

**ROLE OF PAKISTANI GOVERNMENT IN THE
DEVELOPMENT OF ISLAMIC BANKING: COMPARISON
WITH MALAYSIA**



By

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Abstract

This research is conducted to determine the roles played by Pakistani government in the development of Islamic financing as compare to Malaysian government. Islamic financing is the concept that is vastly used by the muslim countries these days to eradicate interest from their economies. The need for the development of Islamic financing arises as an essential system required changing for the islamization of the economy of Pakistan. Role of the government of Pakistan is analyzed and compared with the roles of Malaysian government for the development of Islamic financing. In both countries Islamic banking is relatively new concept with lack of research. Descriptive methodology is used to analyze the performance of both countries based on the documented records. It has described the current roles of the both governments, their advantages, disadvantages and developments. Based on the available literature and documents it is difficult to compare the both countries performance. Pakistan experience of Islamic financing is almost half of the Malaysian experience. It is found that the pace of developments in Pakistan is very slow as compare to Malaysia. This study suggests that the timely implementation of planed strategies by Pakistani government is necessary.

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INTRODUCTION OF ISLAMIC BANKING

1.1 History Of Islamic Banking

Islamic banking refers to a profit oriented system that comprises of banking operations that follow the principles of Islamic law (Shariah). Foundations of Islamic banking are established upon the base provided by two basic principles; sharing of profit & loss and prohibition on the collection and payment of interest (Riba). The purpose of Islamic banking is not as same as the conventional banking; they differ in their ideology as Islamic banking operates under the supervision of shariah rules known as fiqh ul muamalat (Islamic rules on transaction).

The principle source of shariah is the Quran followed by the recorded actions and sayings of Prophet Muhammad (s.a.w)-the hadith. In a situation where the solution of a problem is not found in these two sources then the guidance of Muslim scholar community are taken to solve the problem through ijmah (Mutual consent).

History is filled with the sources that provide the evidences which show that Islamic financing was practiced by the Muslim world in the Middle Ages for trade and business activities. Muslim merchants use to serve as middleman for the trading activities in Spain and the Mediterranean and Baltic states. It is found that many Islamic financing concepts, techniques and instruments were later adopted by European financiers and middlemen that are being used up till now by the west, with desired modifications.

Almost 40 years ago, Islamic banking was a desired thought to be implemented and it was considered as a “Desired Dream” of the Islamic states. Islamic banking has grown throughout the Islamic world since 1960s. Egypt was the first country that introduces the first Islamic saving bank that was established on the basis of profit sharing in 1963. In the same year Malaysian government has also introduced the first Islamic financial system. Bank Islam Malaysia Berhed was the first bank in Malaysia that started its operations on the 1st July, 1983. Dubai Islamic bank was also founded as the first Islamic commercial bank in 1975. Bank Muamalat was the first Islamic bank established in Indonesia in 1991. First Islamic bank in Bahrain was established in 1978; where as in Pakistan Meezan bank was the first commercial bank that was established in 2002. Since then, firstly Dawood Islamic bank, bank Islami, bank Al-Barakah and Dubai Islamic bank have started their

operations as full fledged Islamic banks. The initial branch network consists of 5 full fledged Islamic banks and 12 conventional banks which had been reached to 684 branches in 2010; whereas by the end of 2014 it has been increased to the network of 1350 branches.

In early 1970s the initiatives for the development of Islamic banking started taking place. These includes the first international conference on the Islamic economics, organized by King Abdul Aziz University in Makkah; Saudi Arabia, development of first commercial Islamic bank named “Dubai Islamic Bank” in UAE, formation of international Islamic development bank (IDB) in Jeddah to provide the basic infrastructure for the Islamic banks, development of many private and partial private Islamic banks after that in Bahrain, Egypt, Sudan and Kuwait etc. Islamic banking proves itself as a viable and feasible substitute of conventional financial institutions. It serves as an effective and productive mechanism to obtain risk bearing profits from the financial intermediations between the deficit and surplus economic activity generating organizations.

