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Islamic Investment Options Available for Liquidity Surplus in Islamic Banks in Bahrain

Fahed M.Alqatabi*1 and Omer A. Hag Hamid*2

**1-MBA Student, College of Administrative and Financial Sciences, AMA International University of Bahrain, Bldg 829, Road 1231, Blk 712, Salmabad, P.O. Box 18041, Kingdome of Bahrain*
**2-Assistant Professor, College of Administrative and Financial Sciences, AMA International University of Bahrain, Bldg 829, Road 1231, Blk 712, Salmabad, P.O. Box 18041, Kingdome of Bahrain*
Corresponding Author:Fahed M.Alqatabi

ABSTRACT:*The research project has been undertaken to analyse the liquidity surplus management implemented in the Islamic Banking Sector in the Kingdom of Bahrain. In this regard, the research is focused on examining prospective ways utilised in functioning for investing liquidity surplus. Further, the relationship between the liquidity and profitability of the Islamic banks has been observed with the help of secondary data. The research has utilised the quantitative data collection tool to fulfil the research objectives effectively. In this study, quantitative research method has been utilised to address the research objective effectively. For this purpose, quantitative data has been gathered through the 5-year financial statement of Islamic Banks in the kingdom of Bahrain.In addition to this, the secondary data has been collected to find out the available Islamic investment options in the Islamic Banks in the kingdom of Bahrain. The quantitative data collected through the secondary sources have been analysed through Microsoft Excel. The study has also founded Islamic investments options available to invest the liquidity surplus and maximize returns from available liquidity. Thus, the research findings are a good source of information for the Islamic banks in the Kingdom of Bahrain.*

KEY WORD*: Liquidity Surplus, Islamic Investment Options, Profitability*

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I. CHAPTER 1 – INTRODUCTION

This chapter presents the background information on the research topic by providing a detailed overview of liquidity surplus management issue in Islamic banking in the Kingdom of Bahrain and exploring the available profitable investment alternatives. Islamic banking is a banking system designed to be consistent with the tenets of the Holy Islamic Shari'a and principles that prohibit Riba. The banking system adheres to three key rules which involve the absence of interest, Islamic tax ZAKAT, and prohibition of certain activities that are disallowed and constitute Haram in Islam. In practicing the rules, Islamic banks faced a wide array of difficulties with respect to managing liquidity problems, which deepens further due to the constraints that arise from Sharia. Along with this, the chapter states the purpose, objectives, significance, scope, limitation and hypothesis of the study.

1.1 Research Background

In the operations, financial institutions or banks faced a wide array of risks that create a threat in achieving the desired performance level. In this context, surplus of liquidity is a crucial issue faced by Islamic banks. Further, benchmark best practices involve an integrated approach to manage deposits for reducing on-demand liquidity, so as to manage the liquidity effectively (Khasharmeh, 2018).

A further problem occurs with respect to maintaining a balance between asset and liabilities, which is the crucial challenge faced by Islamic Banks in managing liquidity. A rise in the accumulation of the assets and its inefficient employment create a risk of losing profitable opportunities, while an increase in liabilities beyond the prescribed level, could lead to the failure of banks in meeting customers obligations. Thus, the problem of excess liquidity in Islamic Banks is a burgeoning issue that creates challenges in achieving profitable investment opportunities (Jaara et al., 2017).

This issue of liquidity surplus directly affects investment returns and overall development of Islamic Banking in the Kingdom of Bahrain. With the sharp increase in oil income, real estate boom, and rising financing by the private sector in service and industrial sector development, a significant increase in private equity investment is evident in Bahrain. In the Kingdom of Bahrain, the dual banking system is prevalent that integrates conventional, as well as, Islamic banking principles in operations (Hidayat, Al-Khalifa and Aryasantana, 2012).

The liquidity issue is an integral part for both conventional, as well as, Islamic Banks for the purposes of regulatory capital adequacy, solvency, meeting liquidity commitments and obligations. Therefore, any initiative or effort taken by Islamic Banks for constructing a robust liquidity management is vitally important and needs to be established and administered for every transaction and also established at the systemic level. As Islamic Banks deal with real assets, constrained by the framework of Islamic Shari'a, compelling a strict adherence to the highest ethical standards, and yet following the regulatory framework of conventional banks, a set of unique challenges arise in managing liquidity. Accordingly, the exposure to liquidity excess issue is higher for Islamic banks in comparison to the conventional banks especially in times of downturn in business cycles, or in cases of shareholder disagreement due to dissension or disharmony or any inevitable decline in the business conditions or non-availability of lucrative Islamic options.

Islamic Banks function on trust basis as per the Sharia principles and values which instill the sector with confidence in the internal context, and thus considering the shareholders, management and stakeholders as reliable business partners (Iqbal, 2012). This, as a result, promotes cooperative culture from a sectoral perspective. Further, Islamic Banking encourages symmetric and systematic information sharing that leads to optimised allocation of funds and liquidity on both the assets, as well as, liability sides. Islamically the dominant trait of Profit and Loss sharing which contractually regulates risk sharing between business participants serves to reduce the risk of holding the liquidity unutlised. At a macro level, Islamic banking systems with real business transactions expose banks to varied forms of unique market and business risks such as asset loss risk, price fluctuation risk, economic downturns and amortisation (Iqbal, 2012).

In the viewpoint of Mohammad (2013) the anxiety concerning liquidity surplus is more pertinent to Islamic banks as compared to other banks due to particular nature of the financial activities and products along with the limited accessibility of the Sharia regulated money market instruments, and other Islamic alternatives, and its role of acting as a central bank. In this relation, the main focus of the following research is to examine the liquidity surplus management of the Islamic Banking Sector in the Kingdom of Bahrain, with key emphasis on the available investment options.

1.2 Statement of the problem

Based on the overall background study, Islamic Banks do have an issue in managing their liquidity surplus especially with the absence of some money market instruments and the Shariaa regulations that keep the investment options limited for these Islamic Banks. In the research, the problem of liquidity surplus in Islamic Banks can be expressed in the following questions:

- What are the efficient Islamic investments options available to invest the liquidity surplus and maximise the returns and profitability?

Objective of the Study

The principal purpose of the current research study is to investigate and analyse the liquidity surplus management implemented in the Islamic Banking Sector in the Kingdom of Bahrain. In order to make the research comprehensive concerning the selected topic area, the research also addresses following objective:

- To investigate and evaluate the efficient Islamic investments options available to invest the liquidity surplus and maximize returns from available liquidity.

Hypotheses:

H0: The Islamic investments options are not effective enough to invest liquidity surplus.

1.3 Significance of the Study

The undertaken work is focused on examining the issue of liquidity surplus management by Islamic Banking Sector in the Kingdom of Bahrain with emphasis on available investment options. The research findings will mend the gaps existing in the literary sources pertaining to the research problem along with determining the Suitable solutions and information related to unique investment alternatives will be provided in the study that will serve as a significant database for Islamic banking sector in enhancing their profitability. Suitable recommendations concerning excess liquidity will be helpful to the Islamic banking sector and financial institutions operating in the Kingdom of Bahrain in terms of improved liquidity management. Bank managers can consider the findings in formulating effective investment strategies and harness the advantages associated with profitable investment opportunities.

The problem of excess liquidity is prominent in the Islamic banking sector that directly affects the returns of the bank along with adversely affecting the growth and development prospects on the Islamic banking sector in the Kingdom of Bahrain. Moreover, the research findings will be beneficial to the educational practitioners seeking to investigate the similar domain. With the help of this research, efficient Islamic investment options for maximising returns from available liquidity will be explored and identified in detail that can further be applied by the banking sector in practice.

The research will provide a detailed insight into the process of liquidity management in Islamic banks in Bahrain through which deficiencies in liquidity management process can be identified, and proper investment options can be employed. As a whole, the research will be helpful in understanding the link between the functioning of Islamic financial institutions, surplus liquidity, performance, the profitability of the banking sector and holistic development of the Islamic banking sector. Islamic financial institutions can incorporate effective measures by taking into account the advanced investment strategies discussed in the research.

1.4 Scope and Limitation

The Islamic banking sector is prone to the issue of liquidity surplus in comparison to the conventional banking sector, thereby generating the need to examine liquidity excess management practices and available investment options. It is found from the brief review of the secondary sources that limited information is available on the selected research problem. Hence, the findings can be applied in the broader context. Complexities are faced in aligning secondary data and drawing findings in the light of research questions. Results are obtained in the specific context of Kingdom of Bahrain; hence, they cannot be applied in general context.

