

EXPLORATORY STUDY ON FACTORS INFLUENCING  
MALAYSIAN BANKS' PARTICIPATION IN ISLAMIC  
SYNDICATED FINANCING

BY

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## ABSTRACT

Islamic Syndicated Financing (ISF), by which a consortium of banks forms joint participation in raising large-ticket financing for a corporation, has emerged as an alternative source of external debts for firms and a vital risk management tool for banks. ISF's characteristics, amongst others, enable transfer and transaction of the risks such that Islamic banks may hold ISF exposure for a certain period and opt to subsequently sell down this exposure. This helps Islamic banks in managing their credit risks overtime in corresponding to industry and market changes. Despite ISF's viable features, Islamic banks' participation in ISF issuance remains low. According to Bank Negara Malaysia, over the last decade, Malaysia's Islamic banks, have not been actively participating in ISF origination, albeit notable growth compared to the pre-Islamic finance era. Besides, ISF has yet to receive wider mainstream acceptance among the large corporations, the latter appears to have a preference over *Sukuk* to fund their businesses. The purpose of this study was to explore the factors which influence banks' decision to take part in ISF. Qualitative data were collected through in-depth interviews with sixteen (16) relationship bankers from thirteen (13) Islamic banks and development financial institutions. The research has discovered three (3) main challenges facing the banks in introducing ISF including lack of liquidity framework, lack of relationship banking, and lack of standardization in ISF legal documentation. There are four (4) main factors that influence the Islamic banks to participate in ISF comprising relationship banking, liquidity supply, financing parameters, and religiosity. These findings have led to several implications including the need for regulatory support and collaboration among financial institutions to achieve standardization in ISF market practice. This may be achieved through the digitization of ISF legal documentation to ease standardization efforts and reduce transaction costs. The findings also suggest the need for insourcing of client coverage role to a standalone Islamic business unit and for boosting liquidity supply through the fintech platform. The novelty of this study is underpinned by the fact that it is the first study that has produced in-depth insights into the internal workings of ISF in the Malaysian Islamic syndication market. It has yielded genuine industry-based evidence that diverges from the classical understanding of lender-borrower relationships produced in syndicated loan literature. Hence, the study has made significant contributions to the literature, in helping to bridge notable knowledge gaps in the Islamic corporate finance literature. This study has also unearthed fresh insights that pave the way for future quantitative and qualitative research in the field of ISF.

Keywords: Islamic syndicated financing, syndicated loan, banking syndication

## خلاصة البحث

قد برز التمويل المجمع الإسلامي - الذي من خلاله تُشكّل البنوك مجموعة مشتركة لأجل توفير تمويل ذي مبلغ ضخم لجهة ما - بمثابة مصدرٍ بديل للمؤسسات في سبيل الحصول على دَينٍ خارجي، وكذلك أصبحت أداةً فعّالةً لإدارة المخاطر بالنسبة للبنوك. فمن خصائص التمويل المجمع الإسلامي، من بين أمورٍ أخرى، بأنها تمكّن من تحويل وتخفيض في المخاطر بحيث تتحمل المصارف الإسلامية المخاطر المعرّضة في التمويل الإسلامي المجمع لفترة معينة، وتختار بيع المخاطرة بعد ذلك. وهذا يساعد المصارف الإسلامية في إدارة مخاطرها الائتمانية خلال الفترة بالتوافق مع تغيرات الصناعة والسوق. على الرغم من خصائصه القيمة، فإن مشاركة البنوك في إصدارات التمويل المجمع الإسلامي تبقى منخفضة. بناء على المصرف المركزي الماليزي على مدار العقد الأخير، فإنّ البنوك الإسلامية في ماليزيا لا تشارك بنشاطٍ أثناء مرحلة طرح معاملات التمويل المجمع الإسلامي، وهذا مع النمو الملحوظ للفترة قبل المصرفية والتمويل الإسلامي. إلى جانب ذلك، فإنّ التمويل المجمع الإسلامي ما زال ينتظر القبول الشامل من قبل المؤسسات الكبيرة، كون الجهات الأخيرة تفضل الصكوك من أجل تمويل أعمالها. والغرض من هذه الدراسة هو استكشاف العوامل التي تؤثر على قرار المصارف من أجل المشاركة في التمويل المجمع الإسلامي. وقد تم جمع البيانات النوعية من خلال مقابلات مُركّزة مع (١٦) من منسوبي العلاقات المصرفية الذين مثّلوا (١٣) مصرفاً إسلامياً ومؤسسات التطوير المالي. اكتشف البحث أن (٣) تحديات تواجه المصارف في تقديم التمويل المجمع الإسلامي، هو غياب إطار السيولة، وغياب العلاقات المصرفية، وغياب المعيرة في المستندات القانونية المتعلقة بالتمويل المجمع الإسلامي. توجد هناك (٤) عوامل تؤثر على المصارف الإسلامية في المشاركة في التمويل الإسلامي المجمع، وهذه العوامل هي: العلاقة المصرفية، وعرض السيولة، ومعايير التمويل، والميول الدينية. هذه النتائج أدت إلى إبراز تأثيرات متعددة والتي تشمل الحاجة للدعم الرقابي والتضامن من قبل المؤسسات المالية لتحقيق المعيرة في ممارسات سوق التمويل المجمع الإسلامي. يمكن تحقيق هذا من خلال رقمنة المستندات القانونية للتمويل المجمع الإسلامي لتسهيل جهود المعيرة، وتخفيض تكاليف المعاملة. ويمكن الاقتراح بناء على النتائج بأنّ هناك حاجة لتلبية احتياجات العميل من قبل وحدة أعمال إسلامية مستقلة. وضع السيولة المعروضة من خلال منصات التقنية المالية. تتميز هذه الدراسة كونها أول من نوعها التي أنتجت نتائج عميقة حول الإجراء الداخلي للتمويل المجمع الإسلامي في السوق الماليزية للتمويل المجمع الإسلامي. وقد نتجت منها شواهدٌ صريحة مرتبطة بالصنعة، والتي تختلف عن الفهم النمطي للعلاقات المرتبطة بين الدائن والمدين كما جاء في أدبيات القروض المجمع. لذا، فإنّ الدراسة قد قدمت مساهمات بارزة لأدبيات ذات الصلة من خلال تسديد الفجوات المعرفية الملحوظة في أدبيات التمويل الإسلامي التجاري. وكذلك، فإن هذه الدراسة قد كشفت نظرات حديثة التي مهدت الطريق من أجل بحثٍ كمي ونوعي في مجال التمويل المجمع الإسلامي.