Now a day’s Islamic banking is not an avoidable or an interim phenomenon. It has showed its long lasting potential to survive. Several other signs have also proved that it will grow continuously with further progressive expansions. The practices of Islamic financing are not limited to the Arabs and Muslim countries only but they are spreading from “East to West”. Other than Muslim countries, several non Muslim countries like Europe and USA, UK, Australia and several other non Islamic countries have introduced Islamic banking in their markets. On the serious notes, many conventional banks also use the techniques of Islamic banking in their banking system these days.

1.2 History Of Islamic Banking In Pakistan

Islam is the basis for the creation of separate nation within the undivided Indo-Pak subcontinent. Elimination of riba was the basic objective of the Pakistan’s state policy. Islamic banking emerged in Pakistan as a response of both religious and economic needs. The efforts made in this regard to find an alternative to the interest based system can be sought from the council of Islamic ideology (CII). The introduction of interest free banking in Pakistan was the result of different measures that were taken by the SBP. It has also amended various laws that were required for the initial operations of the newly born industry in the country.

Islamic financing in Pakistan was started from 1977-1978 with an intense eager of the government of Pakistan to Islamize the banking activities in country. Elimination of interest from the financial institutions was the basic measure of islamization plan. In 1979 Government-owned mutual funds (NIT and ICP) eliminated interest from their activities to play their part in the islamization process. In the same year HBFC (House Building Finance Corporations) also started taking certain measure to eliminate interest from their operations. In 1980's, government of Pakistan permitted to issue the very first interest free instruments of financing naming Participation Term Certificate (PTC).

Mutual funds structure was also reviewed to remove interest from them in 1979 but elimination of interest from the commercial banking activities was cumbersome and it took a time of almost 5 years, from 1981-1985. Amendments were made in the Banking Ordinance 1962 to accommodate and facilitate the interest free banking activities in the country. Activities of all commercial banks were sought to be interest free in 1985 and it raised the deposits ratio in the Profit & Loss Sharing accounts from 9.2% (1981) to 61.6% (1985). In 1981 all the commercial banks along with one foreign bank (Bank of Oman) initiated interest free counters in their branches in which they collect deposits on the PLS basis but did not pay any interest on them. Government had instructed the banks to use these deposits in those investments that support government's commodity operations and charge markup rate on its purchase price. These deposits can also be used to make investments on the basis of Mudariba and Musharika (to meet their working capital needs) by the banks. However, foreign currency deposits in Pakistani banks continued to be used as they were used before.

Deposited amounts were invested through 'mark-up' techniques, mostly used by the banks with or without the buyback agreement. In 1991, these operations were declared faulty and un-Islamic by the shariah court and the appeal was heard in the Shariah Appellate Bench (SAB) of Supreme Court of Pakistan. The SAB concluded in its judgment that the present financial system needs some changes to bring it into conformity with the shariah. In this regard the SAB gave instructions to the government to form a commission for making a transformation in the financial system and to develop two task forces, one to plan and other to implement the transformation process. In 2000, the commission for transformation of financial system was formed. It includes two task

forces one was appointed by the Ministry of Finance, Pakistan and other task force was appointed by the Ministry of Law, Pakistan. Task force appointed by Ministry of Finance was assigned to identify that how the interest can be eliminated from the financial activities and the other task force was assigned to implement the courts judgment. These task forces reported the required changes and their implementation plans in their reports. After the final report submitted by the both tasks forces very 1st islamic banking license was issued by the State Bank of Pakistan to the Meezan Bank Limited.

1.3 History Of Islamic Banking In Malaysia

Tabung Hajji, an organization was established in Malaysia by the governing authorities of Malaysia in 1963. It was a specialized institution that provides a system that works through mobilizing the funds of Muslims to assist them in performing the pilgrimage in Makkah. It has also encouraged the Malaysian Muslims to take part in shariah compliant investments and generate economic activities according to the Islamic shariah. Funds managed by Tabung Hajji were used according to the Islamic trade rules; they are generally invested on the basis of mudariba, musharika and ijara.