1.5 Research Framework

The study will have a descriptive structure in which research aims and objectives can be achieved in an appropriate manner. Both Theoretical and Conceptual frame work will be explored in details under the following main factors which will be clearly explained on the literature review of this research study:

1. Methods used for managing liquidity surplus in Islamic Banks.
2. Efficient Islamic Investments options available for maximising the returns from liquidity surplus.
3. Relationship between improved efficiency in deployment of funds and confidence in the Islamic Banking Sector.
4. Relationship between profitability and liquidity balancing.

II. CHAPTER 2 - LITERATURE REVIEW

The Islamic banks in Bahrain have gained significant attraction from conventional banks and consumers alike. The Islamic banks in Bahrain follow the banking policies as devised in accordance with the Shari'a law and use different modes financing and contract-based sales and purchasing to invest their surplus liquidity. Murabaha is the most widely used method of investing by the Islamic banks in Bahrain. Murabaha is an Islamic finance term which means, "cost-plus financing." Under the regulations of the Shari'a law, the Islamic banks are restricted to take interest money on the loans given to their clients. In order to invest their liquidity and earn a significant profit in return, the Islamic banks engage in a sale and purchasing process with their clients, who request the banks to invest in a commodity which is required for him/her. The Banks invest their liquidity in purchasing that particular commodity desired by the client and then sell it to him/her on a pre-decided profit margin over the actual purchase cost.

The main purpose of undertaking literature review is that it provides easy access in research work, as it includes high-quality studies and scholarly articles that are valid, meaningful and relevant and thus, facilitates into making a complete report. A literature review facilitates in providing an in-depth study of the chosen topic or subject, and therefore, helps in better understanding the topic area. The processes involved in a literature review make the dissertation or research more authentic and reliable. Initially, the literature review facilitates in formulating research questions, at the same time, it also aims at identifying relevant theories.

In this respect, the literature review chapter has divided into multiple headings and subheadings with a view to evaluate and summarize the current state of information regarding liquidity risk management in the Islamic Banking sector. This literature study focuses on analyzing the conceptual framework of liquidity surplus management of Islamic Banks in order to understand the research work better. The study has examined the methods used for managing liquidity in Islamic Banks and investing surplus from liquidity in order to better understand the investment options. Additionally, the study has stated the relationship between improved efficiency in the deployment of funds and confidence in the Islamic Banking Sector. In more specific terms, the literature review has examined the relationship between profitability and liquidity balancing in Islamic banking sectors. Lastly, the literature study has been summarised with a proper conclusion, that presents a conclusion to the analysis in-depth information of overall research subject and thus, provides credibility to the research work. In addition, the literature review chapter has summarised the essential aspects of the Islamic Banking sector that can facilitate in undertaking a future study.

2.1 Research Framework

The theoretical and conceptual framework of this review is aimed at structuring a descriptive structure following which research aims and objectives can be achieved in an appropriate manner. This research framework has divided the central theme of the research into four subjective themes that will help conduct an in-depth empirical study of the selected research topic. As the research aims towards analyzing the practices of liquidity risk management that are applied in the Islamic Banking sector in the Kingdom of Bahrain; thus, it is the central theme of the conducted literature review.

Figure 1: Theoretical Framework

As Islamic Banks do not have the right to sell their debts higher than their minimal determine cost, as well as their assets, remain to be the subject of the time till they can repay their debts. Thus, Islamic banks face difficulties in managing their liquidity with respect to focus on investment option. One of the major challenges faced by Islamic bank with respect of liquidity is related to maintenance of balance among assets and liabilities. Due to the availability of excess liquidity, Islamic banks fail to generate or use profitable investment opportunities that directly affect revenue generated by banks and profits on the return for depositors (Iqbal & Molyneux, 2016). In this regard, the below conceptual framework will facilitate assistance in identifying prevailing issues in liquidity surplus management practices of Islamic Banks in the Kingdom of Bahrain through the themes as mentioned below.

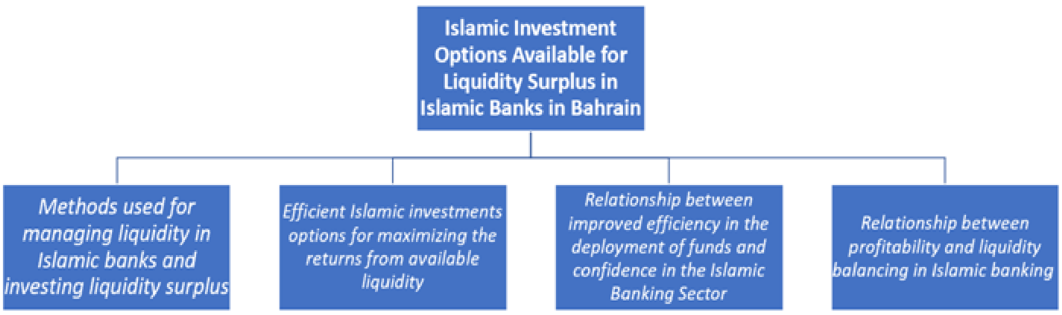

Figure 2: Conceptual Framework

2.1.1 Methods used for managing liquidity surplus in Islamic Banks

According to Iqbal &Mirakhor (2017), a tremendous increase has been observed in the Islamic banking practices across the world. Islamic banking practices are followed in more than 75 countries at present including both Muslim and non-Muslim countries such as Saudi Arabia, Egypt, Sudan, Bahrain, Kuwait, the UK, France, the USA, and France. Islamic banking operates on a distinctive factor from the commercial banks as it does not integrate any of interest based financial products.

The study conducted by Ernst & Young states that Islamic banking practices are continuously growing at a tremendous pace wherein it has crossed the mark of $2 trillion in the year 2014. Islamic banking and all the products and strategies integrated into performing Islamic banking practices are based on the principles of ‘Sharia'. Sharia relates to the prohibition of ‘Riba' which refers to interest and is linked with the religious laws mentioned in Quran. In this respect, Islamic banks face severe issues in managing the money market liquidity as Islamic banks do not have access to short-term money market instruments which are based on interest rates.

One of the methods used to manage the liquidity surplus in the Islamic banking is adhering to the international banking best practices, where banks should incorporate a robust set of policies for liquidity management, a responsible committee for Asset and Liability management commonly called ALCO. The internal control systems and compliance are overseen by an Audit Committee. Its role is to help ensure that profitability can be maximised, but within the constraints of having to maintain adequate liquidity, adequate capital and not incurring risks in excess of the bank’s stated appetite. In particular, it needs to ensure there are well rehearsed plans in place to deal with potential stresses – without such plans, mitigating actions are likely to be less effective and costly.

Investing in short-term and long-term products is another method used by Islamic banks. According to (Iqbal &Mirakhor, 2017), the key findings of his study state that varied assets have different maturity periods including medium and long-term assets and liabilities mostly which are short-term. In this respect, it can be discussed that the presence of a mismatch between assets and liabilities results in difficulty in managing liquidity for Islamic banks and address the immediate needs for making payments. The presence of a mismatch between assets and liquidity creates a pressure on the banks to sell financial assets of high value in their portfolio at prices that are lower than the market value of the assets. Bahrain plays a significant role in the growth and spreading Islamic financial practices to a great extent however it is observed that the Islamic banking organizations face severe issues in concern with the maintaining liquidity in an appropriate amount and further are required to maintain additional capital for meeting the need for cash assets.

According to Kammer et al. (2015), the absence of well-developed and structured liquid financial products that comply with the ‘Shariah' principle is a major issue that impacts the profitability of the Islamic banks in Bahrain. In this respect, creating an effective an enhanced money market and interbank instruments that comply with Shariah principles are is also another method in which Islamic Banks can manage their liquidity surplus and maximise their returns and prodigality. The Islamic banking institutions in many countries are inclining towards integration of specifically designed monetary policies that will help them in maintaining effective liquidity management by making adjustments in the liquid assets available with the bank, that will further impact the economy of the country through lending channels operated by banks.

In this respect, there is also a need for exploring and conducting research about the financial instruments and techniques that can be of significant help in improving profit-sharing ratio for Islamic banking institutions in Bahrain and other countries through integration of best liquidity management practices.

