of them are in line with conventional part approach. It is complicated to bank to explain to them. He thinks that, it is better to implement full-fledge of Islamic concept and discuss and re-discuss with them deeply. Gives them time to understand is better. Make understand to the Islamic financing products offered by bank and this also can reduce the credit risk. The percentage coverage within this reference is 12.88 percent. Besides, coded in reference two (2) within respondent E, the percentage coverage was 7.89 percent as he noticed that continuous relationships with customers tend to lead to an easier credit assessment process.

It is because each type of contracts offered is halal/ permissible in Islam, they do not charge the interest, and they try to make more comfortable with their customers by making any promotions which allow them to do more effort to make the payment within the time-line of financing. Furthermore, coded in reference three (3) within respondent E, the percentage coverage was 6.55 percent as he addressed that new customers make their credit evaluation process more difficult. Bank might evaluate them time-by-time to ensure that their customers are in line with shariah principles and guideline instead they might go further to their premise/ company to make a watch-list the types of business and what types of products/ services they do. In contrast for respondent C with lowest percentage coverage, in reference one (1) with a total of 2.5 percent coverage, he noticed that a good relationship with a customer is important because it helps them to have information and as soon as possible. In addition, in reference two (2) with a total of 5.34 percent coverage, he noticed that a continuous relationship with customers tend to lead to an easier credit assessment process because bank already know the customer so well, have information of it and the identity of the customers and the company they worked are.

Besides, in reference three (3) with a total of 5.41 percent coverage, he noted that relationship with new customers make their credit evaluation/assessment process more difficult because bank needs more time to look further their character and capital of their company. It is so hard times if the customer lacks a professional management.

To sum up from the previous chapter of empirical findings within this section, all of respondents said in reference one (1) it is important to have a good relationship with customers. For reference (2), respondents who conduct dual banking approach (respondent A, C and D) do not fully practices a continuous relationship with their customers but they admitted that a continuous relationship is good. Respondent B and E as practices full-fledge of Islamic banking approach admitted that continuous relationship is good as Islam acknowledge this practices in business activities. Meanwhile, for reference (3), all of the respondents admitted that new customers make their credit evaluation more difficult. As concerns, the relationship questions, from the empirical section and relating to the theory, the study support to a certain extent the results from the longevity of knowing a customer but hold strongly to the conclusion of respondent B and E who noticed that no matter you know well your customer, knowledge is some of the important to understand such the contracts offered used. Both of respondents admitted the Musharakah financing contracts as in this contract; they are borne each other as a business partner. But still there is issue regarding to the practices about knowledge of types of contracts offered in Islamic banking practices as these hard to measure each of the elements used in evaluation process to the customers. But they give an advice to implement syura' (discussion) and explain to them deeply thus give them time to understand and make a choice which contracts is affordable to them.

## **7. Conclusions and Recommendations**

After the findings are drawn, the study still found that credit risk management really has a great role to play because it makes financing decisions less risky, it helps the banks to have a secure system of two-dimension of credit risk management with different types of contracts because as we know that Islamic banks are unique principally thus enhance the trust which banks might develop, it helps to diminish the concept of risk to interest rates which conventional banking approach are applied. Besides, the study also came to realize that the commencement of credit risk management is in the time of stage in before the financing decisions until when it does repayment from customers. Besides, during the time of making financing decisions, information needed and most important elements collected are both valued differently by the different banks. Even though the trusts are always bear in their mind, they must in aligned of no asymmetric information.

The study recommend that for Islamic banking industry to have developed industry with Islamic principles are well-practiced as well as to accomplish greater success, they should ensure that continuously ought to an ability to value all information regarding to the customer's business operation, physically and spiritually of customers, with a high level during the financing decisions. The reason is the information which they might be considers being not as much of important possibly will be the situation of a miscarriage in their financing decisions process or either wise it possibly will be the capacity from which customer's default arises. Bank practitioners should be duty-bound to have it in mind that two-dimension of credit risk management in the line of pre- and post- approval stage of financing is not to be acquainting with or stopped at a particular stage of the business banking activity, on the other hand it should be a continuous process. Therefore, the study believed that this will lead to greater attainment or success since credit risk which leads to this particular is supplementary with the key activity of the banks and can't be avoided.

Besides, to sustained in the banking industry, bank practitioners should be accommodated to follow the step-by-step process in managing credit risk, policy guidelines and make their customers know them well. Both of them should have continuous relationship as well as share risks. The study believed that these may evade some problems and the issue of confusion in case of the absence of predecessor. The study also believed that a good relationship with customers as in the business financing activity, both of them should be aligned together right from the beginning in making financing decisions, through and along the business will make it easier to identify and if possible solve problems in time before they get off hand and thus this can diminish issues beforehand, so that automatically bring a good solutions.

### **8. Future Research**

Concerning to credit risk and credit risk management to customers defaults have been through by various studies related to these are of study such as Vodová (2003), Nor Hayati Ahmad & Mohamed Ariff (2007), Smith and Fischbacher (2009), Imbierowicz and Rauch (2014), Gavalas and Syriopoulos (2014) and other field works of other researchers. On the other hand, there are still some areas of interests for future research which may perhaps be considered into. Here for future research will look at part of how Islamic Principles used in Islamic financing in perspectives of banks and shariah advisers in Malaysia. Therefore, for future works on research, the researcher will applied qualitative method of research as such conduct in-depth interviews with banks officer and shariah advisers to know what reality is reality towards credit risk management in how well this system are applied and to know as well their point of view on Islamic principles used in Islamic financing. Hence, the assumptions will clearly open the eyes of practitioners to an extent and lay them more work for better achievement to be accomplished.

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