**الكلمات المفتاحية:** التمويل المجمع الإسلامي، القروض المجمع، التمويل المجمع المصري.

## **APPROVAL PAGE**

The thesis of Aida Noraini Manap has been approved by the following:

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## DECLARATION

I hereby declare that this thesis is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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# TABLE OF CONTENTS

Abstract .....	ii
Abstract in Arabic .....	iii
Approval Page.....	iv
Declaration .....	v
Copyright Page.....	vi
Acknowledgements .....	vii
List of Tables .....	xiii
List of Figures .....	xvi
<b>CHAPTER ONE: INTRODUCTION .....</b>	<b>1</b>
1.1 Introduction .....	1
1.2 Research Background .....	3
1.3 Problem Statement.....	13
1.4 Research Objectives .....	19
1.5 Research Questions .....	19
1.6 Research Scope.....	20
1.7 Significance of Study .....	21
1.8 Organization of the Chapters.....	25
1.9 Chapter Summary .....	27
<b>CHAPTER TWO: LITERATURE REVIEW.....</b>	<b>28</b>
2.1 Introduction .....	28
2.2 Theoretical Review.....	28
2.2.1 Theory of Financial Intermediation.....	28
2.2.1.1 Classical Theory of Financial Intermediation .....	29
2.2.1.2 Modern Theory of Financial Intermediation .....	32
2.2.2 Syndicated Loan and Syndicated Financing.....	38
2.2.2.1 Benefits of Banking Syndication Facilities to Borrowers and Customers .....	41
2.3 Methodology of Literature Review .....	42
2.4 Thematic Findings of Empirical Review.....	47
2.4.1 Bank Liquidity Supply.....	48
2.4.1.1 Equity .....	49
2.4.1.2 Liability .....	52
2.4.1.3 Asset .....	55
2.4.2 Firm Information Disclosure .....	60
2.4.2.1 Financial Disclosure .....	62
2.4.2.2 Managerial Behaviour .....	65
2.4.2.3 Shareholders' Rights and Ownership .....	67
2.4.2.4 Corporate Governance.....	69
2.4.2.5 Ethical Values.....	71
2.4.3 Relationship Banking .....	72
2.4.3.1 Bank-firm Past Relationship.....	74
2.4.3.2 Syndicated Banks Past Alliances.....	87
2.4.4 Financing Parameters .....	92