2.1.2 Methods used for investing surplus liquidity by Islamic Banks in the Kingdom of Bahrain

According to Suzuki & Miah (2018), Murabaha has been the extensively used by the Islamic banks in Bahrain as a mode of financing and investment. Khaleeji Commercial Bank, which is one of the prominent Islamic Banks in the Kingdom of Bahrain, has recorded for the highest financing through its liquidity investment in Murabaha contracts with the clients. This data presents primary research without citing the references of external sources, and thus, represents a descriptive style of analysis. The statistical data provided in context with the example of Khaleeji Commercial Bank, however, represents secondary research and therefore, reflects the thematic nature of the data analysis.

According to Khan (2017), one of the strongest and extensively growing sectors in the Kingdom of Bahrain is the real-estate sector. The rapid growth of the real-estate sector has increased the number of clients seeking mortgages to purchase new houses. The increase in people applying from real-estate mortgages has provided the Islamic Banks in Bahrain with a prominent mean of investing their liquidity. Furthermore, the Islamic Banks in Bahrain have also been involved in project finance methods; wherein, they have been investing in different real estate and housing developing projects in different nations under the Gulf Cooperation Council (GCC). The sourced data considered for the above-mentioned study is based on the interpretations of different academic sources, based on scientific research methodology. Therefore, the sourced data represents secondary research with thematic analysis.

As stated above, the Islamic Banks in Bahrain and other GCC countries are prohibited from charging "Riba", that is interest to their clients. In addition to this, these Islamic Banks are also prohibited from investing in commodities wherein, they are required to pay interest rates. In order to accommodate their surplus liquidity, these Banks tend to invest in non-conventional commodities which comply with the Shari'a laws of finance and banking. One such commodity is "Sukuk," which means Islamic bonds. In Sukuk, or Islamic Bonds, the bondholders are not required to pay interest to the bond issuers at regular intervals, but instead, the holder shares undivided ownership in the finance generated by the bonds. The Islamic banks, thus, tends to create surplus amount for further project financing through the funds obtained from Sukuk and effectively manage their liquidity. In Bahrain, Sukuk is issued by Bahrain Monetary Agency and has been purchased by Islamic Financial Institutions like Islamic Banks and Shari'a Insurance Agencies.

Another method of investing liquidity, which is used by the Islamic Banks is the lending of interest-free loans to the people in critical financial conditions. These interest-free loans are known as "Qard Hasan" in Islamic financial terminology. Since all the Islamic banks in different nations across the globe follow the same laws and regulations, the Islamic Bank in Bahrain also offers the services of Qard Hasan and use it as a way of investing their surplus liquidity (Visser, 2012). The sourced data is the representation of secondary research, which is based on the interpretations of different research material, and thus, is descriptive analysis.

2.1.3 Efficient Islamic investments options for maximising the returns from available liquidity

In the viewpoints of Oubdi and Elouali (2016), investment defines the financial stability of an individual. However, making investment without knowledge and information can negatively impact one's total profits. The 1997 crisis proved that making an investment in the stock market severely affects institutional investors and individuals. Investors faced the worst time during 1997, but they also gained significant profit during good times. The financial crisis of 1997 made banks to give special attention to liquidity management. Islamic banks were also required to carry out specific fund management with a view of coping up with financial risk and constraints. However, underdeveloped and weak Islamic stock market created difficulties for banks in managing excess liquidity. The government initiative to establish the adequate structure of Islamic money market has provided various investment opportunities to manage excess liquidity.

Khan (2010) stated that there are wide investment options available to Islamic banks to manage with liquidity surplus. Islamic banks can invest in the stock market in order to manage their liquidity surplus. Moreover, Islamic banks can also invest in various investment vehicles, such as bonds, derivatives, and saving accounts with a view to ascertaining maximum profit on their investment. With respect to Islamic banks, there are various guidelines that are required to adhere in order to achieve higher profit and Falah maximisation. Islamic banks does not only rely on achieving profits, but they also focuses on Falah maximisation. According to Khan (2010), liquidity management is one of the major concerns for all the Islamic banks. A wide number of studies have been conducted in order to identify the level of liquidity in the Islamic banks. It is stated that Islamic banks bear 40 percent more cash as compared to other conventional banks.

As per the report issued by Dali and Shah (2015), conventional banks have better liquidity management as compared to Islamic banks. In addition to this, they elaborated that Islamic banks are required to develop substantial liquidity stock for effectively managing surplus. Some of the most common investment options available to Islamic banks include Islamic investment funds, investment in shares, investment in equity funds, and commodity funds, and investment in Ijarah funds. The term Islamic fund investment is considered as one of the most profitable investment options wherein investors contribute their surplus money for achieving maximum return on their investment. The investors in Islamic funds are provided with a written document that certifies their subscription. These documents may be known as units, shares, or certificates and are always subjected towards two basic conditions. Firstly, the interest on Islamic funds is calculated on the basis of pro-rata profit instead of fixed return. Therefore, investors are required to make an investment in Islamic funds with a clear understanding of profit or loss associated with the funds. Secondly, the money accumulated must be invested for business purpose acceptable to Shariah.

Furthermore, Hamza and Saadaoui (2013) claimed that Islamic banks have the option to invest in Islamic equity funds with a view to achieve halal profits and to manage surplus liquidity effectively. In Islamic equity funds, amounts are invested into joint stock companies. The profits of Islamic equity funds are generated through capital gains either by purchasing the shares of the companies or selling them at increased prices. Moreover, the profits in the Islamic equity funds are also generated by dividends distributed through relevant companies. Another investment option available to the Islamic banks includes Islamic commodity funds. In Islamic commodity funds, banks have the option to purchase different commodities for the purpose of resale with a view to ensure a higher rate of interest on their investment. The profit earned by the sale of commodities are distributed on a pro-rata basis amongst various investors.

Archer, Karim and Sundararajan (2010) claimed that Islamic commodity funds are concerned with various conditions in order to be accepted by Shariah. The commodities are required to be owned by the seller at the time making commodity agreement. The person selling commodities without ownership is restricted in Shariah. Furthermore, forward sales are also restricted in Sharia except in the case of istisna and salam. The commodity transaction must be haram, which means it restricted to purchase or to sales pork, wine, and other prohibited items. In addition to this, Ariffin (2012) stated that both the parties are required to agree on the same prices to avoid conflicts and disputes during the transaction. The prices of the commodities are are required to be fixed at the time of making commodity agreement and are known to both the buyer and the seller. Changes in the price for commodities after making an agreement are considered as invalid and null as per the Shariah law. The Islamic banks are required to follow all the rules and guidelines governing the transactions of commodity funds in order to achieve significant interest on their investment.

In addition to this, Tahir and Brimble (2011) explained that Islamic banks have the option to invest in Ijarah investment fund with a view to effectively manage their excess surplus. In Ijarah investment funds, the agreement amount is used for purchasing various tangible assets including motor vehicle, real estate, and other equipment. However, the ownership of the assets remains with the actual owner, and the specific rents are charged by the users using the assets. The rent received from the user is the main source of income for Ijarah funds, and the accumulated rents are distributed among various investors on a pro-rata basis. Tahir and Brimble (2011) opined that every investor is provided with the certificate of evidence including his/her proportionate ownership in the rented asset with a view to distributing pro-rata share to the investors. Ijarah fund is considered as one of the preferable investment options by investors as it does not involve risk of loss and provides a definite return on the investment. Islamic banks can invest in Ijarah funds to manage their liquidity surplus and achieve maximum return on the invested amount.

In the view of Lewis (2010), murabahah fund is the specific kind of investment option wherein commodities are sold on the cost-plus basis. Financial institutions and Islamic banks highly adopt this type of commodity sales as one of the preferred modes of financing. Islamic banks and financial institutions purchase commodities for providing benefits to their customers and sale it to other parties at an agreed price to ensure profit from the difference between purchasing and selling price. In respect to murabahah fund, as undertaken by Islamic banks and financial institutions, the commodities are sold to customers on the basis of deferred payment immediately after purchasing them from the real suppliers. The portfolio of murabahah funds does not include tangible assets, and it consists of either receivable debts or cash. In relation to this, the units of murabahah funds demonstrate either receivable debts and money, and both of them are intangible and not negotiable. According to Lewis, shares including both debentures and preference shares are the most profitable investment options available to Islamic banks. Islamic banks can invest in shares and generate a higher rate of return on their investment. However, Shariah has developed strict policies in respect to making an investment in shares and debentures. For instance, it is not allowed to acquire shares of companies that provide financial services to the public. Shariah has restricted companies, including insurance companies, conventional banks, and companies involved in public welfare, to issue their shares in the market.

