

## **ISLAMIC FINANCIAL SERVICES: THE CHALLENGES IN ADDRESSING THE HUMAN CAPITAL NEEDS.**

**Sabarudin Zakaria**  
*University of Multimedia*

**Norhanim Dewa**  
*Taylor's Business School*

### **ABSTRACT**

In the recent years, there has been a rapid evolution and expansion of the global Islamic financial services industry. Islamic banking has now been accepted as a viable and competitive mode of financial intermediation, not only in Muslim countries but also beyond the Muslim world. Amidst the growing significance of the rapidly evolving Islamic financial industry, human capital is claimed to be the defining factor in sustaining the performance and competitiveness of the industry; globally and locally. Thus, it is very important to place a strong focus on human capital development in embarking Islamic financial services encompassing education, training, research and consultancy. The objective of this study is to determine the perception among practitioners on the issues of human capital that need to be improved in order to enhance human capital knowledge. In addition to that, the study is aim to illustrate the relationship between the area of human capital that need to be emphasize by management of the industry based on employees view. The finding will reveal the elements in human capital that is perceived by employee to be critical which may allow them to contribute in the growth of Islamic banking. Moreover, the finding will also reveal the human capital elements that need to be look into by management of industry and its relationship in order to enhance as well as sustain employees' motivation and interest in the industry.

## **Introduction**

Islamic financial service is one of the fastest growing industries in Malaysia and accepted as a viable and competitive mode of financial intermediaries. Islamic banking has come a long way over the past three decade, despite that it also faces a number of challenges that need to be addressed in order to provide a sound base for its future path (Khan, 2007). The continued progression in the economic and financial landscape has presented many opportunities for the new products, services and innovation (Zeti, 2007). Furthermore, the encouraging success shown by many local banks elucidated that Islamic financial services demand for more accelerating expansion. As corroborated by Wei (2007) in which Malaysian bank is holding 73% of total assets for top 40 Islamic banks in the Asia Pacific region. Nevertheless, the local industry is too small which is recorded at USD65.6 billion with an average growth rate of 18-20% annually (Bank Negara Malaysia, 2007) compared to the size of its potential market whereby current global Islamic banking assets and assets under management have reached USD750 billion and is expected to hit USD1 trillion by 2010 (McKinsey as cited in MIFC, 2007).

The expansion of Islamic banking is not only in nations with majority Muslims populations, but also in other countries where Muslims are minority, such as United Kingdom and Japan (Sole, 2007). For over two decade, Islamic banking industry has been trying to extend its outreach to bring it at least to the level of conventional banking (Abdul Jabbar, 2006). This form the biggest challenge faced by Islamic banking despite undergoing vigorous recognition in country like Malaysia. One of the acute problems facing Islamic banking is the issue of human capital (MIF, 2007). This is shared by banks in Bahrain where Islamic banking growing swiftly but in difficulty to find adequate skilled or qualified staff (Al Maraj, 2007).

Similarly, many managers of Islamic banks are not well trained in the use of Islamic modes of finance (Iqbal et al, 1998). Therefore the supply of trained or experienced bankers is lagged behind the colossal expansion of Islamic banking. Then, Khan (2007) stated in a report jointly initiated by Islamic Research & Training Institute Islamic Development Bank (IRTIIDB) and Islamic Financial Services Board (IFSB) that challenges inflicted in Islamic banking is in term of fulfilling its human resource requirements and the existence of an important correlation between human capital as the main factor for business survival in today's competitive environment. And, as claimed by Saudah et. al (2005) it is human capital, rather than physical or financial capital, that distinguishes the leaders in the market.

Indeed, the fast pace of innovation in global financial services in general and in Islamic financial services in particular, demands new expertise and skills (Zeti, 2007). Likewise, Parker (2007) noted that staffs are largely recruited from the conventional sector. The recruitment of conventional based employee bound to undermine the stated vision of some Islamic financial institutions to shift the focus from Shariah-compliant products and services to Shariah-based ones. The Islamic banking industry has conveniently relied on the human capital from conventional sector rather than investing in the long-term development of own human capital.