2.4.4.1 Commercial Terms .....	93
2.4.4.2 Legal Terms .....	98
2.5 Analysis of Research Gap .....	103
2.5.1 Lack of Documented Research on ISF Instrument and Its Market Development Globally and in Malaysia .....	105
2.5.2 Lack of Evidence on Industry-Based Problems and Challenges in Adopting ISF under DBLM .....	105
2.5.3 Lack of Evidence on the Factors Influencing Banks' Participation in ISF under DBLM and Their Priority Order .....	106
2.5.4 Lack of Qualitative Research in Banking Syndication Including ISF and SL, Globally and Malaysia .....	107
2.5.5 Lack of Evidence About Factors Influencing A Firm's Preference for ISF .....	108
2.6 Chapter Summary .....	109
<b>CHAPTER THREE: ISLAMIC SYNDICATED FINANCING.....</b>	<b>110</b>
3.1 Introduction.....	110
3.2 Historical Origins of Syndicated Loan .....	110
3.2.1 Definition of Syndicated Loan .....	111
3.2.2 Evolution of Primary Syndicated Loan and Secondary Loan Markets .....	112
3.3 Historical Evolution of Islamic Syndicated Financing .....	122
3.3.1 Definition of Islamic Banking .....	122
3.3.2 Emergence of Islamic Syndicated Financing Market.....	125
3.3.3 Permissibility of Islamic Syndicated Financing .....	129
3.4 Modes of Structuring Islamic Syndicated Financing.....	131
3.4.1 Sale-based Syndicated Financing .....	131
3.4.1.1 <i>Murabahah</i> .....	132
3.4.1.2 Commodity <i>Murabahah</i> (Organized <i>Tawarruq</i> ) .....	134
3.4.1.3 <i>Istisna'</i> .....	139
3.4.2 Lease based Syndicated Financing – <i>Ijarah</i> .....	142
3.4.3 Participatory-based Syndicated Financing .....	146
3.4.3.1 <i>Mudharabah</i> .....	146
3.4.3.2 <i>Musharakah</i> .....	150
3.4.4 Fee-based Syndicated Financing .....	153
3.5 Stages in Islamic Syndicated Financing Issuance.....	156
3.5.1 Pre-Issuance Stage .....	157
3.5.1.1 Pre-Mandated.....	158
3.5.1.2 Post-Mandated .....	161
3.5.2 Post Issuance Stage.....	164
3.5.2.1 Monitoring .....	166
3.5.2.2 Secondary Financing Market Transaction .....	166
3.6 Types of Syndication Strategies .....	167
3.6.1 Fully Underwritten Deal .....	167
3.6.2 Partially Underwritten Deal.....	167
3.6.3 Best Effort Deal .....	168
3.7 Facility Characteristics of Islamic Syndicated Financing.....	168
3.7.1 Pricing.....	168
3.7.2 Types of Facility .....	168

3.7.3 Purpose .....	169
3.7.4 Maturity / Tranching .....	170
3.7.5 Covenants and Collaterals .....	170
3.8 Parties To Islamic Syndicated Financing.....	171
3.8.1 Corporate Customer.....	171
3.8.2 Lean Arranging Bank .....	172
3.8.3 Participant Banks.....	173
3.8.4 Agent Bank.....	173
3.8.5 Security Trustee.....	173
3.9 Active Investors In Islamic Syndicated Financing Markets .....	174
3.9.1 Global Islamic Syndicated Financing Investors .....	174
3.9.2 Malaysian Islamic Syndicated Financing Investors .....	176
3.10 Key Markets of Islamic Syndicated Financing.....	180
3.10.1 Global Islamic Syndicated Financing .....	180
3.10.2 Malaysian Banking and Capital Market Syndication.....	183
3.11 Chapter Summary .....	186
<b>CHAPTER FOUR METHODOLOGY .....</b>	<b>187</b>
4.1 Introduction.....	187
4.2 Research Paradigm .....	187
4.3 Research Design .....	191
4.4 Research Method and Appropriateness .....	192
4.4.1 Why Qualitative Method .....	193
4.4.2 Qualitative Inquiry Appropriateness .....	195
4.4.3 Why Qualitative Exploratory Inquiry Design .....	197
4.5 Population and Sampling Procedure.....	199
4.6 Informed Consent, Privacy, and Confidentiality .....	206
4.7 Research Informants .....	206
4.8 Data Collection Technique .....	210
4.9 The Interview Process.....	213
4.9.1 Instrument.....	214
4.10 Triangulation.....	219
4.11 Research Rigor: Validity and Reliability.....	220
4.11.1 Threats to Validity and Reliability .....	221
4.11.2 Credibility (Internal Validity) .....	224
4.11.3 Transferability (External Validity).....	225
4.11.4 Dependability (Reliability).....	226
4.11.5 Confirmability (Objectivity) .....	228
4.12 Data Analysis .....	229
4.13 Chapter Summary .....	231
<b>CHAPTER FIVE RESULT AND DISCUSSION.....</b>	<b>233</b>
5.1 Introduction.....	233
5.2 Section 1: Data Analysis.....	233
5.2.1 Population and Sampling.....	233
5.2.2 Research Questions.....	237
5.2.3 Data Collection Procedures .....	237
5.2.4 Informants Demographic .....	240
5.2.5 Data Analysis Process .....	243