After the experience of Tabung Hajji, the first intension for independent Islamic bank was arose in 1980 in a seminar held in the University of Malaysia. The Malaysian government was requested to pass a law for setting up the Islamic banking in the country. In the response to the request, government established a well interlinked and systemized process for the implementation of Islamic financial infrastructure. This process was portioned into three stages. First stage from (1983-1992), it was the period when Islamic Banking Act was passed and BIMB (Bank Islam Malaysian Berhed) was established and all the Islamic banking activities were started in accordance with shariah principles. BIMB was the pioneer of Islamic banking in Malaysia that operated alone for 10 years before the legal body of Malaysia has permitted the traditional banks to obtain Islamic banking products and services, using their traditional infrastructure and operating branches. Government of Malaysia instructed their conventional banks to provide Islamic banking products and services from Islamic counters of their institutions. Government thought that these steps would result in more efficient and effective as more banks will become ready to provide the Islamic banking services at lower cost in a short time of period. This would ultimately result in the increased competition among the

banks and it would also improve the performance by increasing the efficiency of the banks. The second stage of this process started from (1993-2003). In this stage the government created a conducive environment for the competition among the banks and provided enough time to the Islamic banks to capture large share of the total market. In this stage conventional banks allowed to offer the Islamic banking services by setting up “Islamic window”. In last, the third stage was initiated in 2004. This stage was for further financial liberalization. In this stage the central bank makes it easier for the foreign banks to operate the Islamic activities in Malaysia by issuing them licenses.

Malaysia is the first country in implementing dual banking system in which Islamic banking system goes along with the conventional banking system. The banking system adopted by Malaysian banks had been idealized as best Islamic banking and financing model by many Islamic banks. They had shown their interest to adopt this banking system. In fact many country’s officials, especially Islamic countries visit BIMB (Bank Islam Malaysian Berhed) and Bank Negara Malaysia to learn about their dual banking system.

There are two full fledged Islamic banks operating in Malaysia one is BIMB that was developed in 1983 and second one is the Bank Muamalat Malaysian Berhed (Bank Muamalat) established in 1993. There are three full fledged foreign Islamic banks operating in Malaysia which are Kuwait Finance house, Al-Rajhi banking and Investment Corporation and Qatar Islamic bank. Islamic banking industry of Malaysia has shown a tremendous growth in the period of (1997-2003), its assets had increased from the figures of 17.8 billion RM to 77.4 billion RM.

1.4 Objectives

- **To Find Out The Success Factors Of Islamic Banking In Malaysia.**

Islamic banking model of Malaysia is considered as the most advanced and successful model. It is adopted by several Muslim countries while introducing the Islamic banking in their economies. Malaysia has a strong background of thirty years experience in the field of Islamic banking. They have developed a large amount of Islamic products and services and launched them in their local and international markets. They have also successfully developed the pool of skilled and expert employees that have the capacity to improve the Islamic banking industry of

Malaysia. The government of Malaysia has also assisted the Islamic banking industry by both legal and other initiatives. These initiatives have boosted the growth of Islamic banking industry of Malaysia. Severe involvement of general public with Malaysian government has made it possible to gather the success of Islamic banking industry.

- **To Find Out The Dissimilarities Of The Islamic Banking Between Pakistan And Malaysia.**

Although the main features of Islamic banking are same in the both countries however, the operation differs with each other. Malaysia due to its strong thirty years of work has moved to the next stage of improvements. The concept of Islamic banking was introduced to counter the interest based system in both countries. Initially Malaysia had also introduced the Islamic banking in the ongoing conventional economic structure. Later on the government initiated step wise changing in the legal systems that could assist the Islamic banking industry in their operations. Now they have shifted to the new dimension. Now Malaysian government is working on the changes required in their economic structure to facilitate the Islamic banking. On the other hand Pakistan is still in the era for the improvements in the current economic system to assist the operations of Islamic banking industry. SBP has issued a five year plan to facilitate the functionality of the Islamic banking industry. Thus the available options for Islamic banking in Malaysia differ with the options available for Pakistan.

- **To Determine The Effectiveness Of The Roles Played By Malaysian Government In The Promotion Of Islamic Banking.**

Islamic banking was introduced in the Malaysia with the saving accounts provided for the expenditures of Hajj at Tabung Hajji. Later on with the affiliation of discussion in Islamic countries about the launch of Islamic banking, Malaysian government planned to initiate it. In 1983 after a full plan formulation the Malaysian government introduced the Islamic Banking Act in the same year. Thus the establishment of first Islamic bank initiated in the same year as well. Malaysian government took several steps that were necessary for this initiative. Shariah council and boards were finalized to strengthen the Islamic banking. Later on training and education programs were

launched. At this stage, the Malaysian nation has also prepared their minds to achieve the success of Islamic banking. The young students took admission in the Islamic financing related degrees. These degree holders were then taken up by the Islamic banks on the trainings. Thus in this way every new lot of students come up with new and advanced ideas that lead to the further developments.

