

# INTERNATIONAL JOURNAL OF RESEARCH IN COMMERCE & MANAGEMENT

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**ISLAMIC BANKING AND IJARAH FINANCING IN PAKISTAN****KALSOOM AKHTAR****LECTURER****THE DEPARTMENT OF MANAGEMENT SCIENCES****ISLAMIA UNIVERSITY OF BAHAWALPUR****BAHAWALPUR****AIMAN CHISHTI****STUDENT****DEPARTMENT OF MANAGEMENT SCIENCES****ISLAMIA UNIVERSITY OF BAHAWALPUR****BAHAWALPUR****SAMRA KANWAL****STUDENT****DEPARTMENT OF MANAGEMENT SCIENCES****ISLAMIA UNIVERSITY OF BAHAWALPUR****BAHAWALPUR****NADIA ASLAM****STUDENT****DEPARTMENT OF MANAGEMENT SCIENCES****ISLAMIA UNIVERSITY OF BAHAWALPUR****BAHAWALPUR****SOBIA ASLAM****STUDENT****DEPARTMENT OF MANAGEMENT SCIENCES****ISLAMIA UNIVERSITY OF BAHAWALPUR****BAHAWALPUR****ABSTRACT**

Islamic banking came into existence four decades ago and now it is very popular all over the world due to its unique attraction and continuous growth. Muslims accept it because of its religious prospects and its growth trend which is increasing day by day. Islamic banking system increases rapidly not only in Muslim world but other Non-Muslim countries also adopting this system. It is getting more attention now-a-days. Islamic financing is different from Conventional financing in all respect. Ijarah is the one of highly popularize product innovation by Islamic banks. It is also known as AITAB (al Ijarah Thumma Al Bai'). Conventional Banks are using leasing concept which is opposite to the Ijarah financing. Pakistan is among the pioneer countries that embedded Islamic banking concept at early stages. In present scenario Pakistan come into the list of major player of Islamic banking industry. The aim of this study is to understand Islamic banking system and its challenges, and future growth. Further this study investigates the nature and difference of Ijarah financing compared to conventional banks and also sees its growth, challenges and future prospects.

**KEYWORDS**

Islamic bank, Ijarah financing, Islamic banking system in Pakistan.

**ACRONYMS**

IBI-Islamic Banking Industry

SBP-State Bank of Pakistan

AITAB- Al Ijarah Thumma Al Bai'

**INTRODUCTION**

Establishment of Pakistan was based on the name of Islam. Islam prohibits taking or giving interest (riba) on any monetary transactions and this leads towards the concept of Islamic banking. It introduced 4 decades ago and getting more attention now-a-days. First Islamic bank was established in 1963 in Egypt, then in 1973 started at Jeddah; Saudi Arabia. And then it spread all over the world gradually. Today there are about 300 Islamic banks and financial institutions in 75 countries having a paid-up capital of more than 13 billion dollar, having an average annual growth of 15%. It is estimated that its growth increased in future.

Financial system of the Pakistan adopted this concept after 60's. In 1962 it is stated in 2<sup>nd</sup> constitution to remove the interest factor from the economy of Pakistan particularly from banking sector. In 1991, Supreme Court of Pakistan ordered the interest free economic structure until 30<sup>th</sup>-june-1992. It was little success rate till 1980s but in 2001 SBP took solid steps in order to induced Islamisation in Pakistan's financial systems. For this SBP agreed upon the parallel banking approach where conventional and Islamic banks both can be operated together and worked independently. Mezan bank was the first bank in Pakistan, which was established on this new concept of Islamic banking. So for the first time in January 2002 Al Meezan investment bank took license from SBP to operate as Meezan Islamic bank from 20<sup>th</sup> March 2002.

The existing structure allows three types of Islamic banking institutions in the country. (State Bank of Pakistan, 2012)

- a. Full fledged Islamic banks,
- b. Islamic banking subsidiaries of conventional banks, and
- c. Islamic banking branches (IBBs) of conventional banks.

The ethical, native and fair mode of finance is Islamic finance which is purely based on Islamic laws. There are difference between Islamic finance and Conventional finance. These differences are consequent from three main prohibitions by the *Shari'ah Islami'ah*. The first prohibition is against *riba'* (usury), which is deliberate to avoid misuse and to maximize social benefits. Secondly, Islam prohibits *gharar* (uncertainty) in activities. *Gharar* is considered as not Islamic because it is reason of injustice to another party. The third prohibition is against *maisir* (gambling). For the development of Islamic banking and finance, product innovation is a key factor to get competitive edge. The financial instruments of Islamic banking or its products are consisting of nine types of products like Mudarabah (profit & loss sharing), Musharakah (partnership or joint venture), Murabaha (cost plus sale contract), Ijarah (leasing), Salam (sales contract), Sukuk, Takaful, Qarz-e-Hasna, and Istisna. These are according to Shariah board regulations. The first objective of this study is to observe the nature of *Ijarah* financing and its differences with conventional lease financing from the legal and accounting perspectives. The second objective of this study is to discuss different types of products offered by Islamic Banking, its growth in Pakistan, challenges and future forecast of Islamic banking and Ijarah.

Islamic hire-purchase present two new contracts with new modes of financing namely *al-ijarah thumma al-bai'* (a contract of leasing ending with sale) or *al-ijarah muntahiya bittamlik* (a contract of leasing ending with ownership). It is famously known as AITAB. *Ijarah* is basically the Arabic word used for leasing. *Ijarah* means to give something on rent or the "contract of exchange". AITAB still faces some challenges like both customers and Bank's staff has lack of awareness, lack of Shariah framework, difficult documentation process and competition with conventional banks. But it is also estimated that in future Islamic banks overcome all these Challenges and grow rapidly because it is accepted by Muslims and non-Muslims also..

## AIMS AND OBJECTIVES

The objective of this study is to observe:

- What is Islamic Banking and its background, and principles.
- The nature of Ijarah financing.
- Difference of Ijarah financing and conventional lease financing.
- Discuss different types of products offered by Islamic Banking.
- Growth of Islamic Banking in Pakistan.
- Challenges and future forecast of Islamic Banking and Ijarah financing.