In the views of Hidayat, Al-Khalifa &Aryasantana (2012) the Islamic Banking institutions integrate varied operational activities which are associated with high risks. Islamic Banks primarily invest in assets that are not liquid and extends loans in form of short-term loans that are highly liquid assets. In this respect, the creation of a gap between the assets and liabilities in Islamic Banking institutions expose them to high liquidity risks. As per the policies and frameworks designed by the international Banking best practices, it is essential that all the financial institutions must design strong policies for an asset-liability committee and ensure adequate liquid assets for managing liquidity risks effectively.

Effective liquidity management requires accurate forecasting abilities, availability of cash in an adequate amount, and ability to manage foreign exchange. Management of liquidity risks is highly complicated and difficult process for Islamic banking institutions as they follow principles of Shariah law. Bahrain has a well-developed network of Islamic Banking institutions wherein the viability of liquidity risk management practices integrated by Islamic Banks operating Bahrain have been evaluated by measuring the liquidity demand, deposit portfolio, and equity-based financing (Hidayat, Al-Khalifa &Aryasantana, 2012).

The Islamic Banks in Bahrain make use of tools such as comparing the profit-sharing ratio of their Bank with that of the profit sharing ratio of other Islamic Banks with depositors. This practice of liquidity risk management adopted by Islamic Banks is considered as highly effective. Further Islamic Banks also integrate the practices of offering ‘MudarabaMuqayyadah’ account to their customers in place of ‘MudarabaMutlaqah’ account. Depositors are charged with the penalty by Islamic Banking institutions provided they withdraw money in the absence of prior notice to the bank. In addition to this, the Islamic banks are inclining towards the application of profit and loss sharing scheme with the depositors and loan takers in place of making use of the revenue sharing scheme to manage liquidity excess. This study

As per opined by Ahmed (2014) presence of liquidity risks is unavoidable in banking institutions. The Islamic Banks are exposed to high liquidity surplus issues and most of the Islamic Banks operating in Bahrain follows the practices of investing their money in ‘musharakah’ and ‘mudarabah’ for reducing their exposure to credit risk and market risk. As per the guidelines of the IFSB, the investment of money in these instruments helps banks in increasing their revenues. Further designing effective policies by the board of directors in concern with the maintenance of the liquidity in align with the ratio of the long-term asset can help Islamic banks to reduce their exposure to liquidity mismanagement. Some banks and IFSB also emphasis that making relevant improvements in financial reporting and monitoring can be of significant help in improving the liquidity surplus management for Islamic banks.

The limited exposure to trade in the secondary market and not using interest-based products are the main causes of high exposure to liquidity surplus for Islamic banks (Ahmed, 2014). The author makes use of secondary data sources by accessing varied existing researches in the form of books, journal articles, research reports, and bank reports for the collection of data on ways to improve profitability and manage varied kinds of risks associated with Islamic banking practices. Further, the author's findings state that the association of risks with banking practices cannot be avoided, the management of Liquidity surplus is a major cause for Islamic banks because it is based on the principles of Shariah. Designing of effective interventions, reporting, and monitoring policies by the stakeholders, financial institutions, and committee members can help in improving the liquidity surplus management practices for Islamic banks. In this respect, it can be further discussed based on the findings that the inability to create other alternatives of the financial instruments offered by Islamic banks, increases the exposure to liquidity surplus for Islamic Banks (Ahmed, 2014).

According to Ali (2013) excessive liquidity creates a negative impact on the banking business. The surplus of liquidity in an extraordinary amount has resulted in destabilising some of the Islamic financial institutions during the economic and financial crisis. In this respect, it is analyzed that liquidity surplus possess the highest threat for Islamic banking institutions as they are based on profit sharing ration and avoid trading in interest-based securities. It is essential that all banks and regulators emphasize that adequate liquidity analysis and measures are designed for reducing the exposure of Islamic banks to excess liquidity. Liquidity can be understood as the ease with which an asset can be converted into a cash equivalent or cash. The Islamic banks have faced severe losses owing to exposure to high liquidity excess and in this respect are focusing on designing and integration of varied financial tools and practices for mitigating and avoiding any liquidity excess.

The Islamic Banks make use of 'Salam' contract to write off the other 'Salam' contract wherein the second 'Salam' contract is a new contract not depended upon the first 'Salam' contract. Further, the second 'Salam' contract is signed with the third party and the parties involved in the first 'Salam' contract cannot take part in the new 'Salam' contract (Ali, 2013). This investment options is quite difficult to be largely considered in the Islamic banking sector in Bahrain due to the country nature and size of transactions among the Islamic banking sector operating in Bahrain.

2.1.4 Studying the relationship between improved efficiency in the deployment of funds and confidence in the Islamic Banking Sector

Islamic Banking sector has recently gained a rapid rate of growth as it has depicted extraordinary expansion in the past two decades despite its unorthodox financial framework and business practices. IN this regard, Hanif (2014) stated that Modern commercial banking practices that are based on interest tend to be against Sharia (Islamic law); thus, believers of Allah do not tend to deal with institutions that follow interest-based commercial practices. However, on the course of time role of the banking sector have become crucial in ensuring economic growth and social development of any country. Thus, it is a state of confusion for followers of Judaism, Islam and Christianity to undertake the practices that can lead to development or follow the practices preached by religious faith. In this regard, Hanif (2014) have mentioned that Riba which is a synonym of modern-day interest, has been prohibited as per Sharia (Islamic Law); however, it is charged by modern commercial banks at the global level.

The definition of Riba is that it is a practice of charging predetermined extra amount based on the period of the financial loan. As per the Sharia (Islamic Law), if an individual believes in afterlife disclosure, then he or she should not charge additional interest on loans and pursue the blessing of Allah. Thus, it is the responsibility of Allah's followers to give up and avoid the practice of charging interest on financial transactions, as well as promote and develop a financial system that is free of interest (Hanif, 2014).

According to Ullah, Jamali & Harwood (2014), Islamic Financial Institutes (IFIs) work in the same societies and geographical locations as conventional bank and perform all the functions that a financial institution performs. In addition to this, Islamic Financial Institutes are also providing assistance to many organizations in the contemporary business environment by facilitating all the essential services that are required for running an economy appropriately. However, there are varied differences among the approaches, philosophies, and functionality of conventional banks and Islamic Financial Institutes. Ullah, Jamali & Harwood (2014) added that any financial institution is expected to provide assistance to the local and global economy by facilitating saving mobilization, as well as general utility services like safekeeping of valuables, consultancy, international trading platforms and transfer of funds. These services are also provided by Islamic Financial Institutes, as there is no provision in Sharia (Islamic Law) opposing such services. However, the approach of saving mobilization in Islamic Financial Institutes functions on a different mechanism. This mechanism comprises of two phases, namely accepting deposits and extending investments and financing services.

In a similar context, Bacha &Mirakhor (2013) have explained the differences in approach of conventional Banks and Islamic Financial Institutes with regards to accepting deposits. Under the conventional banking system, the rate of return is predetermined and fixed for a certain period. However, Islamic Financial Institutes provide a variable return through Mudaraba and Musharaka, also stated that conventional banks provide a higher return on longer-term deposits and the nominal return on short-term deposits. The same practice is followed by Islamic Financial Institutes in the practices of sharing profits or providing returns to depositors. That is the higher weight of profit is provided to depositors will long-term investments as the funds are available with Islamic Financial Institutes for investing for a longer period and vice versa for short-term depositors as their deposits cannot be invested in long-term projects. However, the difference between the practices of conventional banks and Islamic Financial Institutes lies in the practices of risks and rewards.

Conventional Banks bear the whole risk of investing in the project, and total reward in the form of return is employed for servicing the depositors at a fixed rate. Contradictorily, the practices of Islamic Financial Institutes are developed in a manner that risks and rewards are fairly shared with the depositors. Bacha &Mirakhor (2013) also mentioned that the rewards could only be collected by Islamic Financial Institutes that have the trust of civilians and optimal performance in the financial sector. Islamic Financial Institutes of Pakistan have gained successes in the establishment of trust and credibility with its depositors; thus, being able to increase deposits. In regard to the second phase of savings mobilization process that is extending investments and financing services, Finnerty (2013) have stated that it is important for any financial institution to provide credit facility to business organizations.