Zeti (2007) stated that financial institutions are presented with prospects to expand beyond domestic borders to capture opportunities from regional and global markets however, the emergence of new player creates more challenges among Malaysian commercial banks which is not simply competing among themselves but as well as competing with the new entrants that offer Islamic principles (Haron et al, 1994). Business World has concluded that long term neglect of human capital was undermining the competitiveness of US firms (Hitt et al, 1994). In fact, Badawi (2005) outlined the second most important prerequisite in Islamic economic development is investment in human capital and education. Therefore, organizations should continue the search for innovative approaches to increase competitive advantage in this era which is defined by the utilization of people's talent (Brooks et al, 2006).

As human capital is increasingly recognised as the key indicator as well as prime mover of a company's success (Fong & Yorston, 2003), it is significant to include human capital as the latent for competitiveness. The overwhelming response to Islamic financial services as an alternative is beyond expectations and during its growing stage, it is time to address the inadequacy of human capital development in order to compete with the conventional banking particularly in Malaysia as the initiator of Islamic financial services.

## **Literature Review**

### ***Human Capital Issues in Islamic Financial Services Industry***

General Accounting Office (GAO) (2002) simply stated, human capital means people. First, people are assets whose value can be enhanced through investment. As with any investment, the goal is to maximize value while managing risk. Investment in people includes not only in terms of providing training and development, but also the rewards and benefits offered to them. The term human capital (Fong & Yorston, 2003) was first used by Nobel Laureate, Theodore W. Schultz, in the 1961 American Economic Review Article, 'Investment in Human Capital (HC)'. The term is now frequently used to refer to a combination of skills, experience and knowledge. From the human capital perspective, employees are viewed as a capital resource that requires investment. (Ramayah et al, 2004). Consequently, dynamic product development, good shariah knowledge, product knowledge and technical know-how in operational matters will be useful in gaining supplementary customers trusts and confidence.

According to Chartered Institute of Personnel and Development (CIPD) (2007) human capital is the knowledge, skills, abilities and capacity to develop as well as innovative capability possessed by people in an organization. Aziz (2007) further redefine human capital as incorporation of human intellect labor, workforce and human strengths in the form of employees, customers, business partners and competitors. As an investment, Thomas Davenport, a management consultant, has combined several definitions to come up with his human capital investment theory which can be achieved through ability, knowledge, skill and talent in addition to behaviour (Fong & Yorston, 2003). In view of the fact, a highly talented and skilled labour force is essential to maximize the opportunities consistent with the growing interest in Islamic financial services.

A survey conducted in the UK found a high level of ignorance among the interviewed Muslim strengthens by skeptical view on the matter of what constitutes acceptable Islamic finance principle (Bley et.al, 2005). Meanwhile, both Muslims and non-Muslims in Malaysia indicated that they would want to establish a relationship with Islamic banks if they were given a complete understanding about the Islamic bank (Haron et. al, 1994). This can be seen as an indicator that if Islamic banks could endow with confident and fluent personnel viz. human capital, both of the above issues can be resolved as well as corrected in order to gain customers' trust or confidence and boost the performance of Islamic banks.

In mitigating this issues, Ahmad (2008) stated there are ten essential knowledge that should be possessed by Islamic financial services personnel which is knowledge or understanding of *Qur'an*, *Hadith* and *Sunnah*; knowledge of *ayat* and *ahadith* that deal explicitly and implicitly with financial matters; knowledge of Islamic jurisprudence, the methodology of *usul-al-fiqh* and the objectives of *shari'ah* as well as the *qawaid-al-fiqhiyyah*; knowledge of *fiqh al-Maal* and *al-Milkiyyah* (property and property rights); knowledge of *fiqh al-Buyu'* (Islamic laws relating to market and exchange); knowledge on application of *shari'ah* in financial transactions particularly on Islamic contracts of exchange as a method of financing; knowledge of contemporary Islamic innovations in the use of sale of contracts as tools for financing; knowledge of views of contemporary Muslim thinkers on financial matters; competency to conduct *ijtihad* in development of new Islamic products and skills to fulfill customer satisfaction.

Acknowledging the existence of above quality, practitioners in the Islamic financial services should take initiative to understand the necessity in addressing these issues. Failure to convince the clients about 'true' Islamic finance practice will dampen customers' confidence. Due to that, the expertise of *fiqh* scholars in understanding the pre-requisite of modern financial products and in evaluating these products becomes very important. Based on this, the research is aiming in identifying the limitations of human capital in domestic Islamic banking sector which is alleged to be the concern for inability to capture the global Islamic financial services market.