5.2.6 Evidence of Trustworthiness .....	245
5.2.6.1 Credibility .....	245
5.2.6.2 Transferability .....	247
5.2.6.3 Dependability .....	248
5.2.6.4 Confirmability .....	248
5.3 Section 2: Presentation of Results .....	249
5.3.1 Interview Response to Research Question No. 1 .....	250
5.3.1.1 Major Theme 1: Bank-based Challenges .....	252
5.3.1.2 Major Theme 2: Market-based Challenges .....	262
5.3.1.3 Emergent Findings .....	269
5.3.2 Interview Response to Research Question No. 2 .....	270
5.3.2.1 Theme 1: Liquidity Supply .....	272
5.3.2.2 Theme 2: Relationship Banking .....	274
5.3.2.3 Theme 3: Firm Information Disclosure .....	278
5.3.2.4 Theme 4: Financing Parameters .....	281
5.3.2.5 Theme 5: Religiosity .....	283
5.3.2.6 Theme 6: Regulatory Influences .....	287
5.3.2.7 Emergent Findings .....	288
5.3.3 Interview Response to Research Question No. 3 .....	290
5.3.3.1 Theme 1: Financing Parameters .....	291
5.3.3.2 Theme 2: Relationship Banking .....	292
5.3.3.3 Theme 3: Religiosity .....	293
5.3.3.4 Theme 4: Liquidity Supply .....	295
5.3.3.5 Theme 5: Bank's Credit Appetite .....	296
5.3.3.6 Triangulation 1: Emergent Findings Versus the Firms' Perspective .....	297
5.3.3.7 Triangulation 2: Emergent Findings Versus the LMA's Perspective .....	298
5.3.3.8 Triangulation 3: Emergent Findings Versus Literature Review .....	302
5.3.4 Interview Response to Research Question No. 4 .....	304
5.4 Section 3: Discussion of Key Emergent Findings .....	309
5.4.1 Analysis of Emergent Findings of Research Question 1 .....	309
5.4.1.1 Theme 1: Lack of Liquidity Framework .....	309
5.4.1.2 Theme 2: Lack of Standardization of Islamic Legal Documentation .....	311
5.4.1.3 Theme 3: Lack of Relationship Banking .....	313
5.4.2 Analysis of Emergent Findings of Research Question 2 & 3 .....	316
5.4.2.1 Theme 1: Relationship Banking .....	316
5.4.2.2 Theme 2: Liquidity Supply .....	318
5.4.2.3 Theme 3: Financing Parameters .....	319
5.4.2.4 Theme 4: Religiosity .....	321
5.5 Chapter Summary .....	327
<b>CHAPTER SIX: CONCLUSIONS, IMPLICATIONS, AND RECOMMENDATIONS.....</b>	<b>324</b>
6.1 Introduction .....	324
6.2 Summary of Study .....	324
6.3 Conclusion .....	326

6.4 Implications .....	328
6.4.1 Implication for Practice .....	328
6.4.2 Implication for Future Research .....	331
6.5 Recommendations .....	332
6.5.1 Recommendations for Banks .....	332
6.5.1.1 Increasing Sources of Liquidity .....	332
6.5.1.2 Developing Islamic Secondary Market .....	333
6.5.1.3 Improving Relationship Banking .....	335
6.5.1.4 Enhancing Knowledge and Expertise of Bankers .....	336
6.5.2 Recommendations for Policy Makers .....	337
6.5.2.1 Imposing Regulatory KPI and Incentives .....	337
6.5.2.2 Adopting Ethical Banking .....	338
6.5.2.3 Standardizing Market Practices .....	339
6.6 Contributions .....	342
6.6.1 Theoretical Contribution .....	342
6.6.2 Practical Contribution .....	343
6.6.3 Methodological Contribution .....	344
6.6.4 Literature Contribution .....	344
6.7 Limitation .....	344
6.8 Future Research Suggestion .....	347
6.9 Conclusion .....	348
<b>REFERENCES .....</b>	<b>352</b>
<b>APPENDIX I .....</b>	<b>380</b>
<b>APPENDIX II .....</b>	<b>381</b>