Conventional Banks and Islamic Financial Institutes, both provide credit facilities under their financial service offerings for the purpose of boosting the productivity of channel of reward; however, the difference lies in the financial agreement between financial institutions (Conventional and Islamic) and their depositors. Conventional banks offer a loan with a fixed interest rate which cannot be practiced by Islamic Financial Institutes. Islamic Financial Institutes can generate profit on investments but cannot charge interest on loans. In addition to this Finnerty (2013) also stated that conventional banks could facilitate three types of loans to their clients who are short-term loans, long-term loans, and overdrafts. However, Islamic Financial Institutes cannot facilitate any loan to their client except interest-free loans. The term defined for an interest-free loan in Sharia (Islamic Law) is Qard Hasan. Along with this, Islamic Financial Institutes can provide required assets to their clients, instead of lending money.

In a similar context, Abdel Megeid (2017) stated that conventional banks could be facilitated by its clients with the facility of overdrawing or overdraft against a pre-determined interest rate. A credit card is one of the most common forms of this facility, whereby a customer can fulfill his or her financial with plastic money. However, this facility of finance cannot be offered by Islam banks except Murabaha. Murabaha is defined as the practice of facilitating client with their required commodity, instead of lending them cash or credit. In addition to this, the Murabaha is different from credit facility due to the reason that conventional bank charge interest after the customer avail the credit facility; however, under Murabaha profit is due once the commodity is delivered to the customers. Furthermore, conventional banks can charge extra interest from their customer in the instance of default; whereas, provision of extra charge is not available in Murabaha.

2.1.5 Studying the relationship between profitability and liquidity balancing in Islamic Banking

In the views of Hussain, Shahmoradi& Turk (2015), Islamic Banks have a major role in the development of a monetary and financial system of Islamic states due to rapidly increasing societal requirements and their crucial role in the growth of the economy. Islamic banks have a unique structure and distinctive operational process with respect to profitability and liquidity, which have increased their vitality in the contemporary structure of monetary and financial systems. In this regard, the liquidity of any asset can be defined as the ease of converting it into cash or financially measured asset without losing significant value, and the liquidity with respect to banks can be defined as their ability to fulfill short-term obligations. Liquidity is equally important for conventional banks and Islamic banks, however, Islamic banks encounter extensive liquidity risks than conventional banks, as sources of liquidity of Islamic banks are abundant in comparison to conventional banks. Hussain, Shahmoradi& Turk (2015) added that Islamic banks' basic structure is designed in the alignment of religious regulations and rules; thus, the probability and occurrence of illiquidity of assets is significantly greater in Islamic Banks.

For example, as per the Sharia (Islamic Law), clients or customers of Islamic banks have the right to cancel a Murabaha contract before the ownership is completely transferred to them, irrespective of purchase of commodity by Islamic Bank. This may lead to the inability of Islamic bank to sell the purchased commodity at a profitable or reasonable price. In addition to this, Islamic banks are not provided with the freedom of obtaining profits by transacting with short-term assets as the Sharia (Islamic Law) forbids an Islamic bank to receive interest, similarly as it is forbidden to pay interest. Thus, liquidity management with reference to Islamic banks can be defined as the procedure of maintaining balance among the riskiness and necessity of liquidity to avoid unwanted consequences (Hussain, Shahmoradi& Turk, 2015).

In this context, Aziz, Sharif & Salih (2017) have stated that liquidity risk can arise when an Islamic bank is unable to obtain required short-term assets at a reasonable price. This inability creates issues in the functionality of Islamic banks. Likewise, if an Islamic Bank has excessive liquidity, unwanted consequences may be encountered by it. The reason behind this is that liquid assets mostly generate a lower return. Thus, the profitability of Islamic banks is adversely affected due to the increase in the opportunity cost of investing in excess liquid assets.

On the other hand, Abedifar et al. (2015) defined profitability of Islamic banks as their ability to create comparatively more wealth for their client, than banks' spending. Profitability of an Islamic bank is measured by its sustainability. In addition to this, Islamic banks cannot earn a profit by charging interest as it is prohibited by Sharia (Islamic Law). However, It is pointed out that for the purpose of being profitable, Islamic Banks have special ways, such as Murabaha. Murabaha is a contract that allows a customer to purchase any commodity without taking a loan or paying interest. Another method of earning a profit is Musharaka which being is offering partnership to banks clients. Thus, the risk and returns will be borne by Islamic Banks and customer that have become partners as per the share in investment. The common factors among Murabaha and Musharaka are that both forbid paying or receiving interest, risks are borne by all the involved parties, and returns are appropriately distributed among all with respect to their share in investment (Abedifar et al.,2015).

Islamic Banking practices are significantly used by more than 75 countries including Muslim and Non-Muslim countries, and the banking sector is continuously growing at a tremendous rate. The reason behind the excessive growth of Islamic banking sector is that the Islamic banks hold a high amount of liquid assets that results in meeting the cash requirements of the customers, and the availability of substantial liquid assets also facilitates in maintaining fluctuating interest rates in the money markets. The other factor that serves to increase the funds placed in the Islamic Finance is the desire of the customers to fulfill their religious obligations while undertaking their banking or investing activities. However, Islamic banks also face a severe challenge in order to manage the money market liquidity, as the Islamic banks lack access to short-term money market instruments. The assets of Islamic banks cannot be easily sold and traded, as they have very low liquidity. The mismatch between the total asset and total liability in Islamic Banks becomes the primary reason behind liquidity risks.

III. CHAPTER 3 - RESEARCH METHODOLOGY

The proposed research work is directed to reflect the Liquidity surplus investment options available for Islamic Banks in the Kingdom of Bahrain. For the purpose of having critical exploration of the research context, there is a need of having structural procedures and systematic exploration of different activities and tasks so that optimum results can be obtained. In this regard, the presented chapter reflects a roadmap or blueprint for different research related activities across the entire research process.

This research study has included secondary data collection method to provided distinctive data findings including quantitative data findings. The research study for the analysis of this data has used quantitative method approach for data analysis purpose. The data analysis method that is used in this research study are quantitative data analysis method with the use of Microsoft Excel software and the discussion of the analysis in descriptive form. The research methodology chapter has presented a clear and detailed account of ethical considerations that are used in this research study for maintenance of the research validity and reliability. The research methodology framework that is presented in this research work is quite significant and supportive for attaining the required data for reaching the desired research outcomes.

3.1 Nature of the research

The presented research work is a quantitate research work by nature as it directs to include quantitative data into account for the purpose of reaching to a specific goal. In relation to this, the prime objective of the research work is to analyzes the liquidity surplus investment options available to Islamic Banks in the Kingdom of Bahrain. In this regard, the research topic is quite comprehensive in nature which requires some significant amount of data and information from various sources (Lewis, 2015). In such conditions, implication of quantitative data collection will be proved sufficient and effective for the research work. Owing to this reason, the presented research work will employ quantitative research method and data. The prime rationale of selecting this the method is that quantitative data reflects the existing state of art of liquidity management regimes followed in the country and will direct to reflect the reasons behind the trend prevailing in the existing market. In this way, effective and efficient integration of the collection of secondary date and quantitative research allows to obtain an effective and efficient results which can be helpful for the reader to understand the context in an effective manner.

3.2 Research Design

In the presented research work, exploratory research design is the preferred research design. Exploratory research design directs to explore the existing phenomena in an explicit manner so that some hidden aspects can be explored (Creswell, & Poth, 2017). In the same manner, in the presented research work, critical exploration of a real-life perspective, i.e. liquidity investment options available to Islamic banks in the Kingdom of Bahrain. In this way, exploration of existing phenomena is evidenced in the research work which directs to justify the implication of exploratory research design in the research work. In reference to the exploratory research design, both financial statements analysis and literature survey will be taken place in the research work so that exploration of the phenomena can be done in an explicit and effective manner.

In the presented research work, inductive research approach would be applicable and justifiable as it is aligned with the nature of the presented research work. The inductive research approach reflects the flow of the research work from specific to general. In other words, in this approach, the research work is aimed to reach to a generalized and universally applied research results with the help of well-focused and specific research objectives. In the research works, in which, there is no significant number of literary sources available, the direction of the research work is set in advance.

In the presented research work, the research's aim and objectives is determined before conducting the research related articles. This shows that the research undertaken in the paper will be refined and specific. This approach is quite justified and effective in the presented research work as there is no sufficient number of literatures available on the liquidity surplus investment options available to the Islamic Banks in the Kingdom of Bahrain. Owing to this reason, effective deduction of the research focus after having thorough review of various related research articles is possible and feasible. In this regarding, inductive research designing can be considered suitable and justified in the research work (Shamoo, & Resnik, 2014).