### ***Human Capital Management in Islamic Financial Services Industry***

IRTIIDB and IFSB recognized that the challenges faced by Islamic financial services industry includes acquiring qualified people, developing people, determine rewards, create loyal employees and as well as motivating them (Khan, 2007). Human Capital Index (HCI) developed by Watson Wyatt Worldwide Research Report is used by researchers all over the world since 1999 to create a link between the dimensions of investment in human capital to financial performance of companies which can also be applied to Islamic financial services. The five key HCI dimensions are stated as:

- Clear Rewards and Accountability;
- Excellence in Recruitment and Retention;
- A Collegial, Flexible Workplace;
- Communications Integrity;
- Prudent Use of Resources.

Furthermore, ways to improve human assets includes education and training, monitoring performance, hiring qualified people, motivate employees, and fully utilization of people (Gordon, 2006). Thus in realizing this strategic value, organisation has to devise an effective and workable human capital initiative that can be utilizes as a long term planning. Therefore, human resource support is very crucial in devising competitive remuneration, effective training and development, recruiting the right people and designing a good career development program.

Training skills and knowledge are not the only catalyst for better performance it also include recruitment, remuneration and a promise of better career development. Developing human capital is not an easy task given the latitudes that has to be considered and look into. Iqbal et al (1998) emphasized that teaching, training and research are the wherewithal for the development of any discipline. However, training in banking, finance and insurance remains inadequate (Ariff, 2007) since one the human capital inadequacy faced by Islamic banking practitioners is the understanding and knowledge of the *shariah* principles not only in the contact of religion but as well as for business consideration. Due to this, Zeti (2005) expresses the need to increase programmes and initiatives that provide education and training in *Shariah*.

Fong (2006) further added that in general human capital development should be holistic which encompassing the acquisition of knowledge and skills or intellectual capital including science and technology and entrepreneurial capabilities as well as internalizing positive and progressing attitudes, values and ethics through education, training and lifelong learning. Hence, general training and development that encompasses broad set of activities can improve the performance of the workers and teams as well as the organization (Cribb, 2005). Iqbal (1998) believe that the future of Islamic banking and finance crucially depends on teaching, training and research in the desired specialization. There is also a need to arrange short courses for shariah scholars in economics and finance and similar course on economist in *shariah*. Islamic research organizations and financial institutions need to work towards developing a sufficient number of competent Shariah scholars who are equipped with sound knowledge and expertise in Islamic jurisprudence and Islamic commercial laws to deal with innovative and cutting-edge products (Zeti, 2005).

In relations to products design and products knowledge, little research had been conducted. Some scholars have criticized Islamic banks for lack of vision and accused them of currently engaged in subterfuge to make conventional banking products as Islamic banking (Ariff, 2007). It is therefore, not surprising that the Islamic banking industry has not been able to produce enough new financial products (Iqbal et al, 1998). Abbas (1997) further confirms that this is one of the reasons why Islamic banking does not seem to have achieved the market depth

that could ensure long-term profitability and survival. As the industry moves forward, the need to develop the range of products and services including risk mitigating products intensifies (Zeti, 2005). These products are necessary for the Islamic financial industry not only to meet the new and challenging requirements of the domestic and international economy but also to allow for hedging against potential adverse events and uncertainties. Therefore, the provision of training and career development will have a key role in the sector (Zeti, 2005). Learning systems need to be strengthened to meet the skills and talent requirements of the coming years.

Moreover, there are other potential indicators that contributed to the human capital performance which are not to be ignored; remuneration, recruitment and career advancement. Strauss in (Barton & Delbridge, 2001) noted that apart from rewards, direct participation of employees coupled up with prospects of future job security and long-term employment exerted as the best for human capital development. Attractive remuneration benefits are one of the factors in luring and maintaining staff in the Islamic banks apart from commission or performance bonuses for staff at par with the conventional bank to ensure staff motivation and commitment. Competitive salary plus other perks can assure not only commitment and loyalty but also loyalty to the organization. Lawler III & Worley (2006) states that organizational reward systems need to support both the application of knowledge to solve current business problems and the development of changes for the type of knowledge an organization will need as the environment changes.