- **To Assess The Weaknesses Of The Pakistani Government In The Promotion Of Islamic Banking.**

Islamic banking in Pakistan is facing severe hurdles in the process of growth of the industry. In Pakistan the first movement was made in the early sixty's for the interest free economy. Due to the continuous changes in the political structure and implementation of Marshall Laws affected the pace of the movement. Later on in eighty's it was accepted by the government of Pakistan to initiate interest free economy programs in the country. In the early stage no defined rules and shariah councils were made and thus sudden initiated plan was challenged by the ulama's of Pakistan. Later on due to some defects in the movement the resolution was deprived. Later with the consultancy of the Islamic scholars of Pakistan and the government of Pakistan an improved Islamic financing structure was introduced. In 2003 first Islamic bank was provided license to perform in the country as Islamic financing institution. Within the past ten years from the re-launch of Islamic banking in Pakistan no advanced development is made yet. Recently a five year plan is launched to strengthen the Islamic banking operations.

- **To Understand The Strengths Of The Pakistani Government In The Promotion Of Islamic Banking.**

Islamic banking industry in Pakistan is not enough young to take severe actions for the complete shift to the Islamic economic structure. In the past ten years Islamic banking industry in Pakistan has showed its potential to make Pakistan the center hub for Islamic banking industry. This strength is gained from the strong shariah advisory structure of the State Bank of Pakistan. Pakistani government has initiated the islamization of banking project through the State Bank. After the ninety's State Bank was given full authority to monitor the banking system of Pakistan and its monetary and fiscal policies. State Bank after receiving its full power becomes capable to

initiate Islamic banking project. A department was established in the state bank that specifically deals with the affairs related to Islamic financing. The recently launched programs related to the development of Islamic banking professional and experts is also the initiative of Islamic Banking Department to strengthen the Islamic finance and banking industry of the country.

1.5 Hypothesis

- **H1: Government Is Playing Positive Role In The Development Of Islamic Finance In Pakistan.**

In the past decade Islamic finance has grown tremendously in Pakistan. A feasible environment had been provided to the financial institutions to operate according to the shariah guidance. In Pakistan the initial steps for islamization of economy were taken early but due to the several discrepancies in the early model it was rejected. However in 20th century the eager of the government for the interest free economy start taking its place and as a results interest free banking was launched in Pakistan. Being started from the scratch the government handed over the project of Islamization of banking sector to the State Bank. The late commencement of Islamic financing in the country resulted in the aggressive efforts of the State Bank for the development of Islamic financing. Firstly State Bank strengthens the shariah governance for the Islamic financial institutions of Pakistan. Now it has issued five year strategy plan in which major developments are sighted and aggressively working to implement this plan. Thus through this research we will try to find the effectiveness of the roles played by the government.

- **H2: The Pace Of The Development Of Islamic Finance In Pakistan Is Slow As Compared To Malaysia.**

Pakistan was among the first countries that intended to make their economy interest free. Later due to mismanagement the planned ideology was implemented lately. Although with the late start of Islamic financing in Pakistan, this industry has achieved several milestones. Many people now could differentiate between the Islamic and conventional banking. Very high efforts are made by the government to create professionals and experts in this industry. Efforts for the

improvement in the policies and for the development of advanced products are still in process. Malaysia has a background of three decades in this industry. It is difficult for any new born industry to compete the stable and existing industry. However there are some flaws in the Malaysian Islamic banking industry which could be used as the strength of Pakistan. It was considered that Pakistan will serve as the central hub of Islamic financing for Muslim countries but still this goal is not achieved yet. Thus through this research we will try to find out the progressiveness of the development of Islamic finance in Pakistan.

1.6 Methodology

A descriptive methodology approach is used for this theoretical research to present in detail the contents of the area of the research. This research attempts to compare the role of the government of Pakistan in the development of Islamic financing with the roles of the government of Malaysia. It is based on the source of literature available about the performance of government in the promotion of Islamic financing in current dimension. Secondary sources are used for the sake of research from the previous analysis made by the scholars on the related topics. Role played by Central Banks of Pakistan and Malaysia are also considered for the use as secondary source in research.