## IMPORTANCE OF THE STUDY

This study examines the nature of Ijarah financing in different banks of Pakistan and its difference with conventional lease financing from the legal and accounting perspectives. There is a great difference between Islamic finance and Conventional finance. This difference is consequent from three main prohibitions by the *Shari'ah Islami'ah*. The first prohibition is against *riba'* (usury), Second is *gharar* (uncertainty) in activities and the third prohibition is against *maisir* (gambling). This study also discuss different types of products offered by Islamic Banking, growth of Islamic Banking in Pakistan, challenges and future forecast of Islamic Banking and Ijarah. Some recommendations have also been made to overcome all these Challenges because it is estimated that in future Islamic banking could attain more market shares and grow rapidly because of its wider scope in Muslim and non-Muslim countries also by overcoming all these challenges.

## LITERATURE REVIEW

### ISLAMIC BANKING & ITS HISTORY

Khan and Bhatti (2008) found about four (4) decades ago, the concept of the Islamic banking and finance came into existence. In late 1940s, Islamic banking got a great attention and in the next two (2) decades, a model was made which was adopted by the Middle Eastern countries to have their own banks. According to Ahmed (2009), 1<sup>st</sup> Islamic bank in Egypt was established in 1963. In 1973, Islamic financial system was started at Jeddah and Saudi Arabia. Khan and Bhatti (2008) wrote that in 1970s, many Islamic banks came into existence like Nasser Social Bank Cairo (1972), Islamic Development Bank (IDB) (1975), Dubai Islamic Bank (1975), Kuwait Finance House (KFH) (1977), Faisal Islamic Bank of Sudan (1977) and Dar Al-Maal Al-Islami (1980). In early 1980s, three Muslim countries that include Iran, Pakistan and Sudan change their economies and fiscal segment according to Islamic laws. Moreover, to enhance their deposits from the Middle East and Muslims customers in local markets, many Western financial market players like Citibank, Goldman Sachs, Kleinwort Benson and others made their own Islamic subsidiaries. Due to creativity and variety of products the Islamic banking and finance system is growing day by day. The growth is in the areas like Sukuk, Takaful, hedging funds, Mutual Funds, private equity and assets management, wealth management, real estate, corporate finance, liquidity management, treasury, derivatives, swaps, future and forward market, Islamic Stock Exchange and Dow Jones Islamic Index. Ahmed (2009) found that in 1983, many conventional banks were changed into Islamic banks in Malaysia. Moreover, in 1990's decade Islamic banking practices were started all over the world especially in the Muslim countries.

According to Khan and Bhatti (2008), main growth of Islamic banking and finance activities is around three parts of the world including Middle East, South Asia and Southeast Asia. The Middle East is a motherland of Islamic banking and finance and it is tremendously occupied by Muslims. Middle Eastern countries are Bahrain, Iran, Jordan, Kuwait, Lebanon, Qatar, Saudi Arabia, Syria and United Arab Emirates. South Asian countries include Bangladesh, Afghanistan, India, Maldives and Pakistan. Islamic practices are being followed in Pakistan and Bangladesh only but there are chances that Islamic banking will be start in Afghanistan and India in near future. Three Southeast Asian countries like Indonesia, Malaysia and Singapore are supporting the broad and highly developed version of Islamic banking and finance in their areas. Recently, the Islamic banking and finance practices are also increasing in Sudan. Many Western and European countries are also promoting the Islamic banking and finance in their region. These countries include Australia, United Kingdom and United States of America & Canada.

Today there are about 300 Islamic banks and financial institutions in 75 countries, having a paid-up capital of more than 13 billion dollar, controlling assets of value 300 dollar to 500 dollar and investments of 500 billion dollar to 800 billion dollar, having an average annual growth of 15%. According to an estimation Islamic banking and finance industry has aimed to have 40% - 50% of total savings of the Muslim community (estimated as large as 1.5 billion) in all over the world in upcoming 8-10 years (Alam, 2006; Arekat, 2006; Cader, 2007).

## BASIC PRINCIPLES OF ISLAMIC FINANCING

Shariff and Rahman in International Journal of Islamic Financial Services illustrated that the ethical, native and fair mode of finance is Islamic finance, which derives its principles from the *Quran* (The revealed book of Muslims), the traditions of the Prophet Muhammad (peace be upon him), and the *Shari'ah Islami'ah* (Islamic law), which is based on the *Quran* and *Sunnah*. There is apparent difference between Islamic finance and 'conventional' finance (Qureshi and Millet, 1999). These differences are consequent from three main prohibitions by the *Shari'ah Islami'ah*. The first prohibition is against *riba'* (usury), which is deliberate to avoid misuse and to maximize social benefits. Secondly, Islam prohibits *gharar* (uncertainty) in activities. *Gharar* is considered as not Islamic because it is reason of injustice to another party. The third prohibition is against *maisir* (gambling).

*Riba'* can be defined as preset payment over and beyond the actual amount of the principal. It is prohibited because while profit is reasonably allowed, the parties cannot set a certain profit. This is based on the principle of "uncertain gains" which, on a strict understanding, even not allow an responsibility from the customer to repay the borrowed principal plus an amount to take into account inflation. Injustice (*zulm*) is another reason to prohibited Riba and Islam is against all forms of injustice and misuse and pleads for an economic system, which *Gharar means risk and uncertainty and it is derived from Arabic*. It is a kind of sale, which involves giving a commission, which the seller is not sure to fulfill like the sale of fish before they are caught. *Gharar* is not considered good because it

affects both the subject-matter and the price, which can create unearned profit or an unacceptably huge loss. To avoid the risk in sale Gharar is considered prohibited.

In Islamic law, Riba is prohibited as it is clear from Quran. In Surah Al-Imran, Allah said that;

**“O you who believe! Do not devour Riba multiplying it over and keep your duty to Allah that you may prosper” (3:130).**

This prohibition against Riba is strict, complete and unequivocal. The Holy *Qur'an* in verse 278 of Surah Al-Baqarah states:

**“O ye who believe! Fear Allah and give up what remains of your demand for riba, if ye are indeed believers”,**

And verse 2: 279 says:

**“If you do it not, take notice of war from Allah and His Messenger, but if ye turn back, ye shall have your capital sums. Deal not unjustly and you shall not be dealt with unjustly”.**

According to Surah Al-Rum (39), Al-Nisa (160-161) and Al-Baqarah (275-281), fixed interest is prohibited. Gharar indicates the assumptions and guesswork. Islamic banking includes the Islamic finance and all those dealings which have no interest.

## FINANCIAL INSTRUMENTS/PRODUCTS OF ISLAMIC BANKING

For the development of Islamic banking and finance, product innovation is a key factor to get competitive edge. As the rate of globalization increase, secure competitiveness increases the demand for more strong and flexible Islamic banking product. As the primary focus has been on institutional building and financial infrastructure development, it is also important to give some attention to raising the variety of products and services to fulfill the needs and requirements of customers and increase the overall efficiency of business.

