

# Analysis of Islamic Banking Branches Operated Under Conventional Banks



BY

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NIDA AROOJ

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## ABSTRACT

The purpose of this research is to throw light on the way of incorporation of IBWs, the purpose and philosophy of their formation, rules and regulations IBWs are operating under, risks and challenges IBWs are facing. What is the difference between IBs and IBWs and what is the difference between IBWs and CBs. The 5 IBBs out of 15 IBBs are selected and primary data is collected through interviews. The findings are that IBs and IBBs are same in all aspects. They are offering similar products, similar target market, follow similar sharia principles, face similar risks and almost similar challenges. The IBBs and CBs are totally different from each other as they have different roots, philosophies, mission and operations.

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## 1. INTRODUCTION

### Background

#### Islamic Banking

There are number of economic systems in the world like capitalist, communist, Islamic etc. Each economic system has its own social, financial, judicial, political (etc) systems. So if we discuss Islamic economy then it has its own subsystems too. The concern is with Islamic financial system that is typically known as Islamic banking system. Islamic banking is a unique type of banking that has unique features. The special feature of Islamic banking is the prohibition of Riba. This feature is the basis of Islamic banking. According to Islamic point of view riba is totally prohibited in every financial transaction. Riba is the extra amount that is charged on loan. Few verses of Quran are quoted that prohibits riba.

يَا أَيُّهَا الَّذِينَ آمَنُوا اتَّقُوا اللَّهَ وَذَرُوا مَا بَقِيَ مِنَ الرِّبَا إِن كُنْتُمْ مُؤْمِنِينَ  
فَإِن لَّمْ تَفْعَلُوا فَأْذَنُوا بِحَرْبٍ مِّنَ اللَّهِ وَرَسُولِهِ وَإِن تُبْتُمْ فَلَكُمْ رُؤُوسُ أَمْوَالِكُمْ لَا تَظْلِمُونَ وَلَا تُظْلَمُونَ  
سوره البقرة: 2 , آیت: 278-279

O ye who believe! Fear Allah and give up what remains of interest, if you are truly believers. But if you do it not, then beware of war from Allah and His Messenger; and if you repent, then you shall have your principal; thus you shall not wrong nor shall you be wronged.

Chapter 2, Al Baqara, Verses 278-279

وَمَا آتَيْتُم مِّن رَّبًّا لَّيْرُبُوَ فِي أَمْوَالِ النَّاسِ فَلَا يَرُبُوَ عِنْدَ اللَّهِ وَمَا آتَيْتُم مِّن زَكَاةٍ تُرِيدُونَ وَجْهَ اللَّهِ فَأُولَٰئِكَ هُمُ الْمُضْطَّعُونَ  
سوره الروم: 30 , آیت: 39

Whatever you lay out at interest that it may increase the wealth of the people, it does not increase in the sight of Allah; but whatever you give in Zakat, seeking the pleasure of Allah – it is these who will increase their wealth manifold.

Chapter 30, Ar Rum, Verse 39

Islamic banking follows principles of Islam. Islam is a religion of life. Islam imposes two types of duties to his followers. One is related to Allah and known as Haqooq-ul-Allah and second is related to mankind known as Haqooq-ul-Ibad. So in the context of Haqooq-ul-Ibad

serving of mankind is very important. Hence Islamic banks (IBs) were formed in order to fulfil both duties. The basic objective of IBs is not profit maximization but social service.

Islamic banking is asset based financing. Money is not used as a source of profit that means profit is not earned on money. Profit is only earned on value addition on asset. Money has a par value. Any additional amount charged on money is not acceptable in Islamic banking. Profit is only charged on addition in value of commodity. According to Sharia, this is not possible to add value in money because adding value means the increment in purchasing power of money. That's why profit is not charged on money.

In Islamic banking sharing of profit and loss principle is followed. The share in profit is determined on the amount of actual profit earned. The profit percentage is not decided according to the proportion of capital invested. The loss percentage is determined according to the share of capital.

Islamic banking offered two type of financing that are Sharia based financing and Sharia complaint financing. In Sharia based financing the return of financier is not known. A percentage of return is determined but the actual return is not known. The modes in this type of financing are Musharkah and Mudarbah. In Musharkah financing contribution in capital is made by all the parties and profit and loss is shared according to the agreed proportion. Mudarabah financing is also a type of sharing but in it capital is shared by one party whereas other party share services. The running of business is the sole responsibility of the party that share services. The party that share capital is a sleeping partner.

Sharia complaint financing is a type of financing in which the return of financier is known and determined. The modes of financing under this category include Murabahah, Salam, Istasna, Diminishing Musharakah, Ijarah etc. Murabahah financing is a type of sale in which cost and profit is disclosed by the bank to the person who enter in that contract. Salam financing is a type of sale in which advance payment is made for future delivery of commodity. Istasna is also a sale contract in which order is made to manufacture a commodity. In this contract payment is also in advance but the subject matter is not in existence at the time of contract. Diminishing Musharakah is a contract to buy real estate or to finance a trade. In it the IB and customer purchase a building or trade equipment with sharing capital. Latter on the IB sold his share to his partner on a specific consideration. Ijarah means renting out either services or commodity. Normally IBs use commodity ijarah

that means renting out a commodity for specific time. IBs offer halal products that are designed and approved by Sharia Supervisory Board (SSB) using these modes of financing.

The model of IBs is in consistency with Islamic principles. In Islam the Quran and Sunnah are used for guidance. If any issue go beyond these two things than fuqha (Islamic scholars) are allowed to make a collective decision in light of Islamic teachings. IBs play a role of intermediation. IB has funds and it used these funds. There are two main sources of funds; Equity Capital and Deposit money. The principle uses of funds include financing on Musharakah and Mudarabah basis, Ijarah Financing, Murabahah Financing, Baimujjal and baisalam, financing of commercial and industrial enterprise on profit and loss sharing principle.

IBs offer different type of deposit accounts that normally fall under these three types of accounts; current account, saving account and daily product account. In current account IBs give the facility of safe keeping the money. According to Sharia deposits of current accounts are considered as Amanah. So IBs are responsible of deposits security and safety. The money in such accounts are not used or invested by IBs. In saving accounts the deposit money is used to finance business projects under Musharakah and Mudarabah financing modes. The IBs share profit and loss to the saving account holder according to Sharia principles of Musharakah and Mudarabah financing modes. The daily product account is slightly technical and complex type of account. In this account the holder is allowed to deposit and withdraw any sum of money without time limit but at the same time the holder can earn return on his deposited amount. In order to know actual investment of the holder his daily product of account is calculated. In order to calculate the daily product average balance of month is divided by 30 days and then this amount is considered the daily investment of holder in a Musharakah or Mudarabah contract.

IBs use funds to invest in multiple projects to diversify its portfolio like real estate, business or business projects, consumer products etc. These investments follow the rules of Sharia complaint financing modes. Ijarah, Murabaha, Salam etc are used in backend of these investments. IBs gave special importance to weak sectors of economy like agriculture sector. IBs designed special features in order to maximum facilitate such sectors.

## History of Islamic Banking

Islamic banking concepts were introduced in sixties. The first though a small scale IB was formed in Egypt in 1963. An idea for Islamic banking was also gathered from Hajj services offered in Malaysia in early sixties. In 1973 in Jeddah, city of Saudi Arabia, a conference of Finance Ministers of Organization of Islamic Conference (OIC) was held. In this conference basic ideology for IBs was discussed. A great accomplishment of this conference was the decision of development of Islamic Development Bank (IDB). The IDB was formed in 1975. The basic objective behind establishment of IDB was strengthening and spreading of Islamic banking. The initial planning regarding operations and management of IBs was done by IDB. Hence it is not wrong to say that the basis for Islamic banking was made by establishment of IDB. When IBs spread throughout the world, multiple issues started growing. In order to standardize the reporting procedures Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI) was come into existence in 1991. It had two boards. One is accounting and auditing board that standardize reporting procedures while the other is Sharia standard board that standardized Sharia procedures.

Islamic banking got attention from non-Muslim countries but it got extraordinary attention from Muslim ones. Islamic banking is clustered on three broad areas in the world that are Middle East, South Asia and Southeast Asia. The countries included in Middle East are Bahrain, Iran, Jordan, Kuwait, Lebanon, Syria, Saudi Arabia, Qatar, and United Arab Emirates (UAE). Bahrain is considered the house of Islamic finance and banking. A lot of work on Islamic finance including research, policies, regulations etc is done there. In 1978 Islamic banking was started there. There are 33 full-fledged IBs operating in Bahrain. Iran adopted Islamic finance prior 1979. The decision of adopting Islamic banking is very delicate. The problematic decision is to decide between the complete switching of banking towards Islamic banking or to run both, conventional and Islamic, parallel. Two countries Iran and Sudan took bold steps and they converted their banking on Islamic laws. Iran made Usury free banking law in 1983 and discarded interest-based banking. Sudan also enacted Banking law in 1992 which follow sharia principles and switched towards Islamic banking. Kuwait is the third largest country in the world that holds Islamic banking assets. In 1977 Kuwait started Islamic banking and by 2010 Islamic financial institutions hold funds of \$56 billion. Islamic banking is in early stage in Lebanon. The Islamic banking law was passed in 2004. The government of Lebanon encourage establishment of IBs but does not allow CBs to

establish IBWs. Qatar is also big centre of Islamic banking in Middle East. The first IB was established in 1983. There are 4 IBs currently working there. Islamic banking flourished a lot in Saudi Arabia despite of the fact that there is no separate law for Islamic banking there. CBs are also playing their role by offering Islamic products through IBWs. Islamic banking is introduced in Syria recently. By the end of 2004, there are three IBs going to start their operations. UAE has the credit that it becomes the pioneer of Islamic banking by establishing world's first IB in 1975. There are four IBs and huge number of IBWs working in UAE. UAE has the greatest conversion rate of CBs in full-fledged IBs in the world. The government of UAE also planned to shift their whole economy on Islamic finance.

Bangladesh and Pakistan are the countries that adopt Islamic banking in South Asia. Islamic banking was started in 1980s in Bangladesh. The first IB was established in 1983. There are six IBs and number of IBWs operating in Bangladesh now. Islamic banking movement was started in 1980 in Pakistan. There are six full-fledged IBs and number of CBs having IBWs serving in Pakistan.

The countries committed to Islamic banking in Southeast Asia are Indonesia, Malaysia, and Singapore. Indonesia is the largest Muslim country of the world. Like others countries of world, Indonesia also started Islamic banking in 1990s in order to meet need of Muslims. There are two IBs operating there. Government of Indonesia recently allowed CBs to start IBWs in order to offer sharia products. By the end of 2010, there are 9 conventional banks having 25 IBWs and number of Islamic banks reached to 144. Malaysia started Islamic banking after success of Hajj services in 1963. From 1960 to 1980 tremendous efforts were made to promote and start Islamic Banking. Malaysia is ranked second in having number of IBs now. The first Islamic bank in Malaysia was Bank Islam Malaysia Berhad in 1983. This bank offered sharia products. The bank played significant role in strengthening Islamic banking industry in Malaysia. In 1993, the government of Malaysia allowed conventional banks to start separate IBWs. This decision was made in order to expand Islamic banking industry with existing capital. Singapore is also taking active part in promoting Islamic banking. Singapore entered in Islamic banking by offering its own Sukuk in 2001.

Islamic banking was also started in Europe and western countries. IBs and IBWs are formed their in order to attract oil wealth of Muslim countries. Islamic banking is not experiencing tremendous growth there but better future is predicted. There are 56 countries in the world that run 396 Islamic banks and 320 conventional banks run IBWs (Sulaiman Abdullah Saif Alnasser Jorjah Muhammed, 2012).

Islamic banking passed a long journey in Pakistan. Interest free banking movement was started in seventies throughout the world including Pakistan. Pakistan is an Islamic country and it was also mentioned in constitution of 1973(Articles 2, 31, 37, 227) that interest should be eliminated from Pakistan's economy. In eighties Council of Islamic Ideology (CII) directed by General Zia ul Haq gave a report titled 'Elimination of interest from economy'. After this report serious efforts were started to eliminate interest. The alternative to interest was, profit and loss sharing mechanism, suggested. It was a big challenge to implement such mechanism as whole economy and system was on interest. M. Mansoor Khan (2008) mentioned a model suggested by CII for interest free banking. According to this model three instruments are proposed that are primary instrument, secondary instrument and unsuitable instruments. Primary instrument includes profit and loss sharing. Secondary Instrument includes special loan category, hire purchase, bai muajjal, normal rate of return etc whereas in unsuitable instrument includes service charges and indexation. A model for central bank was also proposed in that report. CII made a regulation for all banks to operate under profit and loss sharing mechanism. The government accepted this report and implement it through Finance ministry. The two bodies used in its final implementation were SBP and Pakistan Banking Council. These bodies made many changes in banking Companies ordinance as well as in concerned documents. In CII report no alternative to interest was mentioned and discussed due to which there was no proper system in which interest is totally removed. After this report all conventional banks transformed there system on profit and loss sharing mechanism. In 1991 Sharia court declared interest and banking system of interest totally haram. Government challenged this in Supreme Court. In 1999 Supreme Court also favoured the decision of Sharia Court. At that time it was very difficult to replace overall economy to Islamic one due to foreign investments and loans. So Government decided to start Islamic banking parallel to conventional banking. In 2003, a new department Islamic Banking Department (IBD) in SBP was formed. IBD was responsible in designing and formulating laws and regulations and performance of IBs. The objectives of IBD include strengthening of Sharia compliance framework, adaption of AAOIFI standards, review products offered by IBs, increase awareness regarding IBs etc. After these serious efforts Islamic banking started growing and flourishing in Pakistan.