The performance of Islamic banking industry in Pakistan and availability of limited literature in this regard played a motivational role for the author towards this research. Islamic financing is a newly implemented concept in the world. The short tenure of practice of Islamic financing is the prime reason for the scarcity of literature in this field. This research is carried out to fill the gap in literature and to analyze the efforts made by both central banks.

The hypothesis of the research will be tested by the use of available sources of literature and document analysis technique. Secondary data gathered from the sources of books and past literature will be analyzed in the sight of current government's roles and performances. All the data necessary to the improvements in Islamic financing will also be analyzed to assess the feasibility of their implementation.

This study may help the government authorities, policy makers, bankers, law practitioners and academicians in both countries. It would not only help them to determine the deficiencies in the systems but also help them to implement new rules and

regulations. It would also help in the planning of shariah compliant service generation to the Islamic finance industry's customers. It would also help the Government of Pakistan to understand and eradicate the non productive efforts made in the promotion and development of Islamic financing industry in the country.

This research will provide the sound grounds for the future researchers to empirically evaluate the efforts made by the central banks of several other Islamic countries for the promotion of Islamic financing in their particular regions. It would also provide them base for the understanding of Islamic systems necessarily required to assist the Islamic financing in any country.

1.7 Literature Review

Financial sector is an important part of the modern economies; fully operating and sound financial institutions and markets results in better exchange of goods and services, fostering long term investments and thus growth (Beck 2011). Islamic financing replaced the interest based returns with the returns in direct function with profits; the use of profit sharing modes will diversify the commercial banks into the investment banks in an Islamic economy, depositor received the share of profits from bank where as bank receive this share from the borrower (Khan And Mirakhor 1989). Islamic financial system can play a major role in the development of Islamic countries; by deploying unused savings that are intentionally kept safe from the conventional interest based operations and by assisting the establishment of capital markets, such system would enable the lenders and borrowers to choose financial instruments capable to fulfill their social values, business needs and religious beliefs as well (Iqbal 1997). Preferred way of earning for Muslims is trade whereas interest is prohibited for them, this requirement demands the development of those financial systems that promote equities; the crux of the Islamic financing lies within the promotion of equity based instruments an alternative to debt based financing (Hassan, Sadaf and Sohail 2013). Islam encourages trade and commerce in particular; Islamic business philosophy and operations represents a substitutive mechanism to conduct a business, both the organizations and individuals are required to maintain a balance between profits and social responsibility (Alserhan 2011). Corporate social responsibility could be defined via concept of Khilafah; business firms are the caretakers for both shareholders financing and society's economic investments, performing the

functions that benefits the society as a whole and ultimately gathering the blessings of GOD (Dusuki 2008). Islamic financial institutions operates on the philosophy of profit sharing and deals in the transaction of sale of goods and services and are not involved in the sale of money; thus Islamic banks are the only financial institutions that can fill the gap to build interest free economies (Chachi 2005). The Islamic modes of financing are considered to be based on the variable nature of the rate of returns; mudarabah is mode of pure finance whereas Musharakah is treated as investment in real transactions, the diversified nature of Islamic financing is capable to meet the various financial needs of the society (Kahf And Khan 1992). The concept of Islamic finance is operated under the shariah supervision; it focuses on the surpluses that accepts risk, fairness, honesty, avoidance of hoarding and tort, which is an important part of the shariah law (Bertillo and Salando n.d.). The key essence of Islamic financing is shariah compliance, it define the rule and policies for the Islamic operations and draw boundaries for the Muslims to achieve the benefits for the society as whole; the growth of Islamic financing can be achieved by the implementation of shariah compliant goods and services (Shirley and Robin 2006). Shariah laws are derived from the guidance of Quran, Hadith, Ijma and Qiyas, Quran and Hadith are the available primary sources whereas Ijma and Qiyas are secondary sources used to benefit the society; the shariah laws are designed to earn surpluses by fair means through risk bearing and they forbids hoarding and tort (Julius and Josefina n.d.). Islamic financing is not just an alternative to the conventional financing; based on the restrictions imposed by shariah, their operations are limited to the business activities that promote social welfare; Islamic financing creates the environment in which financial transactions can be executed without loss to any party (Alsadek and Andrew 2009). Islamic financing is available by both independent Islamic banks and through supportive windows of conventional and they are operating under the guidance of shariah boards, an Islamic bank operates differently than conventional banks in the way of mass benefits (Memon 2013). Islamic financial philosophy supports entrepreneurship and promotes business, Islamic banks invest in the projects based on their feasibility reports with an interest of profits; Islamic banks will continually expand and grow with effective and efficient profitable ideas (Ariff 1988). Being a reality and without uncertainty, Islamic finance is at great success; it is a billion dollar industry that