At the same time, career development is also a process by which employees assess existing skills, knowledge, abilities and interests; explore job opportunities; establish career objectives linked to organizational goals; and develop career plans. Watts (2002) claimed that career development is a lifelong process of managing progression in learning and working. The quality of this process significantly determines the nature and quality of individuals lives: the kind of people they become, the sense of purpose they have, the income at their disposal. Careers are now increasingly seen not as being 'chosen' but as being constructed, through the series of choices about learning and work that people make throughout their lives. People don't automatically come to work, continue to work or work hard for an organization. They need to be motivated to take a job with a company, to come to work each day, to continue working, to learn, to perform efficiently, and to accept change.

Due to this, the research is intended to ascertain the human capital management areas that need to be focus by the company in order to enhance human capital investment as well as its relationship to influence the company performance in term of growth as perceived by the employees.

**Reliability Statistics**

	Cronbach's Alpha	Cronbach's Alpha Based on Standardize items	N of Items
BOK	.607	.611	2
SK	.522	.522	2
IPK	.667	.668	2
IPDS	.788	.789	2

*Table 1: Reliability testing for the limitations of human capital*

**Reliability Statistics**

	Cronbach's Alpha	Cronbach's Alpha Based on Standardize items	N of Items
RP	.915	.916	3
TD	.954	.954	9
RB	.839	.840	3
CD	.958	.958	3
PIBG	.698	.700	3

*Table 2: Reliability testing for the elements of human capital management*

A Principal Component Analysis result in Table 3 is performed to extract the relevant factor that contributes to the limitations of human capital based on reduction of data. Additionally, Table 4 is Principal Component Analysis performed to extract factors in human capital management that is requires to be monitored in order to improve Islamic banking growth as perceived by respondents.

**Total Variance Explained**

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
BOK	1.440	71.990	71.990	1.440	71.990	71.990
SK	1.353	67.668	67.668	1.353	67.668	67.668
IPK	1.502	75.077	75.077	1.502	75.077	75.077
IPDS	1.651	82.549	82.549	1.651	82.549	82.549

Extraction Method: Principal Component Analysis.

*Table 3: Principal Component Analysis for the limitations of human capital*

**Total Variance Explained**

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
RP	2.569	85.649	85.649	2.569	85.649	85.649
TD	6.664	74.045	74.045	6.664	74.045	74.045
RB	2.276	75.869	75.869	2.276	75.869	75.869
CD	2.768	92.276	92.276	2.768	92.276	92.276
PIBG	2.243	74.781	74.781	2.243	74.781	74.781

Extraction Method: Principal Component Analysis.

*Table 4: Principal Component Analysis for the elements of human capital management*



Based on the extracted factors, normality testing was performed with results which can be referred in Table 5 and 6. This is followed by validity testing with result tabulated in Table 7 and 8. The values of Kolmogorov Smirnov for both tables show a significance level of < 0.05. As for KMO's value which shows 0.797 and 0.844 is an acceptable level for an exploratory research as a rule of thumb.

Tests of Normality

	Kolmogorov-Smirnova			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Operation Knowledge	.286	57	.000	.755	57	.000
Shariah Knowledge	.252	57	.000	.804	57	.000
Islamic Product Knowledge	.217	57	.000	.912	57	.001
Islamic Product Development	.302	57	.000	.764	57	.000

Lilliefors Significance Correction

Table 5: Normality testing for the limitations of human capital

Tests of Normality

	Kolmogorov-Smirnova			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Recruitment Policy	.213	56	.000	.808	56	.000
Training & Development	.254	56	.000	.689	56	.000
Remuneration Benefit	.229	56	.000	.823	56	.000
Career Development	.261	56	.000	.685	56	.000
Perceived IB growth	.224	56	.000	.819	56	.000

a. Lilliefors Significance Correction

Table 6: Normality testing for the elements of human capital management

KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.	.797	
Bartlett's Test of Sphericity	Approx. Chi-Square	139.712
	Df	6
	Sig.	.000

Table 7: Validity testing for the limitations of human capital

KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.	.844	
Bartlett's Test of Sphericity	Approx. Chi-Square	230.037
	Df	10
	Sig.	.000

Table 8: Validity testing for the elements of human capital management

The result of Pearson correlation analysis reveals that there is significant relationship between each elements of human capital with perceived Islamic banking growth at confidence level of 1% as tabulated in Table 9. However, collectively the relationship is not supported as in Table 10 and 11 which shows the result of Multiple Linear Regression for the elements of human capital management that is significant to be address in order to improve the growth of Islamic banking in Malaysia. The model R square is at 0.817 with F test probability of less than 0.05. Based on the coefficients of 0.530 and 0.286 and significance level of less than 0.05, the elements of human resource management which need to be address is on training and development (TD) as well as career development (CD).