In the presented research work positivism research paradigm can be considered effective and applicable. The positivism research paradigm directs the researcher to have scientific and quantified results of the research problem so that effective solution can be asserted. The prime rationale behind the implication of this paradigm is that this paradigm leads to enhance the overall validity and reliability of the research work in the most efficient manner (Blair, & Blair, 2014).

3.3 Sources and types of data collected

For the Secondary data collection purpose, audited financial statements of 5 Islamic banks in Bahrain have been analysied to meet the study objectives and test the related hypothesis. The literature review has been conducted with the exploration of wider range of literature databases. Along with this, a good range of books, and scholarly articles are also used in this research study for reference purpose. The use of the literature sources has been done in order to determine the concept of liquidity and the key investment options of liquidity surplus and recommendations of liquidity surplus management.

The data collection from both these sources will be used to have testing of the research hypothesis and will be highly contributing and supportive to reach significant and expected research outcomes. The research study with the implication of both these methods will have significant implications in the real research context.

3.4 Sampling and Technique

All the needful information would be collected through the financial accounts and reports of 5 Islamic banks operating in the Kingdom of Bahrain. Owing to this reason, the sampling technique that is found most suitable in this research study is convenience sampling. In this strategy, different available secondary data sources will be reviewed and compared critically and the source which is having adequate data will be take into account as sample. Through this sample, the working of Islamic financial institutions with the analysis of the data available on budget and financials, surplus liquidity, and performance will be done.

3.5 Data analysis Method

The data analysis in the research work is governed in quantitative data analysis way. In this research study the data is collected from secondary sources and hence quantitative method approach has been applied for data analysis purpose. In the method approach quantitative data analysis methods are applied in this research work. The quantitative data analysis has been governed with the application of statistical methods for the purpose of hypothesis testing. For such purpose Microsoft Excel software has been applied in this research study. The quantitative data analysis of the data in such a way has been accomplished with the help of graphical data presentation method. The results of the available secondary data findings will be evaluated and analysed as well to come up with best conclusion and recommendations. The data analysis accomplished in such a way has been proved a supportive and effective approach to reach the desired and expected research outcomes of this study.

3.6 Ethical Considerations

Ethics is an integral element of the research work. For having ethical compliance within the research work, the researchers have to keep abidance with the ethical codes of conduct that are defined by the universities for specific academic courses (Adams, Khan, &Raeside, 2014; Mallinson, Childs & Herk, 2013).

In this context, the data retrieved from varied literature sources and other secondary data sources has been interpreted and presented in my original language rather than copying data from any source. The research study with the compliance of this ethical consideration has secured itself from the ethical issue of plagiarism that is considered an offensive activity in the academic ethical codes of conduct. The research study has also kept abidance with the ethical consideration of credibility. In order to secure the issue of violation of the copyright act, the research study has given full credit to all the authors whose work has been used for reference purpose in this research study. The research study in this regard has secured against the issue of copyright violation. The research study has also ensured that this copy of the dissertation has never been submitted in any university for any degree course or any other academic purpose.

IV. CHAPTER 4: ANALYSIS AND DISCUSSION

Data analysis is considered as the systematic process of data cleansing, modelling and analysis of the findings. In the current research, financial statements analysis has been undertaken to analyse the lucrative investment options available for the Islamic banks. In order to analyse the impact of Islamic investment option available for the Liquidity surplus, an analysis of the investment strategy of 5 Islamic banks has been made to analyse the manner of deployment of investments out of their available liquidity in both core and non-core business lines. The objective of our study is the observation of the investments made in practice and to ascertain the tendency to favour certain investments over the others. Further our aim is to study and analyse the composition and mix of the investment bouquet so as derive a consensus view and certain preliminary insights on the Islamic banking sector. After that, the discussion of the data analysis has been presented in the alignment of the literature data.

4.1 Analysis

These 5 Islamic Banks were chosen due to the fact that they were systemically important banks in Bahrain, with mature and well-developed investments strategies backed by teams with excellent domain knowledge. Further, they have been established for several years and therefore have already have a well-established methodology for investments made in the core banking book based on the liquidity assigned to business but also have sufficient funds for investments in non-core banking investments such as real estate and sukuks.

Hypothesis:

H01: The Islamic investments options are not effective enough to invest liquidity surplus.

The five banks selected are:

- KHCB
- BISB
- Ithmaar
- Al Baraka
- Al Salam

Core banking investments

These investments represent the core Islamic banking activity of the 5 retail banks chosen. Islamic banks in Bahrain tend to exchange excess funds among one another on Mudharaba/Musharaka basis in addition to financing made to customers using various instruments.

These are set out for the 5 year period in the table below:

	2013	*2014*	*2015*	*2016*	*2017*	*Average*
Core						
KHCB						
Murabaha	*73%*	*76%*	*83%*	*89%*	*92%*	*83%*
Musharaka	*19%*	*12%*	*7%*	*2%*	*2%*	*8%*
Wakala	*9%*	*12%*	*10%*	*8%*	*6%*	*9%*
Mudharaba	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*
Istisna	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*
BISB						
Murabaha	*48%*	*65%*	*68%*	*70%*	*71%*	*64%*
Musharaka	*17%*	*21%*	*19%*	*19%*	*17%*	*19%*
Wakala	*35%*	*14%*	*13%*	*11%*	*13%*	*17%*
Mudharaba	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*
Istisna	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*
Ithmaar						
Murabaha	*13%*	*88%*	*88%*	*90%*	*5%*	*57%*
Musharaka	*2%*	*2%*	*4%*	*6%*	*7%*	*4%*
Wakala	*0%*	*9%*	*7%*	*4%*	*0%*	*4%*
Mudharaba	*85%*	*0%*	*1%*	*0%*	*88%*	*35%*
Istisna	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*
Al Baraka						
Murabaha	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*
Musharaka	*32%*	*34%*	*33%*	*48%*	*41%*	*38%*
Wakala	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*
Mudharaba	*68%*	*66%*	*67%*	*52%*	*59%*	*62%*
Istisna	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*
Al Salam						
Murabaha	*37%*	*41%*	*43%*	*32%*	*30%*	*37%*
Musharaka	*5%*	*2%*	*1%*	*2%*	*3%*	*2%*
Wakala	*30%*	*28%*	*17%*	*28%*	*22%*	*25%*
Mudharaba	*29%*	*29%*	*39%*	*38%*	*46%*	*36%*
Istisna	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*

Perceptible trends in Core Banking Investments

As can be noted from the above, a significant investment of core banking resources is in Murabaha which represents on average 48% of total core-banking investments over a 5-year period.

A summary of the 5-year average will emphasize this bias with more clarity:

Core Banking Investments						
Product wise		***Murabaha***	***Musharaka***	***Wakala***	***Mudharaba***	***Istisna***
KHCB		*83%*	*8%*	*9%*	*0%*	*0%*
BISB		*64%*	*19%*	*17%*	*0%*	*0%*
Ithmaar		*57%*	*4%*	*4%*	*35%*	*0%*
Al Baraka		*0%*	*38%*	*0%*	*62%*	*0%*
Al Salam		*37%*	*2%*	*25%*	*36%*	*0%*
Average		***48%***	***14%***	***11%***	***27%***	***0%***

Thus as can be noted in descending order of importance the Banks investment predominantly are made in:

1. **Murabaha**: A murabaha is normally a sale contract whereby the institution offering Islamic financial services sells to a customer a specified kind of asset that is already in its possession, whereby the selling price is the sum of the original price and an agreed profit margin. As can be seen the structure is simple and secure and most banks prefer such investments, with the exception of Al Baraka. Al Baraka is biased towards mudharaba.
2. **Mudharaba**: A partnership contract between the capital provider (rabb al-māl) and an entrepreneur (muḍārib) whereby the capital provider would contribute capital to an enterprise or activity that is to be managed by the entrepreneur. Profits generated by that enterprise or activity are shared in accordance with the percentage specified in the contract, while losses are to be borne solely by the capital provider unless the losses are due to misconduct, negligence or breach of contracted terms. This is a pure financing activity and as in case of murabaha collateralized by the asset itself. The structure however is perceived to be more complex than that of a simple murabaha.
3. **Musharaka**: This is a business structure type of Islamic transaction, comprising a partnership contract in which the partners agree to contribute capital to an enterprise, whether existing or new. Profits generated by that enterprise are shared in accordance with the percentage specified in the musharaka contract, while losses are shared in proportion to each partner's share of capital.
4. **Wakala**: This is an agency contract where the customer (principal) appoints an institution as agent (Wakīl) to carry out the business on his behalf. The contract can be for a fee or without a fee. In recent years some Islamic institutions use this structure for financing trade financing deals.