will keep growing with the money revolution and continuity of establishment of Islamic financial institutions (Warde 2000).

Central banks are the key institutions to ensure financial stability; they bear risks to achieve financial stability, being a supreme monetary authority they play the supervisory roles to achieve this goal (Schinasi 2003). Central banks can play a regulatory function in the equity based Islamic banking framework; the need of economic well being of a region is necessary, thus the central bank should play its part to achieve the economic goals in a interest free banking structure as well (Zangeneh And Salam 1993). Central banks can act as policy makers for the Islamic banking streams; these policies not only help to ease the Islamic banking operations but also assist them to enhance overall liquidity management of the banking industry (Shaikh 2009). A conventional economic structure demands the central banks to move along diversified streams that are opposed to the Islamic economies; Islamic banking requires the framework that is compatible with equity based financing (Ahmad 2000). Central banks are the supreme authorities in the banking industry; in case of Islamic banks, it is the responsibility of the central banks to provide the comprehensive regulatory framework and a supportive financial base (Sole 2007). Central banks act as the last hope for the banks in case of banking failure; based on the interest free dimension Islamic banks don't interact with central banks on interest base, thus central banks with certain changes in policies could assist Islamic banks in financial need (Alamsyah 2011). Islamic banks have some prominent characteristics that should be emphasized to obtain efficient supervision; an appropriate regulatory framework is sought to manage the operational risks involved in Islamic banking industry and the related information disclosure necessities (Errico And Farahbakhsh 1998). The challenges of this diversification can be overcome by ensuring the appropriate environment and conditions through central banks; a well functioning Islamic financial structure could enhance social and economic growth, this could be achieved with the equity based work oriented businesses (Qorchi 2005).

Government of Malaysia and industry are together persuading to fetch the progressive growth pattern for Islamic finance and banking industry of the country; several initiatives are provided to the industry to foster the growth in the country (Islamic Finance 2010). Malaysia is continuously ensuring the effectiveness and competitiveness by enhancing

the institutional infrastructures for Islamic financing; it possesses the comprehensive Islamic financial foundations (Zin, Ishaq, Kadir and Latif 2011). Islamic financing is positively collateral in the long run with the economic growth and capital accumulation of Malaysia; role played by Central bank of Malaysia to develop a comprehensive Islamic financial infrastructure is the most effective one (Furqani And Mulyany 2009). Malaysia is involved in the development of innovative products and services to meet the growing market; a progressive development with transparent transactions is the eager to become the Hub of Islamic finance (Asia Focus 2009). Islamic finance industry in Malaysia possesses potential to achieve great heights; Islamic capital markets have much space to assist innovative instruments, Islamic derivatives are still sought to give this industry strength (Aziz n.d.). The rapid progress of Islamic banking industry is the keen efforts of the Islamic financial institutions and the related concerned authorities; Malaysia has won to its Islamic banking industry a success (Laldin n.d.). Islamic banking is growing in Malaysia at an increasing rate leaving its counterpart at stable rate; Islamic banks did not achieved their optimum level up till yet; however the independent Islamic institutes are performing more efficiently than the ones owe Islamic windows only (Mokhtar, Abdullah and Habshi 2006). Ownership of Islamic financial institutions lies with the government; the centralized ownership in Malaysia supportive with government policies is also an important factor for the growth and effectiveness of the industry (Abbas, Rahman and Mahenthrian 2009). There is some possible lacking in the regulated infrastructures of the Islamic banking industry in Malaysia; operational and financial reforms are still sought to develop the Islamic banking industry that present the true Islamic economies (Anwar 2000). High pace of growth in Malaysia for Islamic banking depends upon the innovative product and services offered; innovations sometimes lack the shariah compliance, proper shariah compliance is necessary to change the dimensions of the industry (Hambali, Jamal, Ali And Manap 2008).