## LIST OF TABLES

Table 2.1	Selection Criteria for the Systematic Literature Review	43
Table 2.2	Bank Liquidity Supply	48
Table 2.3	Firm Information Disclosure	61
Table 2.4	Relationship Banking	73
Table 2.5	Financing Parameters	93
Table 2.6	Analysis of Research Gaps	104
Table 3.1	Syndicated Loan Activities in Southeast Asian Countries from 2000 - 2004	121
Table 3.2	Full-fledged and Leveraged Islamic Bank Subsidiaries	126
Table 3.3	Application of <i>Murabahah</i> Syndicated Financing	134
Table 3.4	Application Commodity of <i>Murabahah</i> Syndicated Financing: Case 1	138
Table 3.5	Application Commodity of <i>Murabahah</i> Syndicated Financing: Case 2	139
Table 3.6	Application of <i>Istisna</i> ' Syndicated Financing	141
Table 3.7	Application of <i>Ijarah</i> Syndicated Financing: Case 1	144
Table 3.8	Application of <i>Ijarah</i> Syndicated Financing: Case 2	145
Table 3.9	Application of <i>Mudharabah</i> Syndicated Financing	149
Table 3.10	Application of <i>Musharakah</i> Syndicated Financing	152
Table 3.11	Application of <i>Wakalah</i> Syndicated Financing	155
Table 3.12	Mandated Lead Arranger Share of ISF Issuances as of FY2018	175
Table 4.1	The Positivism and Interpretivism Approaches to Research Philosophy	189
Table 4.2	List of Conventional Commercial Banks	200
Table 4.3	List of Islamic Commercial Banks	201
Table 4.4	List of Development Financial Institutions (“DFIs”)	201

Table 4.5	Type of Probability Sampling with Advantages and Disadvantages	203
Table 4.6	Type of Non-Probability Sampling with Advantages and Disadvantages	203
Table 4.7	Table League of Banking Syndication in Malaysia as of FY2015	208
Table 4.8	List of Participating Bank Informants	210
Table 4.9	List of Participating Corporate Firm Informants	210
Table 4.10	Linkage between ROs, RQs and Semi-structured Interview Questions	216
Table 4.11	List of Conducted Interview Dates	217
Table 4.12	List of Qualitative Strategies to Achieving Validity and Reliability	223
Table 4.13	List of Adopted Qualitative Strategies to Achieving Validity and Reliability	224
Table 5.1	Bank Informants Demographic	241
Table 5.2	Corporate Firms Informants Demographic	246
Table 5.3	Results of ISF Challenges	251
Table 5.4	Results of Bank-Based ISF Challenges	252
Table 5.5	Results of Market-Based ISF Challenges	262
Table 5.6	Emergent Finding of Research Question 1	269
Table 5.7	Results of Factors Influencing ISF Issuance	271
Table 5.8	Bank Liquidity Supply	272
Table 5.9	Relationship Banking	275
Table 5.10	Firm Information Disclosure	278
Table 5.11	Financing Parameters	281
Table 5.12	Religiosity	283
Table 5.13	Regulatory Influences	287
Table 5.14	Emergent Findings of Research Question	289
Table 5.15	Interviews Results with Five (5) Large Local Corporations	291

Table 5.16 Emergent Findings Versus Customer's Perspectives	297
Table 5.17 Findings of LMA 5-Year Survey	299
Table 5.18 Emergent Findings Versus LMA Research Findings	301
Table 5.19 Emergent Findings Versus Literature Review	303
Table 5.20 Results of Research Question 4	305

## LIST OF FIGURES

Figure 1.1	ISF Assets of Maybank Islamic Bank Berhad	4
Figure 1.2	ISF Assets of RHB Islamic Bank Berhad	4
Figure 1.3	ISF Assets of Affin Islamic Bank Berhad	4
Figure 2.1	Modern Theory of Financial Intermediation	37
Figure 2.2	The Composition of Literature According to Age	44
Figure 2.3	Composition of Literature According to the Field of Study	45
Figure 2.4	Composition of the Reviewed Literature from 2014 to 2019 According to Methodology	46
Figure 2.5	Thematic Findings based on the Literature Review.	47
Figure 3.1	<i>Bai' Al-Murabahah</i> Syndicated Financing	132
Figure 3.2	<i>Tawarruq</i> Syndicated Financing	136
Figure 3.3	<i>Istisna'</i> Syndicated Financing	140
Figure 3.4	<i>Ijarah</i> Syndicated Financing	143
Figure 3.5	<i>Mudharabah</i> Syndicated Financing	147
Figure 3.6	<i>Musharakah</i> Syndicated Financing	151
Figure 3.7	<i>Wakalah</i> Syndicated Financing	154
Figure 3.8	Stages of Islamic Syndicated Financing Issuance	156
Figure 3.9	Pre-Issuance Stage	157
Figure 3.10	Post-Issuance Stage	165
Figure 3.11	Top 5 ISF Global Mandated Lead Arranger as of FY2018	175
Figure 3.12	Top 5 ISF Global Bookrunner as of FY2018	176
Figure 3.13	Global Islamic Syndicated Financing League as of FY2015	181
Figure 3.14	Global Islamic Syndicated Financing League as of FY2016	182