There are 5 full fledge IBs and many Islamic banking windows (IBWs) of conventional banks are doing their operations in Pakistan. These banks are Meezan Bank Limited, Al Baraka Bank (Pakistan) Limited, Bank Islami Pakistan Limited, Dubai Islamic bank Pakistan limited and Burj Bank Limited.

The first Islamic bank in Pakistan was Meezan Bank incorporated in 2002. It is the largest and most popular bank in Pakistan. The Meezan Bank has 350 branches in 104 cities. Meezan Bank offered personal as well as business banking. The products offered in Personal banking includes deposit accounts, term certificates, asset management and consumer finance. Business banking includes corporate deposit accounts, agriculture financing and investment banking.

Al Baraka bank was also formed in 2002 and it was formed in Bahrain. A merger between Al Baraka Bank (Pakistan) Limited and Emirates Global Islamic Bank was done in 2010 and results in Al Baraka Bank (Pakistan) Limited. There are recently 108 branches of this bank. It categorizes its products into three main heads; Retail banking, Business banking and services. Retail banking includes deposit accounts and consumer financing. In business banking there are corporate and investment banking, Commercial and SME banking, Public sector and institutional relations, financial institutions and treasury. Services include phone banking, SMS banking, e statements, e banking, and safe deposit lockers.

In 2003 Bank Islami Pakistan Limited started its operations and it has now 112 branches. Products and services of Bank Islami Pakistan Limited are Retail Banking, Consumer banking, corporate banking, Investment banking and value added services. In consumer banking home financing and auto ijarah are offered. Retail banking includes different deposit accounts like current account, dollar account, sahalat account etc. In corporate banking trade financing, working capital financing, musharakah financing, mudarabah financing and deposit accounts are offered. Investment banking includes private placement, syndication, underwriting, trusteeship, project financing, merger and acquisitions etc. Value added services include SMS alerts, interbank funds transfer, Debit card etc.

Dubai Islamic bank Pakistan limited was incorporated in 2006. It has 124 branches in throughout Pakistan. It categorizes its product as corporate banking, consumer banking, deposits and priority banking. In corporate banking trade, investment and cash management are offered. Consumer banking includes house financing, auto financing and business financing. Deposits include current deposit, fixed deposit, saving deposit etc. Priority banking includes debit card, ATMs, e statements etc.

Burj Bank Limited, formerly known as Dawood Islamic Bank Limited, started its operations in 2007. It has 74 branches on March 2014. The bank planned to open 300 branches at the end

of 2017. For this purpose they invested a lot and changed their whole software. The new software is highly committed with Islamic finance. Products have following categories corporate, SME, insignia, and retail. Corporate banking includes fund based products, non-fund based products, trade finance and cash management. Fund based financing includes working capital financing, equipment ijarah financing, diminishing musharakah financing and murabaha for local and imported goods. Non-fund based financing means bank guarantee and LOC. Trade financing includes Islamic import refinance scheme and working capital financing. SME banking includes fund based financing, non-fund based financing, Burj tractor financing and trade financing. Insignia banking includes different type of deposit accounts i.e. current account, smart saving account, term deposit account, and foreign currency account and takaful. Retail banking includes deposit, takaful and financing products.

The Introduction of Islamic banking increased competition in Market. Many conventional banks suffer loss of customers after this advent. So in order to cater needs of a specific customer segment conventional banks started separate IBWs. This transformation was done globally. In Malaysia government restricted conventional banks to start IBWs to avoid burden on regulators. At first only three CBs are allowed to start IBWs. This decision was very successful because CBs already have very wide branch network and in starting they used this to offer Islamic products. Keeping in view these achievements Malaysian government allowed CBs to start IBWs. Later on conversion of CB to IB was also allowed.

In Pakistan, SBP also regulate all conventional banks to started IBWs. It was done in order to utilize existing investment of CBs. Moreover CBs are operated in Pakistan from many years and people experienced them and are used to with them. It is obviously difficult for people to affiliate with new bank. So SBP restrict CBs to start offering Islamic products in start. Later on separate IBWs are formed that only deals in Islamic products and their operations are separated from Parent CBs. These IBWs are independent in their business. In Pakistan almost 15 conventional banks open IBWs. There are total 451 IBWs operated in Pakistan. The conventional banks having IBW are Askari Bank Limited, Bank Al habib limited, Bank Alfalah Limited, Faysal Bank Limited, Habib Bank Limited, MCB Limited Pakistan, Habib Metropolitan Bank Limited, National Bank Limited, Silk Bank Limited, Soneri Bank Limited, Standard Chartered Bank ( Pakistan) Limited, Summit Bank Limited, The Bank of Khyber, The Bank of Punjab and United Bank Limited.



Table 1.1 Islamic Banking Branch Network<sup>1</sup>

<i>Islamic Banking Branch Network</i>		
<i>(As of March 31, 2014)</i>		
Type	Name of Bank	No of Branches*
Islamic Banks	AlBaraka Bank (Pakistan) Limited	108
	BankIslami Pakistan Limited	112
	Buy Bank Limited	74
	Dubai Islamic Bank Pakistan Limited	124
	Meezan Bank Limited	349
		<b>767</b>
Islamic Branches of Conventional Banks	Askari Bank Limited	39
	Bank AL Habib Limited	17
	Bank Alfalah Limited	140
	Faysal Bank Limited	53
	Habib Bank Limited	38
	Habib Metropolitan Bank Limited	6
	MCB Bank Limited	27
	National Bank of Pakistan	22
	Silkbank Limited	10
	Soneri Bank Limited	15
	Standard Chartered Bank (Pakistan) Limited	10
	Summit Bank Limited	1
	The Bank of Khyber	44
	The Bank of Punjab	7
	United Bank Limited	22
		<b>451</b>
Sub Branches	AlBaraka Bank (Pakistan) Limited	2
	Askari Bank Limited	2
	BankIslami Pakistan Limited	89
	Habib Bank Limited	2
	United Bank Limited	1
		<b>96</b>
		<b>1314</b>
* Source: Banking Policy & Regulations Department, State Bank of Pakistan.		

<sup>1</sup>Islamic Banking Bulletin

Askaribank started its IBW in order to offer halal products and to enhance economic development. There are 29 IBWs operating all over Pakistan to serve their customers. The Sharia Advisor of Askari Bank Limited is Prof. Dr Mohammad Tahir Mansoori. The products offered are Ijarah by Sayyarah, Islamic investment certificates and home musharakah.

Bank Al Habib Limited established its 17 IBWs covering major cities of Pakistan. The bank offered deposits schemes as well as sharia financing to its customers. Mufti Dr Ismatullah is the sharia advisor of the bank. Bank al Habib offer three type of deposit schemes i.e. current account, saving account and term deposit account. Different types of Islamic financing i.e. murabaha financing, ijarah financing, diminishing musharakah financing and istasna financing are offered. Murabaha financing is offered for local purchase of assets, imports under LOC, local purchase of raw materials and purchase of raw material for exports. Ijarah financing can be used for vehicles and for machinery. Diminishing musharakah financing is offered for only tangible goods. Istasna financing is used for manufacturing of goods, construction of bridge, plants, highway etc and manufacturing of ships aircrafts etc.

Bank Alfalah Limited established IBW in 2003. It is offering sharia products and catering need of their customers and fulfilling promise of responsiveness by giving Islamic financial solutions. Mufti Dr Khalil Ahmad Aazami is the sharia Advisor. In Bank Alfalah four broad product categories are made. These are Personal banking, corporate banking, Treasury and capital markets and Self-service banking. Personal banking includes deposit accounts, financing, Takaful and home remittances. Working capital financing, project financing, letter of guarantee and trade services are offered under corporate banking. In treasury and capital markets treasury and nostro accounts are offered. Self-service banking includes debit cards, e statements and SMS alerts.

Faysal Bank Limited has 53 branches of IBWs. The products offered by Faysal bank are Union pay debit card, Kamil business account, current account, saving account, investment certificates, foreign currency account, foreign currency saving account, murabaha, auto finance, home finance and basic banking account.

Habib Bank Limited also formed its IBW according to SBP regulation. There are 38 Islamic branches in Pakistan. The deposit accounts offered by HBL are HBL basic banking account,

HBL current account, HBL PLS saving account, HBL Al-Samarat account, HBL Al-Mukhtar account and HBL Al-Irtafa account. The financing products offered by HBL are HBL murabaha, HBL ijarah and HBL diminishing musharakah. HBL also offer wide range of trade and value added services like LOC facility, collection of foreign bills, HBL debit cards etc.

MCB limited Pakistan started its IBW in 2003. Its vision is to be the leader in Islamic banking. It has 27 Islamic branches covering large cities of Pakistan. Dr Mohammad ZubairUsmani is the Sharia advisor. The products it is offering include deposit accounts, Fund based financing, and Non fund based financing. The upcoming products are Islamic banking foreign currency account and diminishingmushrakahhousing

Habib Metropolitan Bank Limited formally launched its IBW in 2004. 6 branches are serving in Pakistan now. Mufti Abdul SattarLaghari is the sharia advisor of bank. The products offered are current account, saving account, investment certificates, murabaha, ijarah, diminishing musharakah and trade services.

National Bank of Pakistan has 22 Islamic branches. NBP offered two types of deposit accounts in IBWs that are current deposit scheme and PLS deposit scheme. For commercial and corporate customer murabaha and ijarah financing are provided. Services like LOC, collection of foreign bills, government collections are also offered.

Silk bank limited is running 7 Islamic branches in Pakistan. It gives the name 'Emaan' Islamic banking. The products offered by it are current account, regular saving account, premium saving account, enhanced saving account, term deposit account and takaful and saving plans.

Soneri Bank started IBW in order to offer such products that are best for both worlds. There are 15 Islamic branches of Soneri bank operated in Pakistan. The products are categorized as financing Products and deposit products. In financing products murabaha, ijarah, salam, diminishing musharakah and trade finance are offered. In deposit products, there is Soneriaasaan business account, Soneribachat saving account, Sonerimunafa saving account, Sonerimeaadi term deposit and SoneriJari current account. Electronic banking is also offered by Soneri bank for its IBW.

Summit Bank also provides a very dedicated IBW. There is only 1 IBW operated under this bank. The sharia advisor of bank is Mufti Muhammad Najeeb Khan. The products offered by it are current account, business account, daily saving account, bachat saving account and Islamic certificates.

Standard Chartered Bank (Pakistan) Limited also established IBW under the name Standard Chartered Saadiq. There are 10 branches of IBW of bank. The Sharia advisor of bank is Muhammad Abdul Mubeen. It offers two product categories i.e. personal banking and SME banking. The products in personal banking are accounts, debit cards, employee banking, credit cards, investments and wealth. The SME banking includes SME solutions.

The bank of Khyber started IBW in order to fulfil need of their customers. There are 44 branches currently working in Pakistan. The products are murabaha, salam, ijarah, murabahawaiqtina and deposit schemes. The deposit schemes includes current account, interest free PLS account, riba free certificates, Khyber Pak munafa scheme, riba free special deposit certificate (RFSD) pool, RFSD- bank pool, RFSD- Corporate pool, and RFSD pool- Mutual fund.

The bank of Punjab has 7 branches of IBWs in Pakistan. The products include current account, PLS saving account, riba free certificates and murabaha.

United Bank Limited established its IBW with name of Ameen. The products offered by bank are Ameen current account, Ameen saving account, Ameen business account, Ameen monthly saving account, Ameen certificates of Islamic investment, Ameen daily munafa account, Ameen minor saving account, Ameen call deposit receipt, Ameen premium certificate, and Ameen financial institution deposit account.

## Critiques

There are many critiques on Islamic banking. Islamic banking is growing industry so there is a lot of potential in it. The basic objective of Islamic banking is social service. Islamic banking is the banking for poor people. When we get a closer look of IBs and IBWs products, their operations and policies then it is realized that there is no special product and procedures only for poor. There are no products specially designed to help and assist poor. The products offered for poor and rich are identical. There are no separate investment plans for widows and orphans. The contract requirements and procedures are also similar with CBs.

There are no separate services for different industries in IBs and IBWs. Islamic banking is the banking that fosters the economic growth. It is bad to say that no importance is given on this regard. IBWs are unable to cover the priority sectors up till now. The main focus of IBWs is on personal and business banking. Few IBs and IBWs design products favourable to industrialists but agriculture sector, small cottage industry are fully ignored. Ahmad Kaleem and Rana Abdul Wajid (2009) mentioned that no financial institution in Pakistan offer agriculture credit based on Islamic rules. Pakistan is an agrarian country. Almost 23 % of GDP is related to agriculture. IBWs have to pay attention on that sector in order to achieve their basic objectives. The client wise financing portfolio table shows that only 0.1% of total financing is done in agriculture sector. In corporate sector 68.9% financing is done. The break over of corporate financing is also shown in financing concentration table. This table shows that IBs finance textile sector mostly. Cement, shoes and leather, automobile and electronic sectors have least financing provided by IBs. These uneven financing concentrations also generate number of questions.