The financial instruments of Islamic banking or its products are consisting mainly on 9 types of products like Mudarabah (profit & loss sharing), Musharakah (partnership or joint venture), Murabaha (cost plus sale contract), Ijarah (leasing), Salam (sales contract), Sukuk, Takaful, Qarz-e-Hasna, and Istisna. These are according to Shariah board regulations.

**MURABAH:** Siddiqui (2008) stated that there are 3 parties involved in a Murabaha contract. i.e. seller, buyer and bank as an intermediary. According to this contract, bank buys the merchandise preferred by the buyer from the seller and sells to the buyer at a rate which involves the cost of the purchase and a pre-agreed profit. Murabaha contract involves competitive pricing, minimum limitations and flexible repayment conditions. This contract is used for financing raw material, equipment, machinery, real estate and creditor durables.

**MUSHARAKAH:** According to Siddiqui (2008), such a contract is called Musharakah when debtor/purchaser does not search for 100% bank financing of the project but contributes some of his own equity capital. In this profit and loss sharing system, two(2) parties are involve and profit is shared according to pre determined percentage whereas loss sharing depends upon the amount of equity contributed. This contract is used for financing trade, imports and to issue letters of credit. It is also used in agriculture and industry sector.

**MUDARABAH:** Siddiqui (2008) said that in this contract, there is no equity partnership but only Profit & Loss Sharing. This contract is between bank and customer. According to this contract, bank lends the capital to the investor/consumer and both parties share profit according to an agreed ratio and only bank bears all the losses if occurred. If customer mismanages the capital, then customer is held the legally responsible for losses. This contract is illustrated in balance sheet of the bank.

**SALAM:** Siddiqui (2008) wrote that it is the future sales contract. According to this contract, bank pays the price of the commodity in advanced in terms of cash to the seller and delivery of the product will be done in future. On the delivery date, bank receives the product and sells it either for cash or on credit. Bank also can permit to the seller to sell the product on its behalf to the third party against fees or without fees. This contract can be used to meet the capital requirements as well as cost of operations of farmers, industrialists, contractors or traders. This facility is also used by the craftsmen and small producers.

**IJARAH:** According to Siddiqui (2008), it is a contract in which goods are hire /purchase at least price. In Islamic banks this facility is provided by two sub contracts. First, the bank signs a purchasing contract with the seller for the desired commodity of the buyer, pays and gets the commodity from the seller. Second, bank signs a leasing contract with the buyer in which commodity is leased to the customer and permit him ownership of the asset after payment of lease installments and outstanding charges. This facility is used for sale of vehicles, equipment or property to start or run the operations of business. Usually the leasing contract is used for dealings in real estate, cars, computers and machinery.

**SUKUK:** According to Nanava (2007), Sukuk is the asset-backed security that follows the Islamic rules and Shari'ah principles on financial transaction. Sukuk contract may be formed either through Islamic bonds or securitization of assets. Funds of Islamic bonds are used for specific projects and bondholders get their income later. While asset securitization is started with the recognition of assets of company that have a need to increase their finances through securitization.

**TAKAFUL:** Nanava (2007) stated that it is an insurance scheme that follows the Shari'ah principles. This contract is based on trust and collaboration of parties joined for common interest and financial resources. Policyholders/Participants of this scheme contribute certain amount of capital and Takaful operator manages the insurance business on behalf of policyholders. Takaful operators receive shares or agency fee for their services.

**QARZ-E-HASNA:** Siddiqui (2008) stated that this facility is for the poor people of society like needy students or small rural farmers. These loans have negative NPVs for the banks. Traditional banks don't have such interest free loan facility for needy people. This facility is manifested funded through charities and grants or scholarships.

**ISTISNA:** SBP (2008) defined Istisna as, this facility is used to finance the manufacturing of commodities, construction of houses, plants, projects and building of bridges, roads and highways. In this type of loan, constructor or manufacturer receives cash in advance or in future and delivery is made in future.

### IJARAH & ITS FINANCING:

In *Ijarah* one party enjoys the benefit which they take in term of services by another party in return for a concern for the services rendered and from the use of an asset. Simply *Ijarah* is “contract of exchange”. Several scholars agree that *Ijarah* is a contract on using the benefits or services in return for reward (Kharofa, 1997).

To understand the nature of *Ijarah* and its differences with conventional leasing is very important. So the first objective of this study is to observe the nature of *Ijarah* financing and its differences with conventional lease financing from the legal and accounting perspectives. Consequently, the second objective of this study is to discuss different types of products offered by Islamic Banking, its growth in Pakistan, challenges and future forecast of Islamic banking and *Ijarah*.

Literally, *Ijarah* means to give something on rent. As a term of Islamic *fiqh*, *Ijarah* can also refer to wages paid to a person in contemplation of the services rendered by him. In the perspective of Islamic banking, *Ijarah* can be defined as a process by which the “usufruct of a particular property is transferred to another person in exchange for a rent claimed from him/her” (Hairetdinov, 1998). This is done even before the time of Prophet and was popular amongst the *fuqaha*.

It is one of the modern approach which is an alternative product to conventional hire-purchase. The major difference between them is that, Islamic hire-purchase is an exclusive contract relating a combination of two different contracts, and also invoking a number of legal and *Shari'ah* issues. At some stages it applies important rules on leasing and sale in the light of *Shari'ah*.

Islamic hire-purchase has developed in numerous stages. The proposal of Islamic hire purchase developed when the scholars introduced a new product via reasoning (*Ijtihad*) based on the Islamic traditional contract of *ijarah* and *al-bay'*. Thus, the Islamic hire-purchase presents two new contracts with new modes of financing namely *al-ijarah thumma al-bai'* (a contract of leasing ending with sale) or *al-ijarah muntahiya bittamlik* (a contract of leasing ending with ownership). It is famously known as AITAB, and widely used in motor vehicles financing however after some time also applied by some banks in corporate financing. This paper focuses on AITAB due to its wider use and demand in the present banking operation. AITAB is still facing problems which are specially related to insufficiency of *Shari'ah* narrow framework to oversee its practice. Still there is no specific law introduce to support AITAB operation.