Islamic banking industry is a newly born one with a track record of twelve years; being an Islamic state the government took steps for the islamization of the economy in early sixty's, religious contents are the source for mass acceptance in the country (Hareem And Nida 2012). The success of present Islamic banking re-launch strategy of Islamic banking industry of Pakistan by the government is the result of keen concern and hard work of the

government; the strategy for the introduction of Islamic banking in Pakistan proves to be a success (Khan 2009). Islamic banking was initiated by the government through State Bank of Pakistan; serious attention from other concerned institutes and authorities is also required to facilitate the Islamic banking industry in Pakistan (Ahmed 2010). Islamic banking is a trade oriented banking system that relies on the pillars of justice and equality; Islamic banking in Pakistan has proven to be a great competitive force for the conventional banking industry that is made possible by the strong efforts of the state bank of Pakistan (Rashid, Noreen and Karamat 2012). Islamic banks are the sellers of the shariah compliant products and services in Pakistan; the service quality and customer satisfaction in Islamic banking industry is far better in Pakistan than its conventional counterparts (Ahmad 2010). Islamic banking has proved to be the best alternative for the conventional banking structures; sound legal and regulatory framework is still needed in Pakistan for the better performance of the industry (Siddiqui n.d.). Being a newly born industry there are certain changes that are required to stabilize the base for the growth of industry; sound foundations for Islamic banking institutions are required to strengthen the industry in the country (Saeed 2012). Products available in the Islamic banking industry are not transparent; more reliable and transparent profit and loss instruments must be developed that presents more efficiency (Dar and Parsley 2000). The most popular product in Islamic banking industry of Pakistan is Murabaha; being attractive and comprising few complexities, mostly the Islamic banking industry deals in assets and not the liabilities (Ausaf 1993). Islamic banking products are profit oriented and restricts the business of fixed returns; based on the current economic structures that supports interest based systems, the foundations of interest from Pakistan must be eliminated to achieve the optimum efficiency of Islamic banking in Pakistan (Kazmi 2014). State Bank have played a great part in the inception of newly born industry in Pakistan; however there is still need for more efforts, thus steps regarding improvement in rules and regulations are required that could play the fixing role for the Islamic banking industry of Pakistan (Saqib, Afzal, Zafar And Mueen 2014).

1.8 Findings & Results

The hypotheses of this study are analyzed with the thematic analysis technique. This analysis is made on the reports and facts issued by the central banks of both countries regarding the performance of their respective Islamic banking industries. Islamic banking is growing at high ratio nowadays. Most of the people are favoring Islamic banking against the alternative banking system.

According to the available data from the State Bank of Pakistan regarding the performance of Islamic Banking, information on several aspects can be found. The data is available from the year of December 2003 to June 2014 and is provided in “Appendix C” of this dissertation. From this data we have evaluated that there is a positive trend in the growth of assets, deposits, Investments and branches of the Islamic banking industry in Pakistan. In past 11 years the Islamic banking industry has achieved a vast network of 1335 branches and successfully fetched the 9.8%, 10.6% and 7.8% share of the total banking industry of Pakistan. These facts show a positive response of the people of Pakistan towards the industry. These rates also provide a glimpse of the supportive developments made by the government for the Islamic banking industry to enhance their operations. Thus we accept H1.

Pakistani and Malaysian government has launched the Islamic banking industry in almost same year 1983. However the Pakistani government had failed to sustain the Islamic banking structure in Pakistan and thus after modifications it was re-launched in 2001. Evaluation of the pace of development of Islamic banking industry in Pakistan can be sought by comparing the early performance of the Islamic banking industry of Malaysia. In Malaysia Islamic banking industry was started with the basic infrastructures like Islamic banking act 1983. There is a consistent growth of assets of Islamic banking industry in Malaysia in its early 11 years as compare to Pakistan. Data in this regard is available in the “Appendix D” of this dissertation. However the growth is present in the assets of Pakistani Islamic banking industry