Non-Core Banking Investments

These investments represent the non-core Islamic banking activity of the 5 retail banks chosen. Retail banks offer products to their consumers in terms of Islamic financing and investments. The latter often represents a lucrative opportunity to improve profitability. These are set out for the 5 year period in the table below:

	2013	2014	2015	2016	2017	Average
Non-Core						
KHCB						
Sukuks	0%	0%	73%	96%	100%	54%
Equities	96%	0%	26%	0%	0%	24%
PPE	4%	100%	1%	4%	0%	22%
BISB						
Sukuks	0%	92%	90%	97%	99%	76%
Equities	0%	0%	0%	0%	0%	0%
PPE	100%	8%	10%	3%	1%	24%
Ithmaar						
Sukuks	100%	97%	71%	0%	83%	70%
Equities	0%	0%	0%	0%	0%	0%
Mudaraba	-4%	2%	28%	-19%	0%	1%
Leasing	0%	2%	28%	93%	15%	27%
PPE	0%	1%	1%	7%	2%	2%
Al Baraka						
Sukuks	96%	99%	100%	88%	0%	76%
Equities	0%	0%	0%	9%	80%	18%
Mudaraba	0%	0%	0%	0%	0%	0%
Real Estate	0%	0%	0%	0%	7%	1%
Leasing	0%	0%	0%	0%	0%	0%
PPE	4%	1%	0%	3%	13%	4%
Al Salam						
Sukuks	99%	98%	0%	0%	0%	39%
Equities	0%	0%	0%	0%	0%	0%
Mudaraba	0%	0%	0%	0%	0%	0%
Real Estate	0%	0%	0%	0%	0%	0%
Leasing	0%	0%	0%	0%	0%	0%
PPE	1%	2%	100%	100%	100%	61%

Perceptible trends in Non-Core Banking Investments

As can be noted from the above, a significant investment of non-core banking resources is in sukuks which represents on average 63% of total core-banking investments over a 5-year period.

A summary of the 5-year average will emphasize this bias with more clarity:

Non Core Banking Investments							
Product wise		***Sukuks***	***Equities***	***Mudaraba***	***Real Estate***	***Leasing***	***PPE***
KHCB		*54%*	*24%*	*0%*	*0%*	*0%*	*22%*
BISB		*76%*	*0%*	*0%*	*0%*	*0%*	*24%*
Ithmaar		*70%*	*0%*	*1%*	*0%*	*27%*	*2%*
Al Baraka		*76%*	*19%*	*0%*	*1%*	*0%*	*4%*
Al Salam		*39%*	*0%*	*0%*	*0%*	*0%*	*61%*
Average		***63%***	***9%***	***0%***	***0%***	***5%***	***23%***

Thus as can be noted from the above the bias in descending order of importance is as set out below:

I. **Sukuks**: Sukuks by far represents the preferred method of investments of funds and the reasons which could support this choice are mostly linked to risk mitigatory goals such as:

1- Stability of returns: A fixed coupon rate would make it possible for the Bank to predict its cash flows and ensure that by matching its maturities and it would honour its maturing obligations in a timely manner.
2- Security; Most sukuks are backed by sovereign guarantees or have high credit ratings
3- Liquidity: Sukuks can be liquidated, when required. They have the added advantage of having bid prices and a market for sale if necessary or if necessitated by circumstances of low liquidity.
4- Asset backing: Sukuks are normally backed by commodities and assets and have rarely seen default even though there have been defaults in recent history. This mitigate credit worthiness risks.
5- Shariah compliance: Sukuks are shariah compliant and banks are prevented from using conventional bonds by their shariah scholars who are required to approve all investments.

This trend seems to be revised negatively in case of Al Baraka and Al Salam, whilst reasons for this departure are not immediately apparent it could be conjectured that this would mirror the downward trend commenced in 2013, starting with the US Federal Reserve’s first indications in mid-2013, and eventual decision in early 2014, to gradually begin scaling back its quantitative easing programme. It can be surmised that declining yields, and concerns of rising global interest rates; spurred disposals of the sukuk portfolios. Also, it can be noted that the period 2015–2017 was characterized by great socio-political and macroeconomic uncertainty in the GCC, due to declining oil-prices coupled with a slow-down in the global economy, leading to subdued economic growth performances. Another factor to which this trend could be attributed is the cost effectiveness of issuing sukuk in contrast to conventional bonds. Sukuks are still alleged to be more time-consuming, costly and complex.

II. **Leasing and PPE assets**: The second major component of investments in non-core areas would represent PPE and Leasing assets. These comprise a total of 28% of investments made. Often the leased assets are in terms of IjaraMuntahiaBittamleek which represents operational leases, (since finance leases are forbidden by Shariah) require investment in the books of banks. Ijara leased assets continue to remain in the ownership of Banks till the tenure of such lease ends and the ownership passes to the customer.

III. **Equities:** The last component of non-core investments represents equities. Often the Banks itself limit exposure to equities due to internal limits and risk parameters. However, a contributory role of the lack of development int the equity market cannot be total ruled out. The Islamic equity index is not very popular and the fluctuation of returns normally makes banks wary of increasing limits and thus the percentage of investment made.

4.2 Discussion

The Islamic funds and investments industry has gained substantial momentum at an international level. The recent acceleration seen in the Islamic funds and investments industry is set to grow further as governments and institutions in the high-growth Asian and Middle Eastern markets continue to seek Shari'ah-compliant instruments as an attractive alternative for raising capital for infrastructure development and investment projects and also for diversifying their investment portfolio.

The findings of the undertaken analysis and the information presented in previous chapters of this research, reveals that Islamic banks obviously entail an extremely sophisticated system of asset and liability management. This level of sophistication has a multiplier effect on liquidity surplus as a majority of the income generated by Islamic banks comes from the ownership risk in real assets. As discussed in the literature, surplus

funds in Islamic banks increase expenses and liability as long as they remain uninvested. Islamic banks in Bahrain have often been observed to have liquidity crunch. In order to avoid such situations, the banks are required to raise profit rates so as to be able to attract more deposits. Despite the complexities of Shari'ah laws, Islamic banks in Bahrain have remained increasingly focused on enabling effective management of liquidity surplus.
The chart given below reveals the proportion of liquidity surplus investment by Islamic banks in Bahrain:

