

# Chapter 12

## Exploring the Determinants of Organizational Resilience in Islamic Banks: A Framework Development

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### **ABSTRACT**

*Resilience has been viewed as the critical component behind Islamic banking organizations' ability to respond and compete during crisis. However, there seems to be scarcity of empirical attempts to explore the determinants of stronger resilience in Islamic banking organizations. This article is an attempt to develop a managerial framework of Islamic banking organizations that identifies these determinants of improved resilience. Two case studies were conducted in two Islamic banks in Palestine. Data were collected via semi-structured interviews, observations, and archival documents, followed by the use of the Resilience Benchmark Tool (RBT). Cross-case analysis of the results shows that organizational resilience in banking organizations is characterized by two dimensional determinants for improving organizational resilience; planning and adaptive capacity along with a set of ten resilience enhancing factors. The article demonstrates important dynamics of how resilient capabilities can be incorporated into the managerial models of banking organizations during turmoil.*

### **1. INTRODUCTION**

Generally speaking, turbulent events that can affect organizational performance take many forms, such as the 2004 Indian Ocean Tsunami, the 2010 Haiti and Chile Earthquakes and the recent global financial crisis. Natural disasters, pandemic disease, economic recession, system failures and human errors can all pose both a potentially unpredictable and severe threat to the continuity of an organization's operation.

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## ***Exploring the Determinants of Organizational Resilience in Islamic Banks***

Therefore, the concept of resilience has been reaching increasing prominence both within academia and industry over recent years (Bhamra et al., 2011). The Concept of resilience is grounded in the roots of ecology and social psychology and has expanded to address various areas including organizations, industrial safety, supply chain management, infrastructure development, crisis, and disaster management. Although the context and meaning of resilience may vary across disciplines, the fundamental principle of resilience remains the same (De Florio, 2015). Resilience relates to the capacity of a system to absorb discontinuities and disturbances, such as natural disasters and other potential crises, and retain essential system structures, processes and feedbacks (Adger et al., 2005). As highlighted by several authors (Seville et al., 2006; Crichton et al., 2009; Gibson and Tarrant, 2010; Lengnick-Hall et al., 2011), through the cultivation of resilience within a system, it may be possible to not only overcome potential disruptions but transcend these events and develop towards a more robust system.

Banking organizations, similar to other organizations, are subject to a diverse and ever-changing environment. The threats that turbulent environment possess can vary in both severity and frequency and may originate internally or externally to banks. An event in one area of the environment can often have disastrous effects on these organizations (Juttner, 2005). The recent global financial crisis has been described as the worst in history. It has adversely affected the global banking organizations performance and profitability. Researchers argued that the major cause of this crisis is financial imbalances. Nevertheless, there is no full agreement about the origin of these financial imbalances. As a result, several banks collapsed and many others were bailed out by their governments. Other large banks, such as Royal Bank of Scotland and Citibank, have survived this crisis but suffered tremendous losses (Acharya and Schnabl, 2010). Conversely, during the financial crisis, researchers and financial reporters witnessed an unprecedented better cumulative profitability and performance of Islamic banking organizations than conventional banks.

Islamic Banks and Conventional Banks have similar roles. They manage all types of risks such as liquidity risk, operational risk and others. The main difference between them is that Islamic Banks operate in accordance with the rules of Islamic principles. The aim of Islamic Banks is not only the creation of maximum returns on capital but also the achievement of socio-economic goals of the Islamic region, such as full-employment, high economic growth rate, equitable distribution of wealth and income, socio-economic justice (Ouerghi, 2014). Central to Islamic financial system adopted by Islamic Banks is the fact that banks are not allowed to benefit from lending money or receiving money from customers. This means that earning interest is strictly prohibited as a method of creating profit. Instead, Islamic Banks can create profit by adopting the principles of trading through selling approved commodities and services to its customers. Therefore, Islamic Banks are expected to trade in Islamic Law-compliant investments using the money deposited by customers, and then profits are shared by the two parties (Hassan and Mervyn, 2007). There are three main schemes that can contribute to the profits gained by Islamic Banks; a) buying a commodity or goods for a customer then leasing it back to them (i.e. Ijara), b) selling a commodity or goods that are owned by the bank to its customer based on mutually negotiated margin (i.e. Murabaha), c) and creating a joint venture where the customer and the bank contribute to a capital for specific project or operation with an agreement about shares and returns for each party (i.e. Musharaka) (Ouerghi, 2014). However, in order to achieve socio-economic justice, Islamic Banks are required to comply with the Islamic law of *Zakat* inherited in Islam; a mechanism for the redistribution of wealth in the Islamic society. The amount of *Zakat* is 2.5 percent on assets held for a complete year. The most important purpose of *Zakat* is to reduce differences in the Islamic society by enabling the poor/needy to have a normal and decent life (Hassan and Mervyn, 2007).

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