According to El-Din and Abdullah (2007) Islamic Banking is increasing day by day from the last two decades. It spread in all over the world in no time. Countries especially with dual banking system adopting it more, like Malaysia, Saudi Arab and Egypt. Dual banking system make country system more controlled and tightly governed. Here there is a separate regulatory authority for Islamic banks and this system increase the intensity of the competition. This intense rivalry

leads Islamic banks to explore more opportunities and they have to introduce more innovative products in order to survive in this stiff competition. One of the innovation come in result of this scenario is *Ijarah wa-iqtina*, which is one of the financing approaches of hire-purchase according to Shariah rules and regulation.

*Ijarah* is basically the Arabic word used for leasing. It is growing importance in today's world because every person cannot afford to buy a house or a land by their own. This is a contract where three parties involved; customer, financing company (Islamic banks) and vendor. For instance we take an example to justify this whole mechanism, let suppose that customer wants to take a car from Islamic bank on leasing, then: (El-Din and Abdullah, 2007)

- The role of Islamic bank comes here as it will purchase car from car dealer on the demand of customer.
- Then bank will rent this vehicle to customer at agreed rate and for particular time duration.
- Ownership doesn't transfer to customer; customer is only allowed to use that vehicle for a specific time period.
- Customer is obliged to pay insurance and road tax with fixed rental payment.
- At the end of this contract customer (hirer) has given two choices; either return this vehicle back to Bank or enter into second contract which is based on purchase of this vehicle from the owner (bank).
- While by purchasing that vehicle entitled customer (lessee) as a owner of the vehicle.

**DIFFERENCES BETWEEN CONVENTIONAL HIRE PURCHASE AND ISLAMIC HIRE PURCHASE FROM SHARIAH PERSPECTIVES**

Item	Conventional Hire Purchase	Islamic Hire Purchase
Terms	<ul style="list-style-type: none"> <li>▪ Type of Loan</li> <li>▪ Interest rate</li> <li>▪ Hiring charges</li> <li>▪ Late payment interest</li> </ul>	<ul style="list-style-type: none"> <li>▪ Financing mode</li> <li>▪ Profit rate</li> <li>▪ Markup</li> <li>▪ Late payment charges</li> </ul>
Eligibility based on	Good credit rating	Not involved in immoral activities against Shariah
Goods	Limited to consumer goods, motor vehicles & non-Act goods (corporate)	Applicable to all types of goods
Contract	one standard contract	2 Aqad in sequential contracts [a hiring agreement (' <i>aqad ijarah</i> ') and a sale and purchase agreement (' <i>aqad bai'</i> )]
Purchase Price/Installments	(cost price x interest rate)/months	(cost price + profit)/no. of payments
Profit Margin /Interest Rate	Floating based on the annual rate, decided up front	Determined based on market value
Responsibility	Hirer/customer bears all costs of maintenance	Owner bears basic and structural maintenance

Source: El-Din and Abdullah (2007)

**RESEARCH METHODOLOGY**

This research is descriptive nature of research. In this research paper our main purpose is to collect data on Islamic banking, its growth trends from last few years in Pakistan as well as globally, *Ijarah* and its types, *Ijarah* financing in Pakistan and Banks in Pakistan who is offering different types of *Ijarah*. This study also explores the challenging facing by *Ijarah* financing and future prospectus of *Ijarah*. We collect these above mentioned data from different sources including; SBP reports, articles, books, Islamic bank's websites, Commercial banks which have Islamic banking branches, we collected data from their official websites and from their annual financial statements, and by electronic media.

**ISLAMIC BANKING IN PAKISTAN**

In 1947 Pakistan came into being in the name of Islam and the purpose behind that to build a homeland where Muslims can live their lives freely and according to the teachings of Quran and Sunnah. According to Ahmed (2009), in the 1<sup>st</sup> constitution of Pakistan in 1956 Islam was stated as an official religion of country where all the rules, regulations and laws would be according to the teachings of Quran and Sunnah. In 1962, 2<sup>nd</sup> constitution was formed to remove the interest factor from the economy of Pakistan particularly from banking sector. In 1973, the purpose of 3<sup>rd</sup> constitution was the removal of interest-which is also called Riba- as early as possible. So the discussion was started in 1980s about the creation of different alternatives to change interest based monetary arrangements in the economy. So finally in 1991, Supreme Court of Pakistan ordered the interest free economic structure until 30<sup>th</sup>-june-1992. In the year 2001 State Bank of Pakistan defined the criteria for the establishment of a complete and a private Islamic bank. For the first time in January 2002 Al Meezan investment bank took license from SBP to operate as Meezan Islamic bank from 20<sup>th</sup> March 2002.

All over the world due to the rapid changes in technology and establishment of more means of communication Islamic banking networks had moved to other countries and it still is continuously expanding in both Muslim and non Muslim countries including USA, Malaysia, UK, Canada, Iran, Qatar, Kuwait and Spain etc (Rashid et al., 2012).

The Islamic banking zone is emerging extremely from many of the previous years and also has the ability to grow further in future. In the year 2010 total assets owned by Islamic banks were Rs.477 billion, industry share of Islamic banking was 6.7% due to the value of total assets, total deposits with Islamic banks were Rs. 390 billion with the industry share of 7.2% and Net Financing and Investment was Rs. 338 Billion and their share in industry was 6.2% (Rashid et al., 2012). The Islamic banking industry's share has increases to over 7 % in 2011 from just 0.5 % in 2002. Islamic finance industry has been growing double in digits constantly (Shaikh, 2012).

Shaikh (2012) illustrated in his paper of "Islamic Banking in Pakistan: A Critical Analysis" that, In Pakistan there are 5 developed Islamic banks functioning and 13 conventional banks with Islamic banking branches in Pakistan. Estimated growth in total assets of the overall Islamic finance industry is about \$1.6 trillion by 2012. According to some reports assets seized by Islamic financial banks may rise by 5 times than the current level to attain more than the \$5 trillion mark in next few years (Source: Moody's Investor Service). This growth is due to some distinctive and intrinsic characteristics of Islamic financial products offered to its customers.