Table 1.2 Client Wise Financing Portfolio<sup>2</sup>

### 1.2 Client Wise Financing Portfolio (Share Percent)

	Mar13	Dec13	Mar14	Industry
Corporate Sector	72.7%	71.8%	74.4%	68.9%
SMEs	4.8%	5.1%	5.3%	6.1%
Agriculture	0.1%	0.1%	0.1%	5.6%
Consumer Finance	13.4%	11.6%	12.7%	6.6%
Commodity Financing	6.8%	9.6%	5.8%	10.6%
Staff Financing	1.7%	1.6%	1.7%	2.1%
Others	0.4%	0.2%	0.1%	0.2%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Table 1.3 Financing Concentration<sup>3</sup>

### 1.3 Financing Concentration - percent share

	Mar-13	Dec-13	Mar-14	Industry
Chemical and Pharmaceuticals	7.2%	6.3%	7.6%	3.6%
Agribusiness	2.1%	3.6%	1.7%	7.5%

<sup>2</sup> Source Islamic Banking Bulletin March 2014

<sup>3</sup> Source Islamic Banking Bulletin March 2014

Textile	18.9%	19.1%	19.0%	17.1%
Cement	1.6%	0.9%	0.7%	1.1%
Sugar	6.6%	3.9%	4.8%	3.9%
Shoes and leather garments	1.0%	0.9%	0.8%	0.6%
Automobile and transportation equipment	1.5%	1.7%	2.2%	1.4%
Financial	1.1%	0.7%	0.7%	2.3%
Insurance	0.0%	0.0%	0.0%	0.0%
Electronics and electrical appliances	1.4%	1.7%	1.7%	1.5%
Production and transmission of energy	9.2%	8.9%	10.8%	12.4%
Individuals	14.8%	13.3%	14.0%	9.0%
Others	34.6%	38.9%	36.1%	39.7%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

Islamic banking faces a problem of lack of resources. People are not trained enough to administer IBs. The Sharia Advisors are responsible in designing and approving products. The Sharia Advisors are the experts of Sharia not of business, so a gap remains there in product development process. Islamic banking gives special importance to Sharia compliant products rather than Sharia based products. The financing mix table shows that very little amount is invested in Mudaraba and Musharakah. It shows that IBs are dealing more in sharia complaint products than sharia based products. Some people consider that Sharia complaint products are not pure Islamic products so they avoid Islamic banking. This is the responsibility of IBs to answer this issue while designing and offering such products.

Table 1.4 Financing Mix<sup>4</sup>

#### 1.4 Financing Mix

Amount in billion Rupees			
	Mar 13	Dec 13	Mar 14
Murabaha	90.4	134.2	106.7
Ijarah	23.2	25.4	27.1
Musharaka	3.6	22.0	27.9
Mudaraba	0.5	0.5	0.6

<sup>4</sup> Source Islamic Banking Bulletin March 2014

Diminishing Musharaka (DM)	89.7	101.8	107.2
Salam	13.0	13.3	18.6
Istisna	16.4	18.5	19.5
Qarz/Qarz-e-Hasna	0.0	0.0	0.0
Others	14.1	14.5	15.5
<b>Total</b>	<b>251.1</b>	<b>330.2</b>	<b>323.2</b>

IBs and IBWs offered sharia compliant products so the returns of these products are low. This makes a complain of customers that IBs and IBWs offer low returns as compared to CBs. Haslindar Ibrahim et.al said that according to their research findings that CBs, corporate societies and foreign banks gave higher return than IBs. People claimed that IBs offer low returns than CBs because their performance is low than CBs. There is lack of awareness in people about the products and procedures of IBWs. Jasim Al-Ajmi et.al. (2009) said that banks performance can be measured by number of things which includes customer base. Customer base can be increased by profitable operations as well as fulfilling sharia rulings. It is highly important for IBWs to increase public awareness about them in order to improve their importance. Liaqat Ali et.al (2013) found that there are two hurdles in real growth of IBs. First one is the lack of proficiency and experienced staff that spread the importance of Islamic banking and other is shortage of consciousness among people about IBs.

IBWs suffer more criticism than IBs. People have more trust on IBs because the whole pillars of it are on Islamic rulings and they are operating independently. There is a wrong perception that as IBWs are operating under CBs so their operations are no more different with CBs. The money injected in IBWs came from riba based business whereas there is no issue for IBs in this regard. The management of CBs have single philosophy for policy making and profit motive that is also same for IBWs. IBWs are bound to go with objectives and policies of parent banks. In such situation it is also assumed that in critical time IBWs borrow money from conventional banking branches and use that haram money to carry business which makes IBWs contaminated with riba.. IBWs have lack of independence. They are unable to plan and execute their operations. The charter of IBWs is also not published that creates lack of trustworthiness.

The customers of IBWs thought that just terminologies are changed in order to attract and satisfy customers but actually there is no difference in IBWs and CBs. They claim that CBs just design their portfolio and separate the terms but the operations behind are same and mutually inclusive. The financial reports of IBWs are not separately published. This also creates doubt in customers mind. The performance, investment trends, type of deposits etc are very difficult to analyse for IBWs. The financial reports of CBs have main focus on conventional banking and the transactions related to it. In such situation, there is no way to check the performance of IBWs. It is very difficult to approach financial statements of IBWs to compare their performance and efficiency. There is no proper system in conventional banks to communicate the progress and functionality of their IBWs.

IBs got priority because they have strong branch network that cater need of million peoples. IBWs also face difficulties due to weak branch network. Badr El Din A. Ibrahim (2006) mentioned that there is concentration of IBs branches in towns and commercial areas. There are fewer branches of IBWs in rural and developing areas which make branch network of IBWs is very weak. In order to serve poor people and poor farmers it is very important that IBWs have branches near them. In case when IBWs live near these people, they become aware of their needs and difficulties. This also helps IBWs in designing products that proved best for them. There is too much expansion needed for development of IBWs.

## Research Objectives

The purpose of this research is to throw light on the actual practises of IBs. So the research objectives are

1. To understand the incorporation of IBWs, the purpose and philosophy of their formation, rules and regulations IBWs are operating under, risks and challenges IBWs are facing.
2. To determine the difference and similarities between IBs and IBBs as well as the difference and similarities between IBBs and parent CBs.

## Research Question

This research is done to find answers of following questions.



1. What is the reality of Islamic banking branches operated under conventional banks based upon incorporation, management, rules and regulations etc?
2. What are the similarities and differences between Islamic banking branches and parent conventional banks?
3. What are the similarities and differences between Islamic banking branches operated under conventional banks and pure Islamic banks?

## **Problem Statement**

The study aims to find out details Islamic banking branches operated under conventional banks. The details will include procedures and ideology behind their incorporation, management policies, rules and regulations IBBs have to follow, risks and challenges faced by IBBs. It will be analysed that whether there is any significant connection between IBBs and parent CBs that is prohibited by sharia.

## **Scope of the Study**

The current research has been conducted in Rawalpindi. The area has been selected due to time and resource limitation. Convenience sampling has been done. The data has been collected from Islamic banking branches of conventional banks. The scope of study would have been broadening to other cities of Pakistan, but due to time and resource scarcity the study has been limited to Rawalpindi only.

## **Significance of Study**

The research is conducted to find out the actual and real positions of IBBs. Though all IBBs claim that they are following sharia principles but there is a need to verify their claims. This study adds to the body of knowledge by verifying general and special compliance of sharia principles. After going through literature it was observed that Islamic banking research limits to pure IBs only. This study is unique as research is done in order to verify the reality only in IBBs.

## **Limitations**

There are few limitations of this study.

1. Only five IBWs are selected out of fifteen due to shortage of time.

2. Data is only collected from IBBs whereas Islamic Banking Divisions are not visited.
3. The scope of study is limited as study only covers IBWs of Islamabad and Rawalpindi of selected CBs.
4. The financial statements of IBWs are not separately published and it is difficult to get them so the research is purely qualitative.
5. In order to maintain the research ethics many documents as evidence are not attached.
6. All data is collected from branches located in commercial areas so the data is related to commercial business.

The remainder of research work is divided into four parts. The second part puts light on existing literature on IBWs. The third part explains the research design and methodology. Fourth part discussed results and findings. Conclusion and recommendations constitutes fifth part.

## 2. LITERATURE REVIEW

When Islamic banking is introduced then CBs started offering Islamic products in order to take advantage of existing networks. After sometime it was decided to form a separate IBW that showed more commitment to sharia compliance. Then besides Islamic products nonbank Islamic products were also offered by IBWs like insurance products, derivative instruments and investment funds. Some CBs after that advent convert in full Islamic banks (Solé, 2007). First of all government of Malaysia allowed conventional banks to start IBWs because it is considered the most effective and efficient in terms of cost and time (Hamim S. Ahmad Mokhtar, 2008). Many researches show that IBs are more efficient than IBWs in Malaysia and CBs are more efficient than IBs.

Government of Pakistan also took steps to remove interest from economy. So it was decided to replace interest with PLS financing than hire purchase was suggested as involving in it gave opportunity to banks to actively take part in economic activities. At that time service charges and indexation of deposit accounts was also proved illegal according to sharia. Banks are allowed to do operations based on mark-up price, leasing and hire purchase in order to start interest free banking. After few years many laws and amendments in law were made in order to adopt pure Islamic banking. Musharakah and mudarabah based accounts were designed, baimujjal financing was proposed for agriculture products and small projects; unfortunately all this was not practically viable at that initial stage. The government of Pakistan was held responsible for failure in eliminating interest from economy.(Khan, 2008). In 2000s it was decided to run Islamic banking parallel to conventional banking so SBP regulates all CBs to start Islamic banking through IBWs.

IBWs mean the separate windows for Islamic banking designed by conventional banks. IBW as department within CB set up, operating and maintaining Islamic banking operations as profit and loss entities that are totally separated from operations of CBs. When owners of CB realized that riba is Haram at that time they wanted to switch on Islamic banking that was practically very difficult, so they decided to run parallel both conventional and Islamic banking. In this way CBs started IBWs. Some CBs only started IBWs in order to cater need of Muslim customers only(A.Alaro, 2009). There are three basic requirements CBs has to be filled while starting IBWs that are segregation of funds, formation of Sharia Supervisory Board (SSB) and compliance of accounting and auditing standards.

IBWs are operating all over the world. CBs have to fulfil certain requirements to start an IBW. The extension of above article was given by NizamYaquby (2011). There are several forms of managing Islamic products. First form is Islamic bank, made a portfolio of Islamic products and then deals in it. The second form described that CBs offer and deals in Islamic products along with their interest based products. The third form of dealing in Islamic products is that CBs open an IBW and start business of Islamic products. The basic requirements CBs have to fulfil in order to start IBWs includes complete segregation of funds, existence of sharia supervisory board to design and approve products and procedures, committed management to Islamic principles, adopt standards prescribed by Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and safeguarding of Muslim investor's funds from discrepancy, fraud, theft etc.(Yaquby, 1999) This paper put light on all initial requirements to fulfil by CBs but tells nothing about the insurance of sharia based operations of IBWs. The paper does not tell anything about the philosophy behind formation of IBWs, the source of capital and the target market. It only gives the initial steps to take in formation of IBWs and the practical applications are missing.

Technically there is no difference between CBs and IBs as both accept deposits and offer lending. IBs are based on sharia principles that prohibit riba. In IBs the interest based transactions are replaced by profit and loss sharing principle, fee or charged based principles, free service principles, and ancillary service principle.(Madun Y. K., 2013)

There is difference between Islamic banking and conventional banking. IBs and CBs are similar in a way that both offer similar services and playing role in economic development. However, unlike CBs IBs strictly comply with the sharia rules. It is clearly define that purpose of IBs is to employ funds according to the sharia principles for the development of society in which they are operating. It is worth noting that there is little number of full-fledged IBs, many countries used IBWs of CBs to offer sharia based or Islamic products. In order to enhance their performance IBs should pay attention on Islamic business ethics, customer satisfaction, innovation of products and services, financial positioning, and operational improvement (Moutinho, 1997). IBs diverge from CBs in several ways. There are four basic differences in IBs and CBs. First, the deposits and investments are explicitly or implicitly assured. Second PLS modes are not strictly applied because in current practise it is unable to strictly comply with them. Third IBs mostly use non-PLS modes and take less risk. Fourth, there is discretion in deciding about collateral (Muhammed S. A., 2013).

The basic motive of Islamic banking is social service whereas conventional banking prefer profit maximization. Islamic banking is the value based system that aims at ensuring material and moral wellbeing of individuals and society(Bhatti M. M., Why interest free banking and finance movement failed in Pakistan, 2006). Islamic finance has positive relation in economic growth that means that in GCC countries Islamic finance is playing role in economic development (Kaouthar, 2014). Poverty alleviation is a teaching of Islam and as IBs ideology also came from Islam so this principle is not new and alien to IBs. The contract of loan or financing is based on two things; trust and collateral. Poor people have lack of collateral so CBs avoid financing them. In such situations IBs have to play their part. IBs can take part in micro financing by mobilizing internal and external funds and offering demand oriented products by using profit and loss sharing modes, exchange modes, hybrid modes and voluntary charitable contracts. In order to minimize risks SPV will be formed that has only objective to promote and deals in microfinance (Dusuki, 2008). IBs should play role in poverty reduction by dealing in micro finance. There arises a question that practically this concept is taking place or not. IBs market themselves on grounds of social justice and poverty alleviation. The IBs claim that they adhere with sharia rulings, they fund socially beneficial projects, design such schemes that help poor, actively participate in charity, donations and community welfare programs and deals in Qard-e-hassana. It is accepted that IBs do all these things (Rammal, 2013). The problem is that IBs pay no attention in reporting all these things. There is lack of evidence on above mentioned things that raise a question of their applicability. On such grounds many claim that there is no difference between operations of IBs and CBs.