Figure 3.15 Global Islamic Syndicated Financing League as of FY2107	183
Figure 3.16 Statistic of 5-Year Outstanding Bond, <i>Sukuk</i> , Syndicated Loans and ISF in Malaysia	184
Figure 5.1 Investment Account Funded ISF	310

# CHAPTER ONE

## INTRODUCTION

### 1.1 INTRODUCTION

The rise of the Islamic banking industry has reinforced Islamic banks' intermediation role in mobilizing financial resources through the usage of various *Shariah*-compliant financing instruments (BNM, 2020; DK Asli & L.Ross, 1999). Traditionally, Islamic banks offer financings on a bilateral basis to large firms, wherein a single bank is granting a financing facility to a single corporate customer. However, over the last decade, Islamic banks have begun to participate in a multibank financing arrangement through the introduction of Islamic syndicated financing. Such an arrangement enables Islamic banks to adopt a multilateral approach to transformation, transfer, and transaction of risks (Altunbas & Kara, 2011; Joseph Yam, 2017). Hence, the necessity for Islamic syndicated financing is established.

Islamic Syndicated Financing (ISF) refers to a financing facility offered by a group of Islamic banks – the syndicate financiers, to a single firm, by forming a partnership in a joint financing operation through one of the *Shariah* permitted modes of financing (AAOIFI, 2015). ISF has been increasingly recognized as an important source of external debt among large corporations to fund various business sectors such as energy, oil and gas, infrastructure, healthcare, and financial (Farbood Hutan, 2009; Godlewski & Weill, 2014). According to Dealogic (2018), there has been a notable surge of ISF issuances globally between 2016 and 2018. A total of 30 deals worth USD19.96 billion were signed in 2017 compared to 28 deals amounting to USD9.38 billion in 2016. In 2017, Malaysia commanded the highest market share totalled 50

percent, followed by the Kingdom of Saudi Arabia (KSA) with a 23 percent market share (Islamic Finance News [IFN], 2018). By 2018, the ISF market further grew by 11.42 percent to USD22.4 billion, which accounted for an increasing share of 0.60 percent (2017: 0.32 percent) of the total syndicated loan market worldwide.

In Malaysia, ISF assets have expanded exponentially by 1871 percent from RM0.52 billion in 2008 to RM13.1 billion in 2019 (BNM, 2020). ISF has been growing on average at 54.36 percent against the syndicated loan market's average growth of 8.6 percent year-on-year in the last 10 years since 2008. ISF has also progressively seized a chunky slice of syndicated loan market share by 41.76 percent as of 2018. This serves as statistical evidence that ISF has truly emerged as a financing alternative for Malaysian corporate firms with large and complex financing requirements. Notwithstanding, the true potential of ISF has not been fully unleashed as ISF product is still plagued with several challenges, which makes arranging for the ISF more complicated than the syndicated loan.

However, given the scarcity of ISF literature, there has yet to be academic documentary evidence that can illuminate the challenges faced by Malaysia's banks in arranging ISF and the factors considered in banks' decision making to participate in ISF. Therefore, exploratory qualitative research is undertaken. In seeking the comprehension of this newly explored topic of concern, it is critical to elicit the viewpoints of banking syndication practitioners as they act as the forefront stakeholders in dealing with corporate customers, pitching for ISF deal mandate, and arranging for ISF issuance (Burhouse, Gambrell, & Harris, 2004). This study explores the influence of concepts of relationship banking, liquidity supply, financing parameters, and firm's information disclosure, over banks' decision making to participate in ISF, through exploring the perceptions of a group of syndication practitioners in Malaysia.

## **1.2 RESEARCH BACKGROUND**

Islamic syndicated financing (ISF) is an important alternative source of external debt for *Shariah*-compliant corporate firms (Godlewski & Weill, 2014). In the language of Boot and Thakor (2000), ISF can be characterized as a combination of “relationship financing” and “transaction financing”; relationship financing contains confidential information of the firm and the bank, while transaction financing is comparable to debt sold in the capital market. ISF arrangement commences with a lead bank undertaking the credit screening and monitoring of the corporate customer in a relationship banking context. Subsequently, the financing exposure is distributed to other financiers through a capital-market like setting (Allen, 1990; Ramakrishnan & Thakor, 1984).