**TABLE 1: INDUSTRY PROGRESS AND MARKET SHARE (DEC 2011-DEC 2012)**

	Industry Progress			Growth (QoQ)			Share in Industry		
	Dec-11	Sep-12	Dec-12	Dec-11	Sep-12	Dec-12	Dec-11	Sep-12	Dec-12
Total Assets	641	742	837	12.8%	4.3%	12.8%	7.8%	8.1%	8.6%
Deposits	521	628	706	12.5%	4.2%	12.5%	8.4%	9.3%	9.7%
Net Financing & Investment	475	571	626	28.8%	8.2%	23.0%	7.4%	7.8%	8.1%
Total Islamic Banking Institutions	17	18	18	-	-	-	-	-	-
Total No. of Branches*	886	977	1097	-	-	-	-	-	-

Source: Islamic Banking Bulletin- State Bank of Pakistan (2012) (*Quarterly Unaudited Accounts*)

\*number includes sub-branches

TABLE 2: INDUSTRY PROGRESS AND MARKET SHARE (DEC 2003-DEC 2010)

Rupees in billion & shares and growth in percent								
	Dec 10	Dec 09	Dec 08	Dec07	Dec 06	Dec 05	Dec 04	Dec 03
<b>Total Assets</b>	477	366	276	206	119	71	44	13
Share in industry	6.7	5.6	4.9	4	2.8	2	1.5	0.5
Growth (YoY)	30.2	32.7	34	73.1	65.3	63.6	238.5	
<b>Deposits</b>	390	283	202	147	84	50	30	8
Share in industry	7.2 %	5.9%	4.8 %	3.8%	2.6%	1.8 %	1.3 %	0.4 %
Growth (YoY)	38.0	39.9	37.4	75	68	66.7	275	
<b>Net Financing &amp; Investment</b>	338	226	186	138	73	48	30	10
Share in industry	6.2	4.5	4.3	3.5	2.3	1.7	1.3	0.5
Growth (YoY)	49.8	21.3	34.8	89	52.1	60	200	
<b>Total Islamic Banking Institutions</b>	17	19	18	18	16	11	11	4
<b>Total No. of Branches*</b>	751	651	515	289	150	70	48	17

Source: Annual Accounts except for December 2010, data for which is based on Unaudited Quarterly Accounts \*number includes sub-branches  
Source: Islamic Banking Bulletin- State Bank of Pakistan (October-December 2010)

TABLE 3: PROVINCE WISE ADDITIONAL BRANCHES (DECEMBER 2012)

Province	Additional Number	Total Number	Share (percent)
Punjab	47	476	43.4
Sindh	38	369	33.6
Khyber Pakhtoonkhawa	16	120	10.9
Baluchistan	7	51	4.6
Gilgit Baltistan	2	4	0.4
FATA	1	4	0.4
Federal Capital	7	60	5.5
AJK	2	13	1.2
<b>Total</b>	<b>120</b>	<b>1097</b>	<b>100.0</b>

Source: Islamic Banking Bulletin- State Bank of Pakistan (2012)

## IJARAH FINANCING IN PAKISTAN

TABLE 5: FINANCING MIX

Rupees in billion					
	Dec-09	Dec-10	Dec-11	Sep-12	Dec-12
Murabaha	67.1	85.4	92.8	81.0	96.1
Ijarah	22.6	24.1	22.1	22.0	22.4
Musharaka	2.8	5.5	5.1	2.2	1.9
Mudaraba	0.6	0.3	0.3	0.3	0.6
Diminishing Musharaka (DM)	48.2	56.1	67.9	77.8	87.5
Salam	1.9	2.7	5.1	4.7	7.3
Istisna	9.8	11.0	9.3	12.8	15.7
Qarz/Qarz-e-Hasna	0.0	0.0	0.0	0.0	0.0
Others	5.7	4.9	9.2	8.9	10.5
<b>Total</b>	<b>158.6</b>	<b>190.2</b>	<b>211.8</b>	<b>209.8</b>	<b>242.1</b>
% Share					
Murabaha	42.3	44.9	43.8	38.6	39.7
Ijarah	14.2	12.7	10.4	10.5	9.3
Musharaka	1.8	2.9	2.4	1.0	0.8
Mudaraba	0.4	0.2	0.1	0.2	0.2
Diminishing Musharaka (DM)	30.4	29.5	32.0	37.1	36.2
Salam	1.2	1.4	2.4	2.3	3.0
Istisna	6.1	5.8	4.4	6.1	6.5
Qarz/Qarz-e-Hasna	-	-	0.0	0.0	0.0
Others	3.6	2.6	4.4	4.3	4.3
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Islamic Banking Bulletin- State Bank of Pakistan December 2009, December 2012.

## CHALLENGES IN THE OPERATION OF AITAB

Abdullah and Dusuki presented a paper at 4th International Islamic Banking and Finance Conference, there they mentioned number of issues that AITAB (*al Ijarah Thumma Al Bai'*) facing now-a-days. Shari'ah expert and bankers discuss or expressed these issues.

- Customers have lack of awareness about AITAB; even some say this that it is similar to conventional hire-purchase except for its Arabic name which sounds more 'Islamic'.
- There is also lack of experience among Bank officers, so they are unable to provide satisfactory information to customers.
- Dealer plays an important role between financial institution and a customer. So it is also necessary that dealer know all information related to AITAB then he can easily explain it Advantages and differences to customers.

- The documentation process is difficult and time consuming so customer prefer conventional facility.
- There is a high competition among conventional and AITAB because Conventional hire-purchase business is well established in market and its operations is easier as compare to Islamic hire-purchase
- Hire-Purchase Act (1967), protect customers to dishonest dealers but it also have some disadvantages :
  - ✓ Insufficient documentation in respect of *Ijarah*
  - ✓ Limited application to certain goods only
  - ✓ Involvement in elements of interest in calculation of term charges.
- Lack of Shari'ah Framework.
- No proper regulation and no understanding of Islamic law.

**FUTURE PROSPECTS OF AITAB**

There is a very bright future of AITAB. AITAB can be viewed in four aspects,

- Strong public acceptance
- Competitiveness
- Legal protection, and
- The proposed *Shari'ah* law of AITAB. (Abdullah and Dusuki).
- Muslim customers who know and understand its features and operations prefer it to conventional banking. AITAB charge 1% penalty for late payment, as compared to conventional banking which charge 8% penalty. Because of this advantage Non-Muslims also prefer AITAB.
- There is no more difference between AITAB and conventional banking but according to Hire-Purchase Act 1967, AITAB is relatively beneficial as compared to conventional because it provide to customer to use a fixed or variable rate in the transaction, protections of customers and guarantors and clear practice of recovery. It also charge very minimal penalty.
- To control the inadequacy of Hire-Purchase Act 1967, *Mu'amalah* Bill introduced the advantages of *Mu'amalah* Hire-Purchase Bill is its wider scope of application as compared to conventional hire-purchase. The law applies to all goods stated in the first Schedule.