Interest is the main thing in conventional banking but Islamic banking is introduced in order to eliminate riba. In IBs interest is replaced by PLS financing. PLS financing built such a relationship of lender, borrower and intermediary that is based on trust and partnership that eliminates number of agency issues and risks. There are four types of activities that are alternative of interest base activities that are investment-based, sale-based, rent-based and service-based(Sufian, 2007).

The products of IBs and CBs are similar as well as different. IBs offer similar products and services as the CBs like current account, PLS saving account, fixed deposit account etc. The only difference lies is the compliance of operations of IBs with sharia laws(Fong, 2011). IBs follow the principle that they exclude interest (riba), avoid major uncertainty (gharar), and

ignore gambling like features (maysir). IBs offer wide range of goods and services like consumer goods, trade related products and investment type of modes of financing.(Siddiqui, 2008)

IBs governance structure is different from CBs. Governance structure of IBs is different and complicated. The governance structure of IBs requires establishing SSB and strict internal control. There are three sections of sharia governance framework the management, board and sharia committee. The bank has to establish two tier sharia governance infrastructure that have two components; a centralized sharia advisory board and the internal sharia committee. The SSB faced several functional issues like independence, confidentiality, consistency, competency and disclosure (Sulaiman Abdullah Saif Alnasser Jorah Muhammed, 2012).The sharia supervision means in IBs. According to them sharia supervision cover four activities that are revising major documents and policies of IBs, issuing religious rules that are used in designing products, revising the compliance of products with fatwas and reporting their opinions. Sharia supervision is important for IBs from religious, legal, economic, social, and governance prospectus. Sharia supervision clarifies that products offered and procedures adopted are in compliance with religion. IBs are legally bound for sharia supervision. When IBs design products through sharia supervision, products ultimately add profit to IBs and added in economic development and shareholders wealth is also increased. Sharia supervision also assists executives and management of IBs.The objectives of sharia supervision include insurance of compliance of products with Fatwas, protect shareholders wealth, awareness of human capital about sharia rulings and increase shareholders confidence. The real practise in IBs and IBWs need to be verified in sharia supervision (Pierce, 2010).In IBs Board of Commissioners (BOC) substitutes the role of BOD. BOC is responsible to appoint the members of SSB. There is a President Director who is head of the BOD and has authority to appoint and deal directly with BOC, SSB and Board of Auditors. IBs main mode of financing is sharia based financing but it is ignored because this type of financing arises several agency issues due to difference in interests of principles and agents, IBs are unable to resolve them. These issues are resolved by introducing Venture Capital in IBs to align agent interest with principles. Another issue is that there is again a contradiction between interests of BOD and SSB. BOD only keeps in mind profit motive and SSB focus only on compliance with sharia rulings. In order to harmonize interests of both BODS has to be committed with sharia rulings and SSB members should have knowledge of finance with Islamic knowledge. The principles of corporate governance are discipline, accountability, fairness, independence, responsibility,

transparency and social responsibility (Ghayad, 2008). In case of unrestricted investment holders IBs ignore discipline and accountability. This situation is very problematic for IBs as investment holders entered in PLS financing so they have right to know how their money is utilized and ultimately their agents have similar interest. IBs have to design their corporate governance that fulfils all needs of stakeholders in order to maintain the trust of them(Saad, 2013).

There is also difference between corporate governance of IBs and IBWs. IBs and IBWs face two issues while designing corporate governance structure that are wealth maximization of shareholder as well as compliance with sharia standards(Faareha, 2013). SSB reporting structure and composition is very strong in IBWs but the orientation, training and development of BOD needed attention and have to be improved. Governance structure of IBs that includes BOD and SSB plays their role in IBs better performance. The roles of BOD include monitoring and controlling the implementation of policies, strategic decision making, counselling and advising top management, and relevant information availability. The value added roles of SSB are controlling and monitoring religious side of IBs, providing relevant information to CEO about sharia rulings, advising and counselling of external environment regarding products and fatwas, and guiding and training top management about Islamic teachings(Ribièrè, 2007).

IBs face number of risk like different organizations and CBs but the nature and reasons of these risks are quite different. The risk face due to noncompliance with sharia rulings is known as sharia risk. The implications of sharia risk are financial and nonfinancial losses. Financial losses include credit risk, legal risk, compliance risk, reputational risk and market risk. Nonfinancial loss includes spiritual blemishes. Sharia risk arouse due to internal and external causes. In order to avoid it efficient and committed BOD and SSB should be required(Karim, 2014). IBs face credit risk, liquidity risk, agency problems, solvency risk etc. It is claimed that IBWs managed their solvency risk by taking assistance from their parent CBs. Another matter of concern is that IBs and IBWs are engaged in short term projects that are beneficial in short term only but for future growth IBs have to be involved in long term projects(Siddiqui, 2008). Risk management is a continuous process that is altered according to the internal and external environment of banks. The CBs and IBs ranked the risk in same order that is credit risk, liquidity risk, operational risk, legal risk, regulatory risk, and reputational risk. They found that IBs face higher level of risk than CBs. The reason

considered, behind this finding, is the large involvement of IBs in murabaha financing and small investments in musharakah and murabaha(Ajmi, 2012). IBs deal in many complicated products and in special environment so the risk they faced is greater than CBs. They found that all IBs are well aware of risk management process. The problems in managing and minimizing risk are lack of skilled professionals and capital. The solution for minimizing risk is the formation of separate risk management department in IBs and IBWs(Amjad, 2012). IBs are facing high risk problem because IBs are relatively new born in industry and they also have to face strict sharia regulations. They also found that CBs and IBs face similar risks in Pakistan but the magnitude is no doubt different. It is also discovered that CBs more rigorously manage and mitigate rate of return risk, liquidity risk, market risk and equity investment risk. Whereas, IBs most frequently practice risk management and mitigation on rate of return risk, market risk and equity investment risk. .Operations of IBs are unique and IBs are new in industry so in order to get customer trust and meet their expectations IBs have to manage their liquidity risk efficiently. The current practises of managing liquidity risk adopted by IBs and IBWs are at liability side they use support from excellent banking services, expansion of branches and variety of return on deposits and asset side management includes compliance with sharia, set up mutual business agreements, and variety of financing schemes(Hassan, 2013). IBs should follow following in order to manage this risk; institutional deepening, restructuring liquidity management process on asset and liability sides , and revitalization of usage of Islamic liquidity instruments. IBs face similar legal risk as of CBs. The difference in IBs and CBs are not of only terminologies but the operations of IBs are different because IBs have to follow sharia principles(Djojogito, 2008).

There are number of issues IBs and IBWs are facing. Some of them are product innovation, operational excellence, distribution, liquidity management practices, managing the talent pool, constant sharia supervision and addressing legal and tax restrictions. Teaching and training is also a big challenge for IBs(Muhammed S. A., 2013).

The most important issue is of service quality of IBs and IBWs that raise complicated issues of customer value, loyalty, preference etc. Service quality is a critical measure for organizational performance especially for banks. The service quality of CBs is better than IBs on the ground of convenience, competency and tangibility(Fong, 2011). These issues arise because of lack of skilled experts in IBs. There are only few service experts that serve few customers at the same time and many customers are ignored. In order to bridge this gap leadership and high commitment of top management is required. The trainings of



professionals have to be conducted for skill development as well as increase their knowledge regarding sharia laws. A bank that offer similar products like CBs can increase customer value by adhering to sharia rulings. Only adherence to sharia is not a reason of customer patriotism. The big mistake of IBs is that they only believe that adoption and adherence to sharia laws is enough for customer satisfaction, service quality is very important component of customer satisfaction that ultimately reflects in customer patriotism(Aftab, 2013).Customer loyalty is the result of satisfaction, trust, and image.In Malaysia, IBs and IBWs win to get customer satisfaction of Muslim and non-Muslim customers. Muslim customers are more attached to sharia laws. Their satisfaction, loyalty, image and trust on IBs and IBWs depend upon the adoption and adherence on sharia laws. It is derived that for IBs and IBWs in order to increase their customer loyalty should adopt such principles and policies that confirm their operations to compliance of sharia(Fontaine, 2013).Individual consumers that are Muslims prefer Islamic banking. The selection criteria of consumers for banking are religion above all other factors. The situation of business firms in selecting banks is very different. The businesses prefer reliability, assurance, price and service quality. The other factors other than religion relating in decision making are cost of borrowing, expected rate of return, and degree of risk sharing(Worthington, 2008). There is lack of information to businesses firm about Islamic finance thatraises the need for IBs to design business related products and extensively market them to attract businesses.

Similar and limited products are also a sensitive issue. In contracts of IBs five tenets that are seller, buyer, price, commodity and exchange mode should be mentioned. It is claimed that growth of IBs depends upon increase in customers and deposits that should be enhanced by attracting business customers. IBs face the issues of limited products, lack of convenience, lack of expert employees, lack of information and incompetency of IBs employees etc. Another big doubt in minds of people is as IBWs are operating under CBs so they share infrastructure and resources. Such issues become hurdle in growth of IBs. IBs have to resolve these issues as well as rigours promote its products for growth(Madun Y. K., 2013).

There is lack of legal structure for IBs. There are two established laws in the world; civil law and common law system. There is lack of proper Islamic laws for contracts, Islamic instruments and operations of IBs. Most procedures are not written as demanded by common law that's why not force able(Djojosingito, 2008). The difference between Islamic principles and sharia laws are not communicated which also raise many problems.

Maintaining profitability is very important for IBs in order to expand and grow. CBs are more profitable in terms of average return on assets, bank size and board size but IBs are efficient in lending activities and controlling expenses. Moreover IBs have better liquidity position and they have better capacity to absorb loan losses than CBs. Net interest margin (returns) of IBs are significantly higher than CBs that shows that IBs are more profitable than CBs(Gunasegavan, 2013). IBs are growing rapidly but there are still number of challenges that IBs are facing like excess liquidity need, scarcity of trained professionals and sharia experts, risk management strategies and corporate governance, complex product and process and insufficient R&D commitment(Bhatti M. M., 2008).

There are number of criticism on IBs and IBs. Reasons of failure of interest free banking movement in Pakistan are following. The major reason was unfavourable government machinery that includes lack of political support and noncommittal attitude of bureaucrats. Lack of Islamic vision, insufficient expertise of bankers, inefficient features of finance and expensive services also became reason of failure of movement. The business and general public also showed hesitation to adopt interest free banking. The absence of fair judicial system also discourages Islamic banking. All these issues became a reason that put a hurdle in a way of Islamic banking(Bhatti M. M., Why interest free banking and finance movement failed in Pakistan, 2006).

The gap investigated between Islamic development objectives and current practice of Sudanese IBs (SIBs). It was assumed that the basic and foremost objective of SIBs is the development of the country. SIBs focused on sharia complaint financing rather than sharia based financing. The uneven branch network of SIBs made a contradiction on rural and backward area development objectives. The study shows that SIBs focused on short term financing and ignored medium and long term financing. SIBs were not considered effective in reduction of poverty as their performance indicators are poor. There was a huge gap in practise of SIBs(Ibrahim B. E., 2006).

IBs practise credit sale in which IB purchase the asset on cash and then sell it on credit basis. In this way IBs are playing role of seller and customer is buyer. In this way the risk taking and value addition principle of Islamic finance is lost. In IBs practise the attributes of ijarah like end financing, taking contractual profits on basis of time value of money and legal charges on purchase of assets that are similar with CBs. Thus the contract of credit sale and lease finance is similar to loan on which return is get without assuming any market risk and

value addition. In this way the credit financing and lease financing of IBs are no more different than CBs. In such a situation the trust of customers and image of IBs is poorly destroyed that results in poor performance of IBs (Bakar, 2003). IBs primarily rely on musharakah and mudarabah but there is a significant difference between theory and practise. The practical scope of these financing is very limited. IBs cannot reflect the return of PLS financing due to lack of regulatory framework in IBs and insurance of depositors (Bhatti M. M., 2008). IBs pay attention to ijarah, murabaha, baisalam and baiistasna but these are not PLS financing modes.

Islamic microfinance (IMF) has to play a significant role in poverty alleviation but IMF is facing number of issues that are broadly categorize in four. There is lack of market penetration by IBs to cater needs of poor. There is lack of funds and lack of product diversification. Transaction cost of IMF is very high even a small loan is too expensive. Ideally IMF is designed to help poor but in reality it is operated by forces like illiteracy, caste, gender etc (Faisal, 2013). The problems faced by farmers include high lending rates, the contracts of loans bound farmers to purchase seeds from prescribed dealers that sold below quality seeds, lack of collaterals, lack of awareness and approach to CBs. In this research paper it is proposed that IBs can assist farmers in getting credit using salam contract. In order to eliminate the risk factor IBs can appoint middle man or use the foresight of their industrial musharakah partners in salam contracts. After entering salam contract IBs have to monitor the crop growth continuously and assist the farmer on regular basis. In such a way the IBs got dual benefits. They took part on poverty alleviation as well as profitable business transaction (Wajid, 2009). The practical adoption of this need have to be investigated for IBs and IBWs.