Thus, where privacy matters and agency problem appears severe, corporate firms prefer to issue debt by way of banking syndication than capital market syndication, as the relationship banking element helps to mitigate the presence of information frictions and agency problem (Champagne & Coggins, 2012; Sufi, 2005; Dennis & Mullineaux, 2000). Due to the benefits accrued to relationship banking, banks in Malaysia have been gradually issuing ISF over the years as can be sighted in their respective banking group’s consolidated annual audited financial statements. Besides, ISF serves as a risk management mechanics to the banks given financing exposures are shared and transferred across several financiers (Maybank, 2018).

As depicted in Figure 1.1, 1.2, and 1.3, ISF assets are reported in the audited financial statement as of financial year ending 31 December 2018 of the three (3) selected Malaysian Islamic banks; the ISF assets of which are reported in consolidation with their respective conventional banking groups’ assets, namely Malayan Banking Berhad, RHB Bank Berhad, and Affin Bank Berhad, respectively (Maybank, 2018; RHB, 2019; Affin Bank, 2018).

<b>15. LOANS, ADVANCES AND FINANCING (CONT'D.)</b>				
(iii) Loans, advances and financing to financial institutions and customers:				
	Group		Bank	
	2018 RM'000	2017 RM'000	2018 RM'000	2017 RM'000
Loans/financing to financial institutions (Note 15(i))	1,586,487	2,040,105	17,329,554	18,817,485
Overdrafts/cashline	21,299,471	20,132,843	8,106,770	9,002,080
Term loans:				
- Housing loans/financing	159,088,775	149,069,563	36,356,772	59,881,852
- Syndicated loans/financing	46,222,426	39,920,409	41,244,555	35,704,531

Figure 1.1 ISF Assets of Maybank Islamic Bank Berhad

<b>9 LOANS, ADVANCES AND FINANCING</b>				
	Group		Bank	
	2018 RM'000	2017 RM'000	2018 RM'000	2017 RM'000
<b>(a) By type</b>				
<b>At amortised cost</b>				
Overdrafts	6,786,330	6,471,039	5,770,136	5,610,819
Term loans/financing:				
- Housing loans/financing	56,096,417	49,566,956	40,489,870	37,523,253
- Syndicated term loans/financing	6,475,098	6,409,437	2,993,804	3,171,702

Figure 1.2 ISF Assets of RHB Islamic Bank Berhad

<b>9 LOANS, ADVANCES AND FINANCING</b>				
<b>(i) By type</b>				
	The Group		The Bank	
	2018 RM'000	2017 RM'000	2018 RM'000	2017 RM'000
Overdrafts	1,874,549	1,867,780	1,500,470	1,554,785
Term loans/financing				
- Housing loans/financing	10,562,367	8,486,642	4,128,165	4,086,865
- Hire purchase receivables	12,470,551	12,365,906	8,226,889	8,501,399
- Syndicated financing	1,826,729	2,634,929	897,168	1,227,635

Figure 1.3 ISF Assets of Affin Islamic Bank Berhad

Albeit notable ISF issuances, marketing, and originating of ISF pose challenges to the relationship bankers due to numerous issues plaguing ISF given the product ecosystem remains underdeveloped (Khaleq et.al, 2012). Firstly, ISF implementation processes are largely unstandardized, ranging from the absence of standard legal documentation format, absence of pricing benchmark, and differing *Shariah* advisory committee's interpretation in connection with the *Shariah* concept and structure applied (Khaleq & et al., 2012). Secondly, the absence of the Islamic secondary market platform hinders Islamic banks from selling down a portion of ISF commitment and restrict them from diversifying the risk. This forces them to hold the long-term commitment which otherwise could have been invested into other more viable financing sectors.

As a consequence of these challenges, ISF product features appear uncompetitive compared to syndicated loans, which in turn, discourages the relationship bankers from promoting ISF to wider corporate customers. Particularly, in the context of Malaysia, the relationship bankers are representing the conventional parent corporate banking arm and at the same time cross-sell ISF and other Islamic financing products, under the dual banking leverage business model (DBLM).

DBLM refers to a business setting where the Islamic subsidiary (Principal) leverages on the strength and resources of the conventional parent corporate banking arm (Agent), by outsourcing the marketing, sales, and client relationship management functions to the latter based on a fee chargeback (A. Amir, 2017). The model has been introduced into the financial system by CIMB Bank since 2005 to drive the Islamic banking business at an optimal operational cost. However, following the cessation of regulatory incentives for Islamic financing since 2010, DBLM has given rise to the competing behavior of the Agent due to the absence of incentives to market Islamic products including ISF.