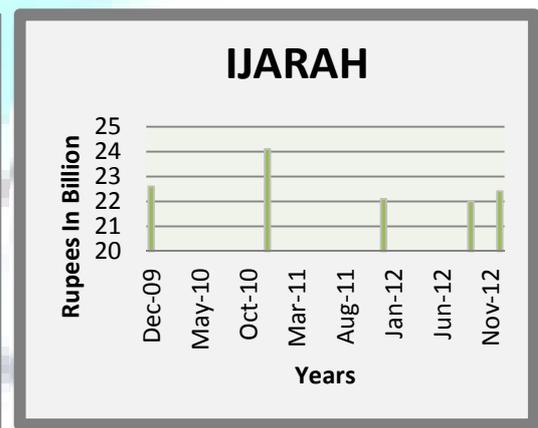
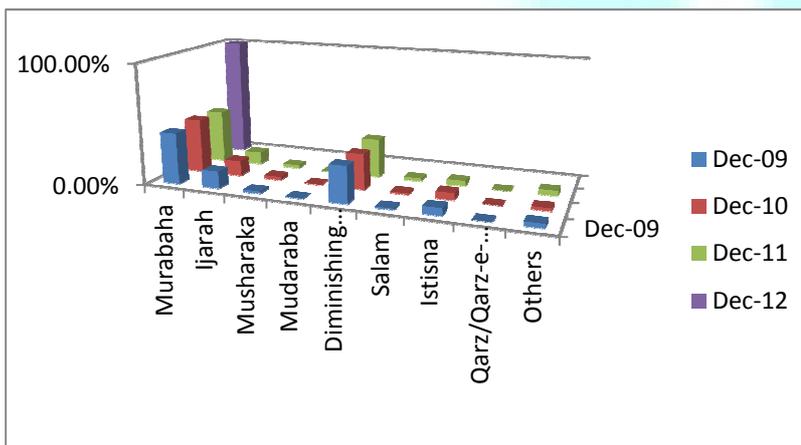
**RESULTS & DISCUSSION**

Islamic Banking Industry getting more popular in present era. It is showing positive growth rate not only in Pakistan from last decade as well as globally too. Ernst & Young published the World Islamic Banking Competitiveness Report 2013 in December 2012. They discussed Islamic banking growth trends in last few years globally and also highlighted some major economies who are major player of Islamic banking industry. These countries which have included in the report are; Pakistan, Egypt, UAE, Kuwait, Malaysia, Bahrain, Qatar, Turkey, Indonesia and Saudi Arabia. In this report they mentioned that an average annual growth rate over the past 4 years of Islamic banking is 19%, except 24% in 2011. According to the estimate Islamic banking assets are also growing to US\$ 1.3 trillion and equity base of 13 Islamic banks have more than US\$ 1 billion. Top 20 Islamic banks make up 55% of the total Islamic banking assets and are concentrated in 7 countries, including GCC, Malaysia and Turkey. But in 2011 the average ROE of Islamic banking sector was 12% while conventional banking sector was 15%. This decreasing ROE of Islamic banking sector was mainly due to the risky financial decisions, poor quality of asset, low earnings, & some losses. Its profitability can be improved up to 25%. In this report Ernst & Young also forecasted future growing rate of global Islamic banking industry, they predicted the assets of Islamic banking sector will reach in 2013 up to US\$ 1.8 trillion and in 2014 it will go more than US\$ 2 trillion. (State bank of Pakistan, 2012)

Table#1, table#2 shows that, according to SBP the Total assets of the Islamic banking sector of Pakistan during the period of 2003 to 2012 showing increasing trends throughout these years. In 2012 assets are of Rs.837 billion by 12.8% and 8.6% share in industry. The deposits during these years also increasing as it is Rs.202 billion in 2008, Rs.283 billion in 2009, Rs.390 billion in 2010, Rs.521 billion in 2011, Rs.706 billion in 2012 and its growth rate of deposit in 2012 is 12.5%. Total number of branches is also increasing day by day. In 2003 there were just 17 Islamic branches but then it increasing till now; in 2008 it was 515, in 2009 it was 651, in 2010 it increased by 751, in 2011 it become 886, and now in 2012 it reached 1097 no. of branches.

This bar-chart of *Ijarah* shows that *Ijarah* Financing in Pakistan which shows increasing trend in 2010 by 24.1 billion rupees but then it decreased in 2011 by 22.1 and then it increased by 0.3 billion rupees in 2012. (Illustrated in Table#5)

The diagram demonstrated below shows Islamic Banking product's percentage share. (From table#5) Murabaha and DM have more shares relative to all other mix. While *Ijarah* is showing increasing trends but its percentage share in all over the mix is low. In 2009 percent shares of *Ijarah* is 14.2% then its decreasing by 12.7% in 2010, 10.4% in 2011, and 9.3% in 2012 which is not good.



Above these discussion shows the increasing trends of Islamic banking industry globally. This continuous increasing growth rate makes Islamic banking more attractive. Many muslim and non-muslim countries rapidly adopting Islamic banking. But still there is some challenges which this industry is facing now-a-days. By overcoming these challenges this industry can enjoy more market shares and can show more growth rate in future.

**SOME OF THE CHALLENGES OF ISLAMIC BANKING ARE**

- Low expertise of Management and staff, they even did not have full knowledge of benefits or advantages of Islamic banking. There is a need to train them.
- Conventional Banking is well established, by this Islamic banking face high competition.
- There is low product innovation and diversification.
- Another big problem is that, peoples are not fully aware of Islamic banking. They consider that there is no difference between both of them.
- There is no strong legal framework of Islamic banking present; by the absence of Islamic law the enforcement of agreements in courts may require extra efforts and costs.

- There is "Monthly Payment Agreement" between customers and Banks. There is more risk in it because if customers default Bank has no security to overcome bank's interest.
- Products offer by all Islamic banks is similar, (90 per cent Murabaha, DM and Ijarah) but all have their own Islamic scholars who approve bank's products and they perform differently.
- Lack of consumer protection.
- Islamic banking just provides Ijarah and Murabaha. They do not deal with interest bearing bonds.
- There is also a liquidity issue in Islamic Banking.
- Islamic money market and capital market is not developed and very small.
- Lack of capital, so a lot of capital needed to compete with conventional banking system.
- Lack of It development as compare to conventional Banks.
- Market demand is good but as well as low.
- Lack of Islamic branches comparatively to conventional banks and it needed to increase at least 3 times more of present number of branches.