## Research Hypotheses

**H1:** Islamic banking branches operated under conventional banks have no relationship with conventional banking.

**H2:** Islamic banking branches operated under conventional banks are similar with pure Islamic banks.

These research hypotheses are formulated after analysing the research gap. The researchers basically focus pure Islamic banks but the reality of IBBs is not audited yet especially in case

of Pakistan. The findings of the literature review raised the need of research in the case of IBBs.

### 3. METHODOLOGY

There are various methods and sources of data collection. The sources of data are primary source and secondary source. In this research primary data is collected through interviews using interview guide from the professionals of Islamic banking branches located in Rawalpindi. The data is collected keeping in view the following areas

- i. Incorporation
- ii. Strategic approach
- iii. Rules and Regulations
- iv. Management
- v. Risks
- vi. Challenges

#### Population

The population selected for the research purpose is Islamic banking branches operated under conventional banks. The IBBs include IBBs of Askari bank, Habib Bank Limited, Faysal Bank, Muslim Commercial bank and Alfalah Bank. Convenience sampling is done and these banks are selected for data collection. Another important thing behind selection criteria is that these banks are easily visited and checked by sharia advisors also. The Commercial market branch of Askari bank was visited. All managers there are very cooperative and share data easily. They consider it their corporate social responsibility. The Hyder road saddar branch of Habib Bank Limited was visited. Their response was very positive and shares all data very friendly.

#### Sample Size

The sample size of current study is 15. Data is collected from five IBBs operated under CBs and three interviews are conducted in each branch. Data is collected by conducting interviews with operations manager, strategic manager, relationship manager and sales officers. Interviews are conducted using interview guide. Branch workers are less in quantity so sample size is small. Data collected through interviews are then analysed.

#### Type of Study

The current study is descriptive and pure qualitative that determines the characteristics of Islamic banking operations carried by Islamic banking branches according to sharia

principles and the relationship of Islamic banking branches with their parent conventional banks.

### **Development of Data Collection Instrument**

A questionnaire is designed that include multiple questions covering different areas. Questionnaire is divided into different sections. These sections include incorporation, strategic approach, rules and regulations, operations, risk and challenges. This questionnaire is used to collect data. Detailed interviews are conducted in a friendly environment. In this way technical information is collected and also some important things are observed. Data is also collected by analysing brochures and websites of these banks. Some helpful documents are also analysed for data collection.

## 4. RESULTS AND FINDINGS

The information got from interviews is presented below.

### 4.1 Incorporation

The basic reason due to which conventional banks start IBB is the regulation of state bank. In 2000s SBP made a policy to start Islamic banking parallel to conventional banking. After that decision SBP passed an order in which it is compulsory for all CBs operating in Pakistan to start offering Islamic banking products. At that time some CBs start offering Islamic banking products through IBWs later on they got license to start Separate Islamic banking branches (IBBs). After that a separate division for Islamic banking was designed that has different setup and experts from conventional banks. It is not wrong to say that there is two wings of parent bank one is conventional and other is Islamic. There is no connection between these two wings except of same parent. All setup, operations, physical space, management etc are different for each one.

The IBBs under consideration started their operations between 2001- 2008. One IBB started operations in 2001, other in 2005, one of them in 2008, one of them started in 2003 and the last one started in 2006. The total number of branches also varies. There are 40 IBBs including 2 sub branches of one bank under study. This bank aims to open 5 more IBBs in current year. One of these banks has 39 IBBs and 3000 IBWs are currently working. The other has 53 IBBs. One of them has just 27 IBBs in operation. One of the banks have a wide network of 140 IBB operated in 132 cities. The branch network of few IBBs under observation is also given in order to show the coverage areas and concentration of IBBs in these areas. One bank under observation has following number of branches in listed cities.

Table 4.5 IBB City wise Branch Network<sup>5</sup>

S.N	Cities	Number of Branches
1	Multan	1
2	Lahore	5
3	Quetta	1
4	Rawalpindi	1
5	Sargodha	1
6	Islamabad	2
7	Gujranwala	1

<sup>5</sup> Source: Primary data collected from source

8	Karachi	6
9	Faisalabad	2
10	Peshawar	2
11	Khushab	1
12	Sukkur	1
13	TandoAllahyar	1
14	Hyderabad	1
15	Rahem Yar Khan	1
Total		27

Other two banks divide all area in regions i.e. North, South and central in order to efficiently manage their IBBs.

Table 4.6 IBB City wise Branch Network<sup>6</sup>

Region	City	Number of branches
North	Islamabad	3
	Rawalpindi	1
	Mansehra	1
	Azad Kashmir	1
	Sawat	1
	Mardan	1
	Charsadda	1
	Noshera	1
	Buner	1
	Kohat	1
	DI Khan	1
	Bannu	1
Peshawar	4	
South	Karachi	10
	Hyderabad	2
	Quetta	2
Central	Faisalabad	3

<sup>6</sup>Source: Primary data collected from source



	Multan	2
	Bahawalpur	1
	Talagang	1
	Sialkot	1
	Gujranwala	1
	Gujrat	1
	Lahore	11
Total		53

Table 4.7IBB City wise Branch Network<sup>7</sup>

Region	City	Number of branches
North	Islamabad	4
	Rawalpindi	4
	Abbotabad	1
	Chilas	1
	Sihala	1
	Kohat	1
	WahCantt	1
	Peshawar	4
South	Karachi	10
	Hyderabad	1
	Quetta	2
Central	Faislabad	1
	Multan	1
	Sargodha	1
	Jalal PurJattan	1
	Sialkot	1
	Gujranwala	1
	Gujrat	1
	Sheikhupura	1
	Lahore	8

<sup>7</sup>Source: Primary data collected from source

Total	46
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Conventional banks start IBBs for the purpose of profit maximization. It is understood that private companies only survived with their earnings. The philosophy behind establishment of separate Islamic banking division is to earn profit and achieve growth. When Islamic banking was introduced in Pakistan at that time many religious peoples welcomed Islamic banking. Another thing that alters the attitude of people regarding conventional banking is the unlawfulness of interest. People avoid conventional banking and especially the products that are based on interest. They started converting their saving and fixed accounts into current accounts on which there is no interest income. When a full-fledged Islamic bank named Meezan Bank was introduced in 2002 than such people moved towards it. This situation gave loss to CBs as there is reduction in their customer base. After that many CBs took a strategic decision to start a separate Islamic banking department to cater need of such customers. This situation becomes second reason for establishment of IBBs.

According to findings 2 out of 5 IBBs show a special commitment with Islamic banking. 1 IBB is going to leave all their conventional banking operations and systems and transform into pure IB in 2015. It is decided keeping in view the successful and profitable IBBS. This bank explains that their first IBB was formed in 2008. After the success and profitability of IBBs the upper management took the decision to become a full dedicated Islamic bank.

In response of question about incorporation procedure of IBB almost all banks respond that they just applied for the license for starting IBBs. The procedure for applying for Islamic banking license includes following steps. First requirement is fulfil eligibility criteria, then submission of proposal and processing fee after fulfilling all prescribed requirements of SBP. Bank has to check the eligibility criteria. Eligibility criteria for CB to start Islamic banking is that bank's CAMEL rating must be 1, 2 or 3; bank has no past adverse inspection; and bank is able to hire skilled professionals for Islamic banking. When bank fulfil eligibility criteria than bank has to submit a written proposal to Islamic Banking Department of SBP along with a processing fee of PKR 25,000/-. The proposals without processing fee are rejected. The proposal should outline all necessary information that includes number of branches, their location, products, infrastructure and logistics, accounting procedures, name and qualification of sharia advisor, and details of segregation of fund. SBP issue the license after evaluation of application which should be in accordance with provisions of section 28 of Banking

Companies Ordinance 1962. The bank is free to reallocate their existing branches. In order to make new or more branches then bank has to apply for permission from SBP. It is required to furnish an Annual Islamic Banking Branch Expansion Plan to SBP in January or February of a year in which opening of new branches is planned. The license of Islamic banking may be cancelled if SBP find any discrepancy or violation of rules and regulations. It is also necessary for bank to submit essential documents like certification from sharia advisor, product manuals, risk management plans etc to SBP before commencement of business. Bank is required to make an Islamic Banking Division (IBD) at its country/ head office. The organizational structure of IBD should be designed and reported to SBP also. The IBD should be headed by senior and experienced executive that reports directly to the CEO and other operations are carried by skilled professionals. Duties and authorities of IBD are also outlined by SBP that has to be fulfilled. The requirements that have to be fulfilled by bank are also mentioned. SBP regulated that bank has to be maintained Islamic Banking Fund. The Islamic branch of bank has to carry a name and this name must be displayed. A qualified sharia advisor must be appointed to check daily transaction of IBBs. The bank has to maintain all documents to ensure segregation of funds. Internal control and Sharia Review should also be carried out. It is necessary for IBBs to maintain their separate books of accounts. Bank has to submit their annual and quarterly financial statements of IBBs separately. The bank has to maintain statutory liquidity and cash reserve requirement separately for Islamic banking. For that purpose separate account for IBB has to be opened with SBP. According to guidelines for opening a separate IBB it is necessary to for IBD to maintain 11% of their time and demand liabilities and 10% of daily SR and CSR in account maintained with SBP. After fulfilling all mentioned requirements that are prescribed by SBP, the banks got license after which they started their Islamic banking operations. This is the detailed procedure followed in order to start IBBs. There is no other legalities or documents except the above mentioned.

All banks have their own corporate visions that are not same for their Islamic banking. The vision of IBB of one bank wants to cater need of their diverse clientele. It wants to serve well their customers with their required products and services. One of the IBBs started with a vision to provide sharia compliance solutions after the regulation of SBP. Another bank wants to provide Halal Banking solutions to their customers. One of the banks wants to be market leader in Islamic banking by capturing major market share. The combined vision of banks for IBBs is to provide people with sharia solutions to meet their daily saving and financing requirements.

The objectives of IBBs include that IBBs want to offer unique sharia products and services, in spite of just being a follower of CB. Another dedicated IBB has aimed to meet Islamic banking needs of customers with the help of well trained professionals. One IBB has objective to offer Islamic products to all sectors and demographic regions in order to cater their need of earning halal profits and also provides sharia solution for complex financial positions which are also assisted and designed by their sharia advisors.

The scope of business of IBBs is offering and dealing in pure Islamic products and sharia products. All operations of IBBs that are necessary to run business are in accordance with sharia principles. IBBs only deal in such products that are designed using modes of Islamic finance. IBBs operating in Pakistan are offering their services only to Muslims yet as there are majority of Muslims in the country.

## 4.2 Strategic approach

When question about mission is asked than the response of one IBB is that there mission is to promote Islamic banking with trust of customer through Islamic products and to increase their customer base and win customer loyalty. Another response is to set up an efficient banking platform that provides social justice and economic welfare of the society. The mission of one IBB is to provide better services and by providing good quality services they want to capture maximum customers. Another IBB has mission to ensure that Islamic banking needs of their customers are fulfilled. The objective and policy formation is done at IBDs at head offices that are not directly communicated to IBBs. The objectives and policies are sub divided into targets that are communicated at branch level. A target is given to each branch which they have to meet within required time. There are separate targets for each product offered by IBBs and there is also some combined targetsof branch which should becompleted before deadline. The targets are normally of sales. Every IBB wants to increase their customer base and ultimately profits.

The strategic approach of IBBs includes put emphasis on further growth and expansion of their IBBs. For that purpose awareness becomes a hurdle. In order to remove that hurdle one bank started a campaign last year to create awareness regarding IBWs that was also in line with SBP regulatory strategy of spreading awareness regarding Islamic banking. All such thing helps this bank to improve its brand image. It also actively took part in various forums for promotion of Islamic banking through distributing brochures, setting stalls in exhibitions

and banking conferences, arranging seminars etc. In this bank recent developments to achieve and secure their strategies include designing and approval of operations and Islamic banking asset based products manuals, formation of pools for transparent management of investments and calculations of profits and costs. Extensive in house and out house trainings are arranged for staff in order to educate them about sharia products and operations. Another very important development in that IBB is the offering of Islamic products through IBWs in conventional branches. This is done in order to facilitate customers and to increase Islamic banking deposits. In 2013 this bank also put application for NOC in order to establish a full-fledged Islamic banking subsidiary that has paid up capital of Rs 10 Billion. SBP approved it in this year and soon working on this project is going to be started. Another bank also started Islamic banking outreach program. Under this program IBWs are going to be opened in conventional branches to offer Islamic products. In order to support this Sales Transformation Program was also launched. There is zero tolerance policy regarding sharia compliance for IBB. So it is not wrong to say that banks have special connections with their IBBs and they want to expand in this area so they are making efforts to achieve this.

Currently all IBBs operated under CBs are market followers. They want to become market leader but they have not enough customer base and product range to be so. Mostly pure Islamic banks are market leaders in Islamic banking. IBBs of CBs are far behind from the place of market leader. Another special thing in market position is that as IBBs are operated under branch names of CBs so their market positioning is not separate for CBs and IBBs. The market position of parent bank reflects the market position of IBBs also. Some IBBs selected belongs to market leaders CBs so their IBBs are also having similar market position with other IBBs. But when these IBBs are compared with overall Islamic banking than it is clear that pure IBBs come first on rating and then IBBs of CBs ranked.