**Correlations**

		PIBG	Recruitment Policy	Training & Development	Remuneration Benefit	Career Development
Pearson Correlation	PIBG	1.000	.712	.889	.615	.858
	Recruitment Policy	.712	1.000	.780	.384	.728
	Training & Development	.889	.780	1.000	.610	.890
	Remuneration Benefit	.615	.384	.610	1.000	.580
	Career Development	.858	.726	.890	.580	1.000
Sig. (1-tailed)	PIBG	.	.000	.000	.000	.000
	Recruitment Policy	.000	.	.000	.002	.000
	Training & Development	.000	.000	.	.000	.000
	Remuneration Benefit	.000	.002	.000	.	.000
	Career Development	.000	.000	.000	.000	.

*Table 9: Pearson correlation analysis between the elements of human capital management and perceived IB growth.*

**Model Summary<sup>b</sup>**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Sig. F Change
1	.904 <sup>a</sup>	.817	.802	.53341131	.000

a. Predictors: (Constant), Career Development, Remuneration Benefits, Recruitment Policy, Training & Development

b. Dependent Variable: Perceived IB growth

*Table 10: Regression Model fitness between the elements of human capital management and perceived IB growth.*

**Coefficients<sup>a</sup>**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.002	.021		.034	.973
	Recruitment Policy	.049	.099	.049	.498	.621
	Training & Development	.530	.155	.530	3.431	.001
	Remuneration Benefits	.105	.078	.106	1.352	.182
	Career Development	.284	.134	.286	2.126	.038

a. Dependent Variable: Perceived IB growth

*Table 11: Coefficients of regression model between the elements of human capital management and perceived IB growth.*

### **Concluding Remarks**

The study is being performed with the involvement of practitioners in order to venture the insight view of Islamic Banking environment in Malaysia after it is being extensively promoted and supported by the government. Despite the aggressive action taken by Malaysian government in promoting Malaysia as the Islamic banking and financing hub which includes the latest establishment of RM500 million of fund by Bank Negara Malaysia for International Center for Education in Islamic Finance (INCEIF) (Parker, 2007) that aim at developing superior talents and best practice for the sector; supplying top researchers and educators for the sector, and offering internationally-recognised professional certification and post-graduate programs in Islamic finance education, Malaysia still experience the lack of human capital or expertise to enhance and nurture the industry.

It is concluded in this paper, that the limitation in human capital for Malaysian Islamic banking industry is in the aspect of Islamic banking operation which may be simply due from the adaptation of conventional banking operation, restricted expertise with sound Shariah knowledge, the imperfect knowledge on Islamic banking product of employees in financial institutions and the lack of capability as well as skills to develop Islamic banking product itself. It is also concluded in this study, that the current training and development initiated by financial institutions are insufficient for their employees to be fluent in Islamic banking may it be in term of operation, Shariah knowledge and product. Moreover, the failure of financial institution in promoting career pathway in Islamic banking to lure human resources participation, commitment and motivation is also identified as another area to be enhanced to ensure the growth of Islamic banking.

Due to this, for Islamic banking industry in Malaysia to be able to grasp the opportunity in this evolving industry, actions need to be taken in the area of training and development along with career development of human resources in order to solve the issues above by means of extensive, comprehensive and continuous training and offers of lucrative career pathway. As a suggestion, some of the initiatives which can be done are mapping out a career pathway to ensure the interest of employees in local Islamic financial services that provide a clear and transparent process of performance assessment for the personnel of Islamic financial services which is fair and objective as well as competitive with conventional banking and foreign Islamic financial services operators. On top of that, employee competencies and knowledge on Islamic banking and financing product can also be the criteria for career enhancement. This can be a

major move towards providing a promising good long term career with Islamic financial services sector in addition to continuous as well as beneficial training and development courses which is not merely intended to new and foreign players but also for current employees in Islamic financial services industry.

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