## CONCLUSION

About last four decades Islamic Banking came into existence and adopted by different Muslims and non-Muslims countries as well. Islamic Banking becomes more popular in present era. It is showing positive growth rate not only in Pakistan from last decade as well as globally too. However there is misconception by some people who consider it as similar to conventional financing. They have no full information about its operations and advantages. So, the purpose of this study is to understand the nature of *Ijarah* financing and its differences with conventional lease financing. Also discuss its growth in Pakistan as well as globally, *Ijarah* and its types, *Ijarah* financing in Pakistan and Banks in Pakistan who is offering different types of *Ijarah*. (Mentioned in Table#7, 8 in Annexure)

The results shows that, however Islamic Banking still face some challenges but its growth rate increased in future because customers who understand its operations and advantages accept it rapidly. According to SBP the Total assets of the Islamic banking sector of Pakistan during the period of 2003 to 2012 showing increasing trends throughout these years. In 2012 assets are of Rs.837 billion by 12.8% and 8.6% share in industry. The deposits during these years also increasing as it is Rs.202 billion in 2008, but it go more up as in 2011 it was Rs.521billion, Rs.706 billion in 2012 and its growth rate of deposit in 2012 is 12.5%. Total number of branches is also shows increasing trends day by day. In 2003 there were just 17 Islamic branches but then it increasing till now as; In 2008 it was 515, in 2011 it increased by 886, and now in 2012 it reached 1097 number of branches. This continuous increasing growth rate makes Islamic banking more attractive. Many countries all over the world are rapidly adopting Islamic banking system in their economies. Therefore, Islamic Banking has a very bright future in coming years.

## FUTURE PROSPECT OF IBI/IJARAH FINANCING & RECOMENDATION

- In future it replaces conventional banking system.
- Expand their branches in future, in the next five years 1200 branches to be opened.
- Pakistan is an Islamic republic nation and Islamic bank is link with religious proposition so people naturally preferred more Islamic banking system.
- There are more opportunities in Islamic banking because it is getting more attention by both Muslims and non-Muslims.
- Its shares also increasing (in 2012 shares in banking sector was 12%).
- According to Ernst & Young report they forecasted that IBI will reach in 2013 up to US\$ 1.8 trillion and in 2014 it will go more than US\$ 2 trillion.
- Providing seminar and training to management and staff which enable them to provide all information and advantages of Islamic banking & *Ijarah* financing to their customers.
- Experts should be hired in order to conduct detail market research to increases *Ijarah* financing and Islamic banking growth.
- Islamic banks should Increase target market and do more segmentation by facilitating more customers with more diversify products.
- Islamic banking industry (IBI) should focused more on its R & D in order to introduce more innovative products.
- IBI should do more research to investigate consumer behaviors for *Ijarah*.
- IBI should consult with experts of Shariah and take their opinions and advices while designing new products or transforming existing products which enables them to give better services according to Islamic laws.
- Should spread more awareness of *Ijarah* financing by increasing promotions and conducting seminars, workshops and programs.
- IBI should integrate with e-commerce by providing product and services directly to customers through internet, and this direct approach will increase sales and customer cycle.
- For increasing *Ijarah* financing IBI should hired expert or skilled HR.
- IBI should create a separate Shariah body where Islamic scholars take all decisions and it will enable banks to perform and operate on Quran and Shariah rules and regulation.

## LIMITATIONS OF THE STUDY

This study focuses just on the nature of *Ijarah* financing in different Islamic and commercial banks of Pakistan and it determines the difference of *Ijarah* financing and conventional lease financing. But this paper has not focus on the other financial instruments or products offered by Islamic banks in Pakistan.

## SCOPE OF THE FUTURE RESEARCH

This paper emphasizes on Islamic hire purchase (*Ijarah*). Scope of the future study can be widened by doing further research on other Islamic banking instruments like *Mudarabah*, *Musharakah*, *Murabaha*, *Ijarah*, *Salam*, *Sukuk*, *Takaful*, *Qarz-e-Hasna*, and *Istisna*.

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**ANNEXURE**

**FIGURE 1: ISLAMIC BANKING BRANCH NETWORK (As Of December 31, 2012)**

	Name of Bank	No of Branches	
Islamic Banks	<i>AlBaraka Bank (Pakistan) Limited</i>	92	
	<i>BankIslami Pakistan Limited</i>	88	
	<i>Burj Bank Limited</i>	67	
	<i>Dubai Islamic Bank Pakistan Limited</i>	100	
	<i>Meezan Bank Limited</i>	310	
		<b>657</b>	
Islamic Branches Of Conventional	<i>Askari Bank Limited</i>	33	
	<i>Bank AL Habib Limited</i>	13	
	<i>Bank Alfalah Limited</i>	110	
	<i>Faysal Bank Limited</i>	52	
	<i>Habib Bank Limited</i>	33	
	<i>Habib Metropolitan Bank Limited</i>	4	
	<i>MCB Bank Limited</i>	27	
	<i>National Bank of Pakistan</i>	8	
	<i>Silkbank Limited</i>	7	
	<i>Soneri Bank Limited</i>	8	
	<i>Standard Chartered Bank (Pakistan) Limited</i>	14	
	<i>The Bank of Khyber</i>	36	
	<i>United Bank Limited</i>	22	
	Sub Total		<b>367</b>
	Sub Branches	<i>AlBaraka Bank (Pakistan) Limited</i>	2
		<i>Askari Bank Limited</i>	2
<i>BankIslami Pakistan Limited</i>		58	
<i>Burj Bank Limited</i>		8	
<i>Habib Bank Limited</i>		2	
<i>United Bank Limited</i>		1	
Sub Total		<b>73</b>	
Grand Total		<b>1097</b>	
Source: State Bank of Pakistan (2012).			
Islamic Banking Branch Network(As of December 31, 2012)			