The market share of one IBB is 5-6%. Another IBB has market share of 2-3% approximately and other IBBs also has similar market share. One out of five IBBs has significant market share which assist them to take a decision of conversion of its conventional banking into pure Islamic banking.

When it is asked about competitive edge of each IBB than one IBB said service quality is their competitive edge. Another IBB claimed that our corporate image is their complete edge. Best branch network is served as competitive edge for another IBB. Brand name is also a competitive edge of IBB.

Interviews regarding the similarities of IBBs and IBs revealed that they are same in products, operations, sharia rulings, regulations to fulfil. It can be said that IBBs are just running under CBs but there is nothing different except this ownership structure. Pure IBs and IBBs are similar in business nature, have similar customers and are direct competitors of each other. There is only a single difference between IBBs and IBs that is of ownership. Otherwise IBs and IBBs are similar in business, operations, products, services etc. There is also a difference in IBs and IBBs that are not same for all IBBs but is present in few IBBs that is the dedication of upper management. In IBs the owners and upper management is highly dedicated to their IBs but in few IBBs Islamic banking is started only under the pressure of SBP requirement. The management is not fully dedicated to IBBs. They only run IBBs to fulfil the orders of SBP.

All respondents said that their target market is those people that consider interest is haram and unlawful. There is no distinction between any sectors, locations, industry, cast or even religion. One respondent is serving following sectors Chemical and Pharmaceutical, Agribusiness, Textile, Services, Sugar, GOP Ijarah Sukuk, Ship breaking, Food and Tobacco and some other sectors. One respondent is serving Chemical and Pharmaceuticals, textile, Financial - Islamic Modes , Food and Beverages, Cement, Information Technology, Printing and Publishing, Glass Manufacturing, Public / Government, Education and Medical, Oil and Gas, Port and Shipping, Telecommunication, Power and Energy, and Others sectors. One respondent share their investment percentage in each sector also. Agriculture / Agribusiness 4.51, Automobiles & Allied 0.04, Cables / Electronics 0.21, Cements 0.52, Chemicals / Pharmaceuticals 0.02, Education -, Engineering 0.24, Fertilizers 6.21, Food and Allied 1.37, Fuel / Energy 0.24, Ghee and Edible Oil 0.03, GOP Ijarah Sukuk ( Airport & Highway Land) 34.27, Hotels and Restaurants 0.06, Individuals 3.64, Investment Banks / Scheduled Banks 28.01, Leather Products and Shoes, Plastic products 0.22, Ready- Made garments 0.46, Real Estate / Construction 0.10, Rice Processing and trading 1.59, Rubber Products -, Services (Other than Financial, Hoteling & Traveling) 1.56, Sugar 4.07, Textile 2.82, Transport and communication 0.01, Public sector / Government 9.26, Others 0.54. All this information tells that IBBs are serving almost all sectors of economy in Pakistan.

### 4.3 Rules and Regulations

All respondents respond similarly to the question about rules for IBBs. There is no special rule IBBs has to follow. The rules IBBs has to obey are mentioned in detail at the time of

incorporation. IBBs only have to observe these rules. They have to carry their operations in line with sharia principles. The products must be Islamic in nature. All policies must communicate Islamic laws and principles. There are no other regulations on IBBs from SBP. SBP relaxed IBBs in order to promote Islamic banking.

SBP put capital requirement and liquidity requirement for IBBs also. It is the duty of IBD of all banks to maintain that liquidity requirement and capital reserve requirement with SBP. IBBs have nothing to do for it. All this is done by IBD for all its IBBs.

All respondents said that it is the duty of treasury and IBD that is operated in head offices to make policies in response of monetary policy. Individual IBBs has nothing to do with it. Normally policies in response of monetary policy are made jointly for CBs and IBBs.

The IBBs are totally independent in all things. There is no connection between CBs and IBBs. IBBs policies, targets, operations, products, professionals, even each and every thing is separate and independent from CBs. There is a possibility that policies and objectives may be somewhat similar for conventional banking and Islamic banking only because they are formulated and designed by person having a specific state of mind and a person's state of mind is reflected from his/her tasks.

#### 4.4 Management

Before discussing the products offered by IBBs under observation the concepts of musharaka, mudaraba, ijara, murabaha, and diminishing musharakah prevalent in IBBs are presented. When asked about musharaka the IBBs professionals tell that musharakah is a partnership mode in which the client and IBB becomes partner in a business and asset. But this mode is not used by IBBs as there are number of limitations of it. Mudaraba is widely used in IBBs on which basis all deposit accounts except current account are designed. In IBBs mudaraba is defined as a relationship between client and IBB in which client invests his/her money and become *rabul mall* and bank is responsible to use that money to earn profit by doing business and perform the responsibilities of *Mudarib*. At the same time IBBs also become *rabul mall* when they use this money to invest in other business and provide it financing and demands profit from that business. Keeping in view the current business environment of Pakistan IBBs are hesitant to become a partner in a business so they use murabaha and ijara to finance other business and earn profit. Murabaha is defined as cost plus profit sale. In murabaha financing IBBs purchase required assets and sale these assets to clients on demand. In murabaha

financing IBBs disclosed the actual cost and profit of asset to client. Ijarah is a term in which asset is provided to client on rent basis. The client has to bear the expenses that are associated with the usage of asset while IBBs bear expenses that are related to ownership. For ijarah client has to deposit a security fee with bank that is returned when ijarah contract is matured. The rent that is prevalent in market is charged from the client. On maturity IBBs offer client to get the ownership of asset in place of security deposit. This decision of client is totally dependent on his/her own will. Diminishing musharaka is also used by few IBBs. In it the IBB and client purchase as asset with mutual ownership. Normally IBB's share in the ownership is 70-80% and remaining share is of client. The IBBs give the asset to client for usage on rent and also give an offer to client to purchase the asset unit by unit. The client agreed and pays rent and a price of each unit monthly. The unit price and rent is decided according to the market conditions. One out of five IBBs under observation offer salam financing also. The salam is a type of financing in which advance payment is given for future delivery of good. That IBB uses salam for agriculture. At the maturity the IBB sale the agricultural product in the open market and the difference between sale price and purchase price constitute the profit of IBB.

There are number of products offered by IBBs. One of the respondent offers these products and services; Basic Banking Account (BBA), Current Account, PLS account, Al-Samarat Account, Al-Mukhtar Account, Al-Irtafa Account, Murabaha Financing, Diminishing Musharaka Financing, Ijarah Financing, Trade services and value added services. The detail of each product is also mentioned. The characteristics of Basic Business Account are that it can be opened with a minimum balance of PKR 1000, there is no profit on this account, there is no minimum balance requirement and it offers 4 free transactions every month 2 for deposit and 2 for withdrawals. Current account is non-profit bearing and the account holder has an ease to operate this account in PKR, EUR, USD and GBP. PLS account is opened either in PKR or EUR or GBP or USD. The profit rate and minimum balance is dependent on selection of currency. The profit paid on this account is on the basis of Mudaraba semi-annually. Al-Samarat account is designed using Mudaraba financing. The holder of account is Rabul mall and bank plays the role of Mudarib. The minimum investment is of PKR 25,000. Profit is calculated according to the rules of mudaraba. The withdrawal of investment or capital is only done at the end of time period that is mentioned in the contract. Al-Mukhtar account is designed in order to give account holder fast number of services and ease. The feature of this account includes free cash deposits and withdrawals from any branch of



serving bank, funds can be transferred online without any fee, free cheque books, free duplicate account statements, free Banker's cheque, free debit card and SMS alerts. This respondent designs a special account to cater need of business and corporations of all sizes. It is Al-Irtafa account. The minimum balance requirement is PKR 500,000. There are multiple profit pay outs options on monthly basis. This bank also offers financing products. The murabaha financing covers the purchase of spare parts, raw materials, semi-finished goods as well as finished goods. These purchases can be done from either local markets or foreign markets. Diminishing musharaka financing is offered for joint ownership in vehicles, machinery and plants for medium and long term. Ijarah financing covers the rentals of plants, vehicles and machinery either for medium or long term. Trade services of this bank include collection of foreign bills, letter of credit facility, and collection of local bills and letter of guarantees. The value added services include ATM/Debit card facility, utility bills collection, phone banking, internet banking and foreign/inland remittances.

Another respondent offers products cover multiples categories like they offer Islamic consumer banking, Islamic general banking, Islamic trade finance, Islamic corporate banking, and Islamic investment banking.. The Islamic consumer banking products include home musharaka and ijarah bis sayyarah. The home musharaka facilitates a person to construct, purchase, innovate and transfer existing houses. The basic features of this product is that it is sharia compliant; finance tenure is from 3 to 20 years, easy and simple. This product is based on diminishing musharaka and follows all series of steps as required in diminishing musharaka. Home financing is further distributed in four categories. Home musharakah purchase is designed to purchase a home and maximum PKR 50 million financing is done through it which has to cover only 85% of the property cost. Home musharaka construction enable people to build their home as desired using halal istasna/musharaka financing. With home musharaka improvement renovation can be done on existing home. Home musharaka transfer enable people to enjoy benefits of conventional home mortgage by adopting halal ways. There are no hard and fast requirements to apply for home financing. The eligibility criteria include the nationality of Pakistan, age limit 21 to 65 years, a person must be permanent employee with at least six months of current service, for businessmen 3 years history of business is required. Another consumer product offered is ijarah bis sayyarah. This product covers the car financing. This product offered local or imported new or used cars on rent to clients. The specific feature of this product is that the rent is charged with the delivery of car to the user. Expenses related with ownership are the responsibility of bank whereas

expenses related with the usage of car is bear by user. Bank is legally bound by SBP to insure the asset so the bank charges insurance takaful which is included in rental instalment in all ijarah duration. A penalty is charged on late payment which is gone in charity account. It is done to safeguard the bank from bad people or habitual defaulters. At the completion of ijarah contract bank offers the user to get ownership of asset against security that is submitted at the start of contract. The other features includes easy and speedy processing time, facility of acquiring more than one vehicle, family income evaluation plan, low security fee and competitive rentals. An eligibility criterion is almost similar with home financing. General banking includes deposit facilities. Different types of deposit accounts are offered. Bank generates fund from 2 modes, Qard and mudarabah. Current deposits are generated on Qard basis whereas saving and fixed deposits are generated on mudarabah basis. Interbank funds are accepted on musharakah basis and thus profit is determined according to rules of Musharakah. Bank made different pools for the benefit of investors. Deposit accounts are divided into two main categories that are mudarabah based deposit accounts and Qard based eposit accounts. The mudarabah based deposit accounts include Pak rupee chequing account, foreign currency chequing account, and Halal investment account. Pak rupee chequing account has following accounts. Halal saving and notice account is a type of saving account offered by that bank. It is based on mudaraba basis. Minimum balance requirement is PKR 100. Profit is calculated on monthly average balance. Funds can be withdraw by giving notice before 24 hours for PKR10-200M and before 48 hours for above PKR 200M. Remunerative current account offered is Halal saving account. It is also based on mudaraba. The acceptable currency is Pakistani rupee. Profit is calculated on monthly average balance monthly. Account is opened with only PKR 100. Profit rate is very nominal. Additional value added services include online fund transfer, Debit card, SMS alerts, I net banking, local remittances etc. A special saving account for pensioners is also offered. It is named as Halal saving and notice account – pensioners. It is also based on mudarabah. There is no minimum balance requirement. Monthly profit is calculated on monthly average balance. Foreign currency chequing account offers Halal US dollar saving account has same features like halal saving and notice account. The acceptable currency for this account is USD, GBP and EURO. Minimum balance requirement is USD= \$1,000/-, GBP=£1,000/-, Euro=€1,000/- only for account opening. Halal investment account includes Islamic investment certificates, Khas Islamic deposit account and Halal certificates of asaan monthly mudarabah. The features of Islamic investment certificate are that it is term deposit facility; minimum investment amount is PKR 50,000. Its tenure is 3 months, 6 months, and 1 – 5 years. Profit calculation is

monthly. Profit distribution for 3-6 month tenure is at maturity whereas for 1-5 years tenure has option of monthly quarterly and at maturity. Premature withdrawals are also allowed. Khas Islamic deposit account is also a term deposit account that accepts PKR. The minimum investment amount is PKR 200,000/-. Its tenure is 3 months, 6 months, 1 and 2 years. Profit is calculated on monthly basis whereas profit distribution is occurred at the maturity. Chequing account is required for this account issuance and profit payments. Halal certificates of asaan monthly mudarabah is also a term deposit account that required minimum balance of PKR 50,000/-. Its minimum tenor is 1 month and there is no limit on maximum tenor. Profit calculation and distribution is done on monthly basis. Deposit accounts on Qard basis also offer accounts in PKR as well as in foreign currency. The PKR accounts include Islamic current account, basic banking account and Islamic current account pensioners. The features of Islamic current account are that it is a current account so there is no minimum balance requirement and it can be opened with PKR 1000/-. Basic banking account has similar features as Islamic current account has. Islamic current account pensioner is designed for pensioners especially and there are no charges required to open it. Foreign qard based deposit account include halal foreign currency current account. Acceptable currency for this account is Euro, USD and GBP.