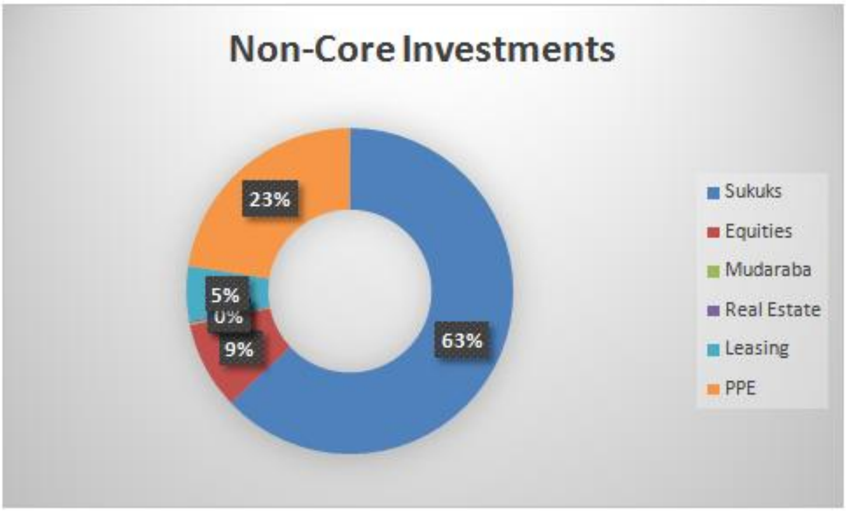

Fig: Non-Core Investments

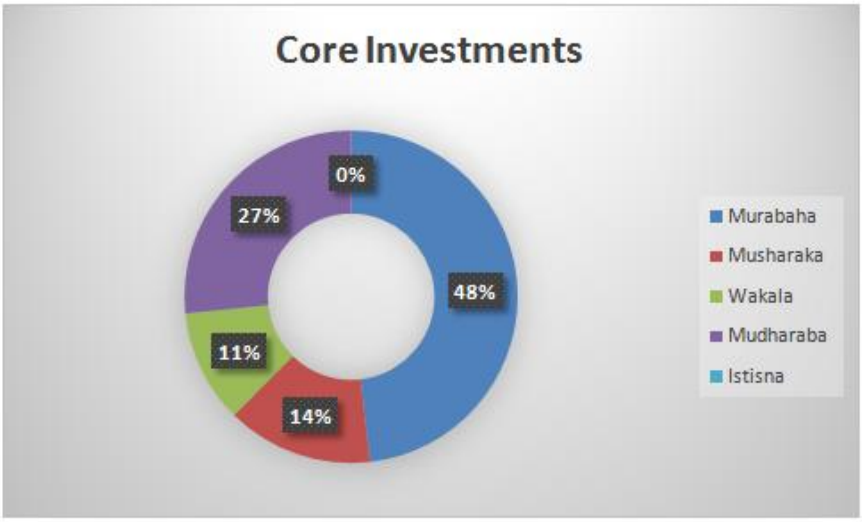

Fig: Core Investments

The graphical information given above falls perfectly in alignment with the views of Suzuki & Miah (2018), who insist that Murabaha is the most popular and widely used as investment option. Although, it is also important to note that Murabaha is second only to the deposits made by Islamic banks in Bahrain with the Central and other banks. Many authors, including Hidayat, Al-Khalifa and Aryasantana (2012) and Jaara et al. (2017) argued that liquidity surplus generated by Islamic banks could not be shifted easily to other conventional banks owing to the Shari'ah laws, which prohibit acceptance of interest. In such cases, Islamic banks in Bahrain tend to exchange excess funds among one another on Mudarabah/Musharakeh basis.

Many Islamic banks place their surplus funds with other Islamic institutions by means of bilateral murabaha transactions based on commodities or metals quite unconnected with the underlying business of the financed party under the murabaha. This is a huge market perhaps dominating all other Islamic transactions.While such transactions have been deemed to be Shariah-compliant because of a lack of alternatives, perhaps this acceptance in itself has stalled efforts to develop structures in which the murabahas are created to finance the underlying business of those requiring financing and in which the murabahas themselves are structured on the businesses' genuine trading goods and services.

The importance of investing in Islamic investment options, as discussed previously, lies in the prohibition of interest or Riba per Shari'ah laws. The compliance with Shari'ah laws offers significant drawbacks to the Islamic financial systems and money markets; however, the leading financial institutions, including the Banks, have found a way to circumvent the compliances by forming separate investment options.
The analysis further reveals that Sukuk &Mudaraba Investments are other popular options available to the Islamic banks in Bahrain to invest liquidity surpluses in. Of the five banks selected for the purpose of this research, investments were also made in Mudaraba and musharaka, but these investments were quite insignificant in comparison to the investments made in other options. It is, however, important to note that since only five banks were selected to conduct this research, it would not be completely logical to form an opinion as to the popularity or profitability of investing in the aforementioned options. Identifying this as a potential research gap, it would be more sensible to expand the focus of this research by including a larger number of Islamic banks in the sample in order to generalise the popularity of investment options available to Islamic Banks of Bahrain to invest liquidity surpluses in.

V. CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

In the past few years, the business model adopted by Islamic banks in Bahrain has changed significantly as it has moved in a direction where it becomes more susceptible to high liquidity surplus. This paper has aimed to explore the aspects of liquidity surplus management, investment options available to Islamic banks in Bahrain, liquidity surplus management, and the relationship between profitability and liquidity in Islamic banks of Bahrain.

5.1 Summary of Findings:

1. The liquidity surplus management in Islamic banks is more difficult and complicated than conventional banks because of the existing restrictions imposed on these banks from central banks and the need to adhere to the Shariaa regulations and standards.
2. In case of liquidity surplus kept unutilised, the resulting financial surplus has unacceptable opportunity cost in terms of missed investment opportunities and thus lowering profitability.
3. If the Islamic Banks are unable to meet or exploit such opportunities, cash balances will be held unutilised and once it reaches a particular threshold, the Bank would be liable to pay a zakat percentage of 2.5% even if it does not make a profit, causing a diminution of both liquidity and profitability.
4. The analysis further reveals that Sukuk &Mudaraba Investments are the most popular and lucrative options available to the Islamic banks in Bahrain to invest liquidity surpluses.

5.2 Conclusion:

The discussion presented in this research reveals that while conventional banks somewhat guarantee capital and a rate of return, the Islamic banking system, based on the profit and loss sharing principle, cannot guarantee a fixed rate of return on the investment. In a few cases, even the capital is not guaranteed, largely due to the fact that if a loss incurs, it must be deducted from the capital.

The discussion further develops an argument in favour of the need for Islamic banks in Bahrain to evaluate and strengthen their liquidity surplus management practices. It is important to note a key finding from the literature review- Islamic banking practices do not have an efficient capital market in Bahrain, without which, it would be impossible for Islamic banks to grow in the region. The banking sector in Bahrain is in dire need of price transparency and liquidity to enhance the prospects for Islamic banks to prosper.

The research reveals that Islamic banking practices are quite prominent in Bahrain. The liquidity surplus for these banks has been on the rise ever since the onset of the financial crisis in the year 2008. Interestingly, the growing consensus suggests that the financial crisis had only a little impact on the liquidity surplus in Islamic banks operating in Bahrain.

Because of the fact that most conventional liquidity management tools violate the Shari'ah laws, Islamic banks tend to sustain higher liquidity ratios in comparison to conventional banks. As a result, the policies formulated by Islamic banks in Bahrain are devised in accordance with Shari'ah laws. Sukuk, for instance, has been used extensively by Islamic banks in Bahrain as an investment option. The data analysis also supports the same as Murabaha has emerged as the second most popular option for Islamic banks to invest their liquidity surplus in, Wakala, Musharaka, and Mudharaba are other important options which the five Islamic banks have chosen to invest in.

Although it is commonly believed that Islamic Banks run on the profit-sharing principle, from the discussion presented in this research, it is evident that this equity principle has somewhat yet to be operationalised. The discrepancies pertaining to Shari'ah laws tends to imply that the Mudarabah deposits are treated similarly to how fixed deposits are treated in conventional banking systems. In these instruments, the risks are borne entirely by the bank's capital. Based on the information presented in this research, it would be logical to conclude that the Islamic banks in Bahrain may not be able to find their competitive edge in commercial ventures or conventional banking investment instruments, as they are stipulated by the Shari'ah laws.

From the data analysis, it can be observed that the popularity of Islamic investment options has been on the rise in the last five years. For instance, the financial information for the five banks used in this research reveals that, a significant investment of non-core banking resources is in sukuks which represents on average 63% of total core-banking investments over a 5-year period.

The analysis goes on to complement the findings of Literature Review as Murabaha has emerged as the second most popular investment options with 48% of total investments made by the Islamic banks of Bahrain going to Murabaha. Other popular investment options include Mudaraba, Musharaka, and Wakala Investments. A key reason for their popularity may have to do with the fact that these deposits are highly liquid and can be withdrawn as and when required at a very short notice period.

5.3 Recommendations

Based on the analysis and discussion presented in this research, it has been concluded that Islamic Banks in Bahrain have struggled with liquidity management for quite some time now. It is, therefore, vital to make recommendations for identifying viable investment options for investing the liquidity surplus. Thus, the following recommendations can be made:

- To support the ways and means of working to recommend strategic Islamic banks so as to enable them to operate easily and efficiently and employ liquidity effectively, which serves the economy of the country as a whole.
- It is suggested that the Islamic banks should have a standby account to invest any surplus of liquidity. This standby account must accrete amounts based on threshold values suggested by their own polices such that any liquidity increase of working capital requirements is added to this account. The banks may use this balance as a reserve as and when required.
- Consolidate the efforts of Islamic banks at the local and international levels and through the involvement of Shariah scholars and specialists in Islamic banking to create financial instruments to manage liquidity in Islamic banks, taking into account the decisions of the jurisprudential councils and the Shariah standards of the Accounting and Auditing Organization for Islamic Financial Institutions.
- The need for the presence of financial experts to a high degree of efficiency to manage liquidity in Islamic banks, and work hard to develop the environment in which these banks operate.
- As discussed in the previous sections of this research, several Islamic investment options are available for Islamic banks in Bahrain. Of these options, as the research reveals, Sukuk, Murabaha and Mudaraba have been the most popular investment options. These options may serve as an alternative to the standby account recommended above.
- Banks' fixed deposits, which are short-term deposits, must be encouraged. Although these deposits are less liquid than Central Bank Sukuk/deposits, discussed above, they can be redeemed quite easily on short notice. These may prove to be a vital investment option for Islamic Banks in Bahrain.

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