FIGURE 2: FULL FLEDGED ISLAMIC BANKS OFFERING IJARAH

Serial	Islamic Banks	Ijarah Offerings	Features
1	AlBaraka Bank (Pakistan) Limited	<ul style="list-style-type: none"> <li>Ijarah for Plant &amp; Machinery</li> <li>Ijarah on office equipment</li> <li>Ijarah on Vehicles</li> </ul>	<ul style="list-style-type: none"> <li>Minimum Tenor 3 years &amp; Maximum Tenor 5 years.</li> <li>Ijarah available for consumers &amp; Corporate/SME &amp; Customer falling under salaried, self-employed and businessmen categories for consumer financing.</li> </ul>
2	BankIslami Pakistan Limited	Car Ijarah	<ul style="list-style-type: none"> <li>Minimum Cost of Vehicle Rs. 250,000</li> <li>Security Deposit 30% to 50%</li> <li>Tenure of Ijarah: Min- 3 Years, Max-5 years</li> <li>All Vehicles costing above Rs. 800,000 are required to be installed with tracker.</li> <li>Target customers: individual, corporate</li> </ul>
3	Burj Bank Limited	Car Ijarah, Equipment/Machinery	<ul style="list-style-type: none"> <li>Minimum Tenor 3 years &amp; Maximum Tenor 5 years.</li> <li>Payment period: Monthly/Quarterly/Semi-annually</li> </ul>
4	Dubai Islamic Bank Pakistan Limited	Car Ijarah	<ul style="list-style-type: none"> <li>New or Used Cars.</li> <li>Local or Imported/Re-conditioned Cars.</li> <li>Payment plan with tenure options ranging from 1-7 years</li> <li>Financing Amount, DIBPL will finance up to 85% of the car value</li> <li>Target customers: Salaried, Self Employed Businessmen and self employed professionals, Manufacturing industries, Construction Industries, Transportation Industries</li> </ul>
5	Meezan Bank Limited	Car Ijarah	<ul style="list-style-type: none"> <li>Minimum security deposit as low as 10%</li> <li>The minimum security deposit for a vehicle up to 2 years of age is 20%, while minimum security deposit for a vehicle over 2 years of age is 30%.</li> <li>Target Customers: Salaried Individuals, Self-employed Professionals, Business Individuals</li> </ul>

Source: State Bank of Pakistan (2008)-Handbook of Islamic Banking Products & Services, & official websites of Banks (2012).

FIGURE 3: ISLAMIC BRANCHES OF COMMERCIAL BANKS OFFERING IJARAH

Serial	Islamic Branches of Commercial Banks	Ijarah Offerings	Features
1	Askari Bank Limited	Askari Ijara Bis Sayyarah(vehicle)	<ul style="list-style-type: none"> <li>Its a vehicle based Ijarah</li> <li>Minimum to max. tenor is 3-5 Years, &amp; Target Customers Salaried Individuals, Self-employed Professionals, Business Individuals</li> </ul>
2	Bank AL Habib Limited	Ijarah	<ul style="list-style-type: none"> <li>Minimum Financing Limit Rs. 2 Million</li> <li>Maximum Financing Limit Rs. 1.2 Million</li> <li>Tenors up to 3 to 10 Year</li> <li>Target Customers Corporate, SME,</li> </ul>
3	Bank Alfalah Limited	<ul style="list-style-type: none"> <li>Alfalah Car Ijarah</li> <li>Ijarah Finance</li> </ul>	<ul style="list-style-type: none"> <li>Financing of new, used and imported vehicle for personal use</li> <li>Multiple tenure options of 3 to 5 years</li> <li>Ijarah Finance is offering asset hire/purchase for corporate sector, Tenor is 3 to 7 years</li> </ul>
4	Faysal Bank Limited	Barkat Auto Finance	<ul style="list-style-type: none"> <li>Barkat Auto Finance is based on Diminishing Musharakah, where you participate with Barkat Islamic Banking in a joint ownership of your vehicle</li> <li>Tenure up to 5 years</li> </ul>
5	Habib Bank Limited	Habib Bank Ijarah	<ul style="list-style-type: none"> <li>Facilitates the rental of vehicles, plant and machinery on medium and long term basis</li> <li>Maximum Financing Limit Rs.50million</li> <li>Minimum Tenors 3 years &amp; Maximum Tenors 5 years</li> <li>Target Customers Small/medium size traders/Manufacturers &amp; Corporate Customers</li> </ul>
6	Habib Metropolitan Bank Limited	Ijarah	<ul style="list-style-type: none"> <li>Financing for consumer and commercial vehicles &amp; financing equipments and machinery</li> <li>Minimum Tenors 1 year &amp; Maximum Tenors 5Years, 7 years(for consumer)</li> <li>Target customers are Corporate, SME Consumer</li> </ul>
7	MCB Bank Limited	<ul style="list-style-type: none"> <li>Al-Makhray Car Ijarah</li> <li>Al-Makhray Equipment Ijarah</li> </ul>	<ul style="list-style-type: none"> <li>For car: Minimum Financing Limit Rs. 250,000 &amp; Maximum Financing Limit Rs. 1600,000 &amp; tenor is 1-5 Year</li> <li>No financing limit for equipment Ijarah.</li> <li>Target Customers Individual and Corporate clients</li> </ul>
8	National Bank of Pakistan	<ul style="list-style-type: none"> <li>NBP Ijarah</li> <li>Vehicles (both Commercial and Private)</li> <li>Office Equipment</li> <li>Plant and Machinery</li> </ul>	<ul style="list-style-type: none"> <li>Maximum Financing Limit Upto Rs.20 million for SMEs and Rs.50 million for Commercial / Corporate Customers, Minimum Tenors 3 Year And Maximum Tenors 5 Years</li> <li>Target Customers: The Small and Medium Enterprises (SMEs) as well as corporate and commercial clients</li> </ul>
9	Soneri Bank Limited	Ijarah (Vehicle/Machinery)	<ul style="list-style-type: none"> <li>Basis for Pricing KIBOR plus Margin</li> <li>No Financing Limit</li> <li>Target Customers Manufacturers, Importers/Exporters, Traders, individual</li> </ul>
10	The Bank of Khyber	Ijarah Muntahia Bitamleek (Vehicle & house)	<ul style="list-style-type: none"> <li>Minimum Tenors 1 Year &amp; Maximum Tenors 5 years in case of Car Ijarah and Commercial Ijarah, 3 years in case of Motorcycle Ijarah and 15 years in case of House Ijarah Facility.</li> <li>Target Customers Business Community, Employed &amp; Self Employed</li> </ul>
11	United Bank Limited	<ul style="list-style-type: none"> <li>Ameen Auto Ijarah</li> <li>Ameen Commercial Ijarah</li> </ul>	<ul style="list-style-type: none"> <li>Minimum Financing Limit Rs.200,000 &amp; Maximum Limit is Rs.1,500,000</li> <li>Minimum Tenors 1 Year &amp; Maximum Tenors 7 Years</li> <li>Target Customers salaried/Professional/Self employed/Govt. Employees, Multinational Companies, large local corporates, public sector entities, sole proprietor, private limited companies.</li> </ul>

Source: State Bank of Pakistan (2008)-Handbook of Islamic Banking Products & Services, & official websites of Banks (2012).

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