The financing products offered are murabaha, musawama, salam, ijarah, and diminishing musharaka. Murabaha is used to finance corporate, commercial and SME customers. The price of murabaha is determined keeping in view KIBOR and market dynamics but once the price is fixed that it will not change throughout the tenor. Financing limit is decided according to SBP rules. The tenor for working capital is up to 1 year and for fixed asset it is 3 years. The repayment is also according to the tenure. Musawamah financing is also used to finance corporate, commercial and SME customers. Its features are similar with murabaha. Salam is also used to serve corporate, commercial and SME customers. The features of salam are that profit on sale of salam good is charged keeping in view the market conditions. Its tenor is 1 year. On the due date the good is delivered to bank than bank sale the good directly or through agent in open market to recover the price. Ijarah financing is used to finance plant, machinery and vehicles to corporate, commercial and SME customers. Its tenor is 1 year to 7 years. The repayment is done by monthly rental payments. Diminishing musharaka is used to finance commercial property, plant and machinery. The tenure is up to 20 years. Repayment is through unit purchase and rental payment.

Another respondent mention that only three types of accounts are offered by them that are Hidayat Current Account, Hifazat Saving Account and Na'mat Term Deposit. Hidayat current deposit account is available for businesses and individuals and minimum initial deposit is PKR 1000. Hifazat saving account is designed for business and individuals based on mudaraba or musharaka basis. The initial minimum balance limit is PKR 100 and bi annual profit withdrawals are offered. The features of na'mat term deposit account are that it is designed on mudaraba basis that gives halal fixed profit on their fixed deposits to individuals and entities. A special product designed for senior citizens and widows is also introduced named Aasoodgi. It is one year term deposit account. Range of deposit amount is from PKR 50,000 to PKR 2,500,000. Profit payment is made on monthly basis. Only Murabahah and ijarah financing is offered by this bank. Car ijarah is offered by bank to become the owner of car by paying 20% security only. At the end of ijarah contract the customer return the car and get the security fee. Another option for customer is to get the ownership of car in place of security fee. The bank only uses car ijarah for local vehicles. Its main features include that it is ribafree, instalment is due after delivery of vehicle, no registration fee and no insurance expense only processing fee that is PKR 4500 plus federal excise duty. Eligibility criteria is that Pakistani national, monthly income must be at least PKR 45,000, monthly rental payment does not exceed 50% of received salary, and age limit for salaried is 21-65 years and for businessmen is 22-70 years. Sannat equipment ijarah is offered for industrialists and corporate clients to provide them assistance in equipment purchase according to sharia principles. Security requirement is to deposit minimum 10%. There are two unilateral undertakings; one undertaking is by bank to give offer in order to sell the asset at maturity to the client and other undertaking is by client to purchase the asset at the maturity of contract. Maeshat murabaha is also a product that is offered to clients in order to provide them their required or desired asset. In this product bank appoints the client as its agent in order to purchase the asset on behalf of bank. The repayment modes in this product are repayment immediate in cash, or according to terms and conditions, or deferred payments, or spot payment. The bank offers types of murabaha that are imports murabaha, local purchase murabaha, and advance against future murabaha. Further types of import murabaha are pledge, hypothecation, term finance, trust receipt, ship breaking and spot. Types of local purchase murabaha are pledge, hypothecation, term finance, trust receipt and spot. In advance against future murabaha goods are purchased by bank and then offered to customer to purchase them, these goods are not used by customer until they are purchased by customer. This product is offered on short term basis i.e., maximum for 1 year. Rafaqat musharaka is another product offered by bank that is

purchased in joint ownership by bank and client. After this purchased client can get the whole ownership by purchasing the asset shares unit by unit and then enjoy the full ownership of asset. The client has to pay actual price plus rental charges in monthly instalments. Bar'aamad export financing is offered to fulfil the working capital requirement for exports of the clients. It is a substitute of conventional aproduct that is foreign bill purchase. With this product it is ensured that all manufacturing can be carried for exports and bank meets the capital requirement. Istasna per shipment export finance is offered to help exporters to finance their pre-shipment expenses. This product is offered to coprporate, SME and commercial customers. The bank also offers Kafalat bank gurrantee in order to ensure secure and confident environment to both parties.In order to meet these objectives number of new products are designed and soon launched. Keeping in view of current demand some products are repackaged these are Hidayat Business Current Account and Hidayat Business Saving Account. The upcoming products are foreign currency deposit account in order to attract foreign currency reserves and diminishing musharaka house financing. Some products are also redesigned in order to meet need of very large corporations.

One of the banks under study offers the following sharia products. Current account is offered to fulfil the requirement of individuals and businesses that need checking account according to sharia principles. The product is offered to provide security to the money of customers. Further benefits includes that the account can be accessed nationwide and in 24 hours. Basic banking account is offered to give comfort to small depositors to fulfil their need of safe deposit. The account can be opened with minimum PKR 1000. There is no minimum balance maintenance charge. Two deposits and two withdrawals per month in cash are allowed. Kamil business account is offered to provide better return on investments with free of cost services. This account is designed on mudaraba basis.It is offered for individuals as well as businesses. Minimum average monthly balance PKR 100,000 has to be maintained to enjoy free services.The profit is calculated on monthly average balance and distributed monthly.The number of other free services like check book, pay orders, online intercity clearing etc are packaged in this account. Saving account is designed in order to offer competitive returns on investments of individuals and businesses. This account is based on mudaraba financing. Monthly profits are determined by calculating weightages by experts. The account is opened with PKR 100 only. Profit is calculated on monthly average balance. This account offers tiered profit structure that means long tenure higher profit. There is no limit on transactions and maintenance of minimum balance.Investment certificate account is

also designed for individuals and businesses that desired high returns on their investments by Islamic modes. This account is designed on mudaraba and musharaka basis. The investment of each individual is pooled and then invested in a designed portfolio and the profits percentages are calculated monthly and displayed in the websites on monthly basis. The minimum investment limit is PKR 50,000. The tenure is 1 month, 3 months, 6 months and 1 year. Profit payment is monthly as well as at maturity as desired. Premature withdrawals without penalty are and automatic renewal is also allowed. Foreign currency account enables the customer to get maximum benefit from their foreign currency. It is based on qard basis so it is free of interest and principle is repaid when demanded. The deposited amount is allocated in specific pool and hence further invested in Islamic assets. The accepted currency is USD, Euro and GBP. The minimum balance requirement is USD \$500 or equivalent. Foreign currency saving account is based on USD and gives opportunity to earn return on foreign currency to individuals and businesses. It is based on mudarabah and profit calculation mechanism is similar with saving account. It can be opened with USD 1000. Other features are also same as saving account has. Murabaha is also offered for individuals, sole traders, partners and corporations to purchase equipment, raw materials, finished goods and all kinds of consumable goods with credit period of one year. There are detailed documents requirement for individuals, corporations, exporters and importers to enter in murabaha contract. These requirements are normally of personal, business, assets and incomes details. Auto financing is also offered on basis of diminishing musharaka. The bank finances a portion of car and become a joint owner in the car. The clients pay monthly instalment that is comprised of two portions one is monthly rent on use of car and other is to increase your ownership of car. When full price of car is paid through monthly instalments than the client is become the whole owner of the car. Auto financing is offered for new, old and imported cars. There is no financing limit but minimum equity requirement is 20%. There are multiple tenures upto 5 years. Instalments are due after delivery and there is built in takaful in instalments. Home financing is also offered by that bank. Home financing is also based on diminishing musharaka in which bank and client have joint ownership in a home and after paying monthly instalments client become the sole owner of the home. The home financing offers to buy new home, renovate existing home and transfer existing mortgage to Islamic banking. The bank provides finance up to 75% of the value of property or up to 50 million. The time period is from 1 to 20 years. It is easy to make prepayments. House takaful is also offered. The documentation and processing is very quick and cheap. A debit card is designed to offer many benefits and ease for shopping, dining, and traveling. This card is accepted in

125 countries and over 1.5 million ATMs and more than 5 million points of sales. Other benefits includes that it is secure and safe than cash, the bank statement of client give all details of expenses of transaction that provide the customer to check and manage his/her expenses, funds transferring is also possible between any two accounts of same banks or to any account of 1 link, utility bills payment, no waste of time on ATM queues just use debit card to pay for shopping, cash deposit facility, for foreign transactions automatic currency transfer, discounts on dining, facility of availing three supplementary cards on a primary account, and 24 hours customer service. Mobit mobile banking is also offered by the bank which is a sharia complaint mixing of convenience and empowerment to monitor and control your finances. The features of it include instant access of account information that includes transaction details, mini account statement, current balance etc. It made it possible to transfer funds in any bank account on 1 link. There is no need of specific either prepaid or postpaid mobile connection. It also made possible for client to pay utility bills through your mobile. SMS alerts on every transaction are also a feature of it.

The IBBs are also offering debit card facility on some accounts for ease of their customers. They do not charge extra service charges on usage of debit card. The logic behind this is that in debit card customer is using his/her own money so it is allowed in sharia

When it is asked that what is the difference between conventional banking products and Islamic banking products that it is said by all respondents that the conventional banking products are interest based as it is money based financing. Money is earned on money and there is no concept of loss on those products while Islamic products are based on assets and the investor become a partner and share profit and loss according to the rules. The basic structure of products look similar with conventional banking products but the operations behind the products made them different from conventional banking products.

Product designing phase is carried in head offices by sharia advisors in all IBBs. Sharia advisor is responsible to design a product in light of sharia rulings. There is no involvement of technical staff. A feedback was taken from staff dealing products on daily about the current demand and requirements of customer as well as the acceptability of already offered products. This feedback is used to design new products and improve existing products. The measures that kept in mind in designing products are that the product is riba free in all aspects, the product has market demand, and above all it does not violate sharia rules.

There are no special products especially designed for Agriculture or industries. The products already designed and offered with same features are used by farmers and industrialist. There are no extra benefits provided to farmers and industrialists to take part in social welfare. IBBs also treating the farmers and industrialists in the same way as CBs treat. They offer no relaxations to any specific industry.

The profit percentages of investor are not decided alone for a single investor and it is a complex thing. In all IBBs pools are formed. The bank plays a role of mudarib and investor is become rabul mall. The IBBs are playing dual role actually. They at a same time acts as mudarib and rabul mall. When they accept deposits then they are acting as mudarib and when they invest the funds of pools then they are acting as rabul mall and sometimes as an agent. It is the duty of mudarib to utilize the capital and give decided portion profit to rabul mall and separate its own profit after meeting all expenses. These pools are like musharaka pool, mudaraba pool etc. In one of the observed IBBs there are three pools made for mudarabah investors that are General pool, Foreign Currency Pool and Financial Institutions Pool. The objective of general pool is to maximize profit of investor and to invest the fund in sharia complaint basis. Foreign currency pool is made in order to invest in foreign currency according to sharia complaint basis. The Financial institution pool is made in order to obtain funds from conventional side of bank and use them to invest according to sharia complaint basis in order to maintain liquidity. All investments relating to that category are become a part of that pool. Sometimes IBBs mix their own equity and balance of current amount in those pools in order to increase the amount available for investment. But for investment purpose the funds of rabul mall give preference and the remaining amount after mixing of banks own equity is invested in sukuk. After that pool formation, the amount in that pool is invested in assets and shares of halal businesses. Then the return on this investment is received after particular time. The bank first meets all operational expenses from the profit received. These expenses includes depreciation on ijarah assets, wakalah tul istismar, brokerage fee on allocation of funds according to Islamic modes of finance, financing write-offs, and loss on sale of investment. All expenses except above mentioned are not chargeable on these pools. Then the mudarib take his share from the amount of profit left. Then weightages are assigned which decided the profit share investor. Same mechanism is followed for musharaka, ijarah etc pools. The pools similar in nature for other IBBs are also designed according to the capacity and requirements of these IBBs. All this work is done in IBD at head offices so line managers are unable to give detailed information in this regard.



Portfolios are formed while investing from these pools in order to mitigate risk which ultimately reduces returns. As the bank is acting as agent or mudarib so it is his responsibility to take care of rabul mall's funds so due care is necessary for that purpose. Investing others money is very risky and it is essential for IBBs to minimize risk as well as loss for their existence. For that purpose portfolios are made. Portfolios are helpful to diverse risk. Portfolios are made by investing the amount of one pool in different and diverse industries. The team of professionals and experts form these portfolios so that event of loss is very rare and if it is occurred then it is of minute amount. At time of loss the loss from one investment or business is sets off with the profit from other investments. Then the net amount received is used to distribute among the investors. In this way the share of profit of each investor reduces but there is no loss. In such situation loss occurred than many IBBs give their own portion of profit to their customers that is known as Hiba.

When asked about the estimated profit percentage that is for share of bank and depositor then it is different in all respondent banks. Two IBBs responds that bank depositor profit percentage is 20% and 80%, one other IBB said it is 40% and 60%, another IBB response is that it is 30% and 70%, one more IBB has same percentage

It is very important to analyse a business in order to invest it because the expected profit is highly depend upon it. The IBBs first of all analyse the industry from which the business belongs to. This can be done from getting information from stock exchange reports or in some IBBs a group of experts did that on regular basis. In this way IBBs are able to know about the existing position of industry either it is booming or declining. If the industry is booming then there are chances of investment in that business if other criteria are fulfilled. If the industry is in decline then IBBs avoid that business. When the industry of concerned business is booming or in healthy stages than the business or firm is analysed. First of all the financial performance of firm is analysed by looking its financial statements. The bankruptcy analysis is done before other analysis from financial statements. After that the credit history of firm is analysed. The expected returns of new projects and projects to be financed are also analysed. This is also the detailed analysis procedure followed by IBBs to grant loan.