The Agent's competing behavior is potentially driven by conflict of interest in whether or not to serve the Islamic subsidiary's interest by being as fair in marketing ISF as a syndicated loan. The Agent may tend to act in a way that is contradictory to the Principal's interest due to asymmetric information such as clientele relationship gap and knowledge gap between the two (2) entities. For instance, the Agent may form bias by leveraging on its existing clientele relationship to favorably promote syndicated loan over ISF as and when the syndication deal opportunity arises. Given the fact that banking syndication is mostly driven by relationship banking, the DBLM model appears to work in the best interest of the Agent as the client relationship manager and to go against the priorities of the Islamic subsidiary as the Principal product owner.

Possibly, the lack of relationship banking may have caused the sluggish growth of ISF despite a significant rise in the availability of Islamic liquidity supply within the Malaysian Islamic banking system. From the supply-side perspective, lack of Islamic banks' participation in ISF indicates a potential lack of relationship banking given the DBLM setting which sees ISF product being marketed through a conventional banking arm where the latter becomes the client relationship manager holding the control over investment decision. This has given rise to a principal-agent problem between subsidiary Islamic bank (as the product developer) and the conventional banking arm (as the sales agent), due to the product knowledge gap. Besides, it exposes the Islamic banking business to direct competition from the conventional counterpart in terms of marketing and origination preference. Since ISF is not aggressively marketed to the wider corporate customers, it creates low visibility on the product compared to SL. Thus, it hinders the effective mobilization of Islamic liquidity through ISF.

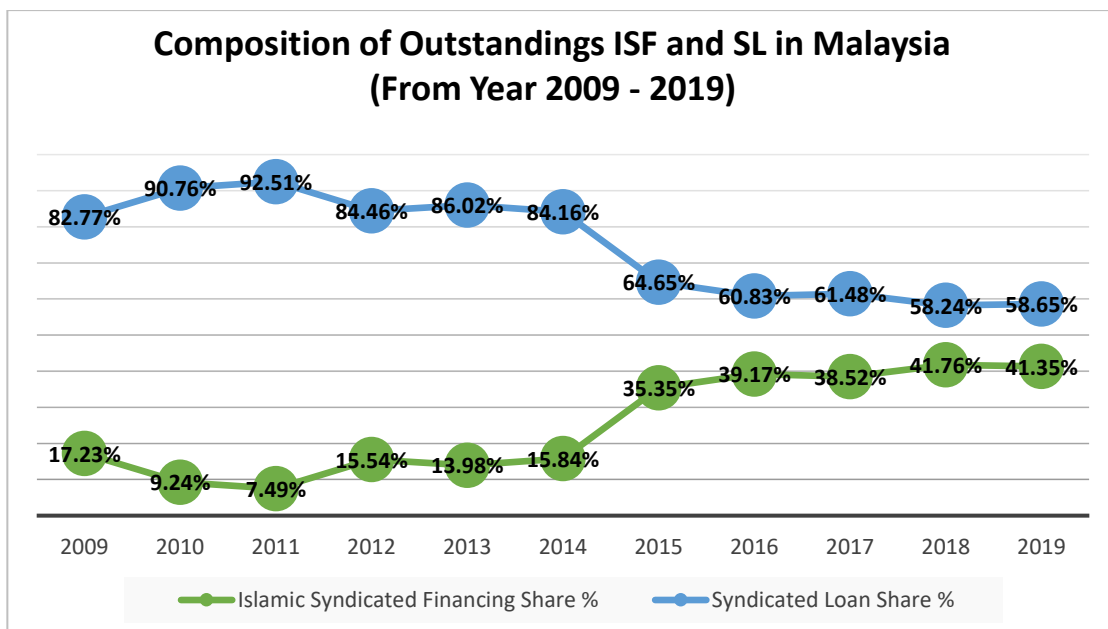


Figure 1.4 Composition of ISF vs SL in Malaysia from 2009 - 2019

As illustrated in Figure 1.4, from the demand-side perspective, save for the corporate customers listed as *Shariah*-compliant counter, the rest have predominantly chosen to raise the syndicated funds through SL instead of ISF. Whilst there has been a consistent rise in ISF market share over the years, SL is still dominating the total banking syndication as of 2019. This is potentially attributed to low product awareness as the conventional banking arm has not been actively marketing ISF. Besides, the demand for ISF remains to be largely determined by the banks' investment preferences and decisions. As for corporate customers, especially those of publicly listed companies not classified as *Shariah*-compliant stock, they are indifferent about the type of syndicated facility proposed by the banks, as their main objective is to raise sufficient liquidity from the debt investors be it from conventional or Islamic sources.

The intricacy of challenges facing the relationship bankers in originating ISF has therefore established an excellent laboratory for examining the perception of relationship bankers regarding the factors influencing banks' decision to participate in