Most of the IBBs are dealing with murabaha and ijarah to provide financing. There is no concept of loan in Islamic banking. IBBs only give desired asset to the client using murabaha, ijarah and diminishing musharaka. There are already designed forms for entering in contract for each product. Every IBB have its own designed forms and formats. When a customer

wants to apply for financing, he/she can visit the nearest branch of IBB and put request for it. The representative of IBB assists them in that procedure. The first requirement is to fill the concerned form and then provide the required documents that are listed in requirements. Once all the required documents and eligibility criteria are fulfilled then the client is required to deposit security or his share according to the conditions of IBBs after which he/she gets the financing he/she needs. The maturity time of these products are already designed including multiple tenures. The client himself/herself decide the tenure according to which monthly instalment is depended. The greater the tenure the less the instalment, is a general principle that is followed for all type of financing.

When asked about the details of instalment payments and default then the respondents said that all clients have to pay their instalments within defined time. There is no rebate on early payments, But if the client does not pay instalment in given time period then penalty is charged on him. The important thing is found from IBBs that if there is genuine reason for late payment or no payment then penalty is not charged. One of the IBBs share a case in which no monthly instalment is paid due to the death of husband of the client. The IBB did not charge even a single penny on that instalment from the widow. The IBB also extend some more time for payment of that widow. The amount of penalty is also decided by the experts with the approval of sharia advisor. The penalty amount is credited in charity account. IBBs do not use this amount as this penalty is only charged in order to punish the client not to earn anything from the mistake of client. The IBBs manage their charity account as all other accounts and also report the balance of this account and the areas and purpose where these funds are donated further. One of the respondent IBBs showed the opening balance of their charity account is PKR 6,892,000/-, total charity collected in last year is PKR 8,485,000/-. After distribution the balance is PKR 2,877,000. The charity is distributed for the purpose of welfare of orphans and widows. Another respondent IBB showed the opening balance of charity account PKR 38,000 and total charity collected is PKR 639,000 and the total funds in that account is PKR 677,000. These funds were used in health, orphanage and education. The composition of charity account is the amount credited in it is from penalties on late payments and Non sharia compliant income. All IBBs have to show their charity account separately in financial statements according to SBP regulation.

In IBBs that were visited they are not offering Qard-e-hassana. They give reason for this as they are on initial stages and the procedures for this are quite complex so they are not

currently offering it. In one out of five IBBs offer Qard-e-hassana only to its employees sometimes.

All IBBs has to follow auditing and accounting procedures as prescribed by SBP for IBs. The financial statements of IBBs are separately maintained and reported in annual financial statements. There is no link or connection between financial reporting of IBBs and CBs. All documents, transaction records, head of accounts are prepared and reported independently. Financial audit is also done separately for IBBs.

#### 4.5 Risks

In IBBs the risk management is done in head offices by risk management department. This department work for both IBBs and CBs. The data is collected from branches so detailed information about types of risks and risk management process in IBBs is not collected. The respondents answer that IBBs face similar risks that CBs face expect few one. The IBBs face credit risk. Credit risk means that the amount invested in other business on basis of mudaraba, murabaha, ijarahetc can be recovered or not. To manage this risk a team of credit risk management is responsible. The other risk IBBs face is market risk that means the change or fluctuations in value of assets like sukuk, murabaha assets etc. This risk is also handled by risk management department. Liquidity risk is also very dangerous to IBBs in it IBBs are unable to meet its short term obligations. It is also a technical risk managed by risk management team. Rate of return risk means the risk rose due to mismatch of return received from investments and distributed to deposit account holders. It is also managed by risk management team. IBBs face operational risk due to inefficiencies and wrong policies in carrying basic business operations. This risk is managed by risk management team as well as upper management who are responsible to design sound policies. The reputational risk is very much high in IBBs. The IBBs said that they are offering halal products and follow sharia rulings to run operations so it is necessary for them to do that what they are saying because there business is wholly dependent upon it. Once it is find that IBBs only said that in words that they follow sharia ruling but actually they are doing the same things that CBs do then their existence come in danger and they lost trust of their customers. After that they are no more in market as they are rejected by their clients. The risk that only IBBs face is Sharia compliant risk. It is a risk that means that either IBB are following sharia principles or not. This risk is managed by upper management by making such policies that ensure the compliance of sharia principles at all levels and in every transaction. Sharia compliance is

very sensitive for IBBs. A sharia advisor does sharia audits off and on to check the compliance of sharia principles. SBP make it compulsory for IBBs to attach a report of sharia advisor with their financial statements that is a proof of sharia audit. Sharia auditor can conduct such audits independently and is allowed to visit the branches without informing. Sharia advisor mention all detail findings of his audit and clearly state the events that are against sharia principles if occurred in IBBs. That is why IBBs are in more pressure than CBs. This situation also eliminates the chances of IBBs abide by sharia principles.

#### 4.6 Challenges

There are number of challenges that IBBs faced. The biggest challenge is regarding awareness of IBBs. There is lack of awareness among people about the existence of Islamic banking and the brand names offering IBBs. The people do not know the range of products IBBs offered and how these products are beneficial for themselves. Some people who are aware of IBBs do not prefer IBBs because of low profit rates. Another big challenge that IBBs face is the acceptability. People are not accepting IBBs as institutions based on halal business. They still thought that there is no difference in actual operations of CBs and IBs. They are not willing to accept the low but halal profits from IBBs. The IBBs also face problems regarding growth. The Islamic banking is on its initial stages so many IBBs want to expand their operations in all over Pakistan but they have no resources yet to do so. The economic environment is also a big challenge for IBBs. The people are not investing in Pakistan and industrial business is also in decline so the avenues of business of IBBs are becoming scare. One of the respondents IBBs said that their networking is also a big challenge for them. They have limited branches that do not serve people as comparatively IBs with dense networking. Some serious issues that IBBs face are commitment from upper and operational management. Few banks started IBBs with the regulation of SBP and they are still running them for that regulation only. They have no commitment and affiliation with IBBs at all. This behaviour becomes a hurdle in efficiency and profitability of IBBs. In these banks there is no concern in expansion and growth of IBBs also. One of the IBBs under observation has issue regarding IT software. They said that same IT software is used for CBs and IBBs. The software which is used in CBs for many years and is specially designed for CBs is used in IBBs also. This software has many problems and is not supporting for IBBs. The proper IT software dedicated to IBBs is required in this bank. The bank decides to purchase new software that serve both IBBs and CBs but this decision is pending nowadays. The IBB has to face this problem up till the replacement of software that must take little time.

In competitive environment the biggest challenge for all IBBs are IBs and in IBs they consider Meezan Bank as their toughest competitor.

Most of the IBBs are very dedicated to Islamic banking. Some of them already applied to become fully dedicated IB. One of IBBs got approval and they will start running pure IB in 2015. One of the IBB applied for separate subsidiary for Islamic banking which is in progress. This makes the future of Islamic banking very bright. H2 is accepted.

The research has importance for institutions as this research helps to build customer trust on IBBs. It helps institutions i.e. IBBs to get information about some issues that are not discussed or give importance so far. These issues are that branch network of almost all IBBs is not sufficient it has to be expanded especially at rural areas. Few IBBs have limited products that ultimately limits their growth. In some IBBs, there are no specific products for agriculture and farmers. Special focus of all IBBs is on consumer goods. This argument is built after observation of product structures and features and the portfolio of product of every IBB has home financing, car financing and deposit accounts. All IBBs said that they are serving all sectors of economy including agriculture but one out of five IBBs under observation mentions agriculture product that shows that agriculture sector is almost ignored by IBBs. In most of IBBs only murabaha and ijarah financing products are in use. Other products are though designed but are not extensively used. There is lack of Islamic banking knowledge among staff of IBBs so that they are unable to clarify the difference between IBBs' products. One important thing that is observed while visits in IBBs that there is no hustle and bustle there. There are only average 2 to 3 customers visit IBBs during 3 hours. From this situation it is concluded that customer base of IBBs is still low.

## 5. CONCLUSION

Islamic banking is growing rapidly in Muslim as well as non-Muslim countries. SBP limits all CBs to start Islamic banking for growth of Islamic banking in Pakistan. Many CBs run separate IBBs. People are unaware about IBBs and they consider that only halal banking word is used and there is no difference between IBBs and CBs. The research investigates that this conception is wrong about IBBs. IBBs are incorporated due to regulation of SBP in order to grow Islamic banking in Pakistan. The current networking of IBBs is insufficient for catering needs of all customers. Some IBBs are going to terminate their CBs and going to become whole IB. The IBBs are offering number of sharia products and serving almost all sectors of economy. The utilization of deposit funds is also done as prescribed by sharia. Frequent internal and external sharia audits are done to ensure compliance with sharia principles. The risks faced by IBBs that include sharia risk, reputational risk, liquidity risk etc. Thus IBBs are similar with pure IBs as they offer same products, have same target market, follow same sharia principles and conduct operations according to sharia principles. CBs and IBBs have no connection with each other except same ownership.

### Recommendations

IBBs are facing number of challenges due to some internal weaknesses that are going to be resolved soon. IBBs have to increase their product range by using other Islamic modes of financing. There is a need to increase the branches of IBBs in order to serve more customers. IBBs have to start a joint or individual advertisement and promotion plan to increase general awareness. It is the need of IBBs to make professionals committed with Islamic banking. This is possible when people have enough knowledge about it and know the basic philosophies of Islamic banking. Extensive training programs should be arranged for that purpose. IBBs should form a group of themselves in which they participate jointly to growth of Islamic banking.

### Implications

This research is helpful for future researchers and managers in following ways. They know that there are almost all banks started IBBs in Pakistan and also offering Islamic products through IBWs. It is clear now that CBs and IBBs have two separate banking lines. They become aware that products of IBBs are halal as the operations behind them are designed on line of sharia principles. It is important for them to know that IBBs have more pressure than

CBs and IBs as there are number of audits including financial audits and sharia audits internally and externally. That's why there is no chance of deviation from sharia principles. The business and corporations become aware that IBBs get special support from SBP and are offering halal financing solutions. It will help them in order to adopt halal financing from IBs and IBBs as the wide range of products is offered by IBBs It is clarified that there is no comparison between IBBs and CBs and whereas there is no similarity between IBBs and CBs. IBBs have no connection with CBs. It is quite clear from the results that there is no difference between IBs and IBBs. IBBs are purely dedicated Islamic banking institutions that have all operations and strategies aligned with sharia principles.

The future researchers can broaden the idea across Pakistan. The study is further expanded by auditing the Islamic banking divisions of IBBs.

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## Appendix A

### Interview Guide

## Incorporation

1. How Islamic window was established?
2. Purpose and philosophy behind incorporation?
3. Strategic view of establishment?
4. Procedures for incorporation?
5. Documentation?
6. Legalities fulfilled for incorporation?
7. Vision behind Islamic window?
8. Scope of business?

## Strategic Approach

1. Major objectives?
2. Policy formation and implementation mechanism?
3. Their market position?
4. Market share?
5. What is your competitive edge?
6. Their similarities with Islamic banking industry?
7. Major difference between them and pure Islamic banking?
8. Difference with their conventional counterparts?
9. Their view about quality and procedures adopted to attain it?
10. What is their target market?
11. What is the size of bank in terms of customers and employees?

## Rules and Regulations

1. What rules are they following?
2. What are the regulations they are facing?
3. Do these regulations are beneficial or harmful?
4. What type of bindings SBP put on them?
5. What is the minimum capital requirement?
6. Do they have to maintain liquidity requirements?
7. Do monetary policy effect on them?
8. What are the regulations they are facing from their conventional branches?
9. Are bank procedures are sensitive to such regulations?

# Management

1. Products they are offering?
2. What the basic difference between products they offer and conventional banks?
3. How products are designed and approved?
4. Which measures should be kept in mind while designing products?
5. How profit percentages are decided?
6. What is the share of bank in profits?
7. How pools are formed and managed?
8. How business are analysed for investment?
9. What minimum standards should business has to fulfil?
10. What are the research procedures they are following?
11. How they grant loans?
12. What are the procedures for loan applications?
13. How maturity of loan decided?
14. What things should they observe before granting loan?
15. How default risk is managed?
16. What are the procedures adopted if there is breach of contract?
17. How penalties are decided, charged and handled?
18. What are the financial reporting ways and procedures?
19. How much almost the bank allocate for farmers, industrial loans and education loans?
20. What is the profit percentage earned from each product?
21. How profit is utilized?
22. What is the dividend ratio?
23. What are the products that fall under ijarah?
24. Which ijarah principles are followed?
25. What is the practical application of ijarah?
26. How Musharka and Mudarba used to design products?
27. How Sharia complaint products are designed?
28. What are there practical applications?
29. Which sectors are they serving?
30. Please specify the %age of loans to each sector?
31. What are the details of Qard e Hasana?
32. Which steps they specifically take for poor and needy peoples?
33. Do you offer debit and credit card?
34. Please specify under which shariah rule they are offer?
35. Which type of accounts you offer?

36. What are the shariah guidings regarding these accounts?
37. How much you charge for service fee?

## Risk

1. What type of risks they have to face?
2. What measures are taken to avoid them?
3. Do these risks bind them to alter their management styles?
4. What type of risk they face from pure conventional banks?

## Challenges

1. What are current challenges?
2. What is their expected future?
3. Their dangerous competitors?
4. The policies that is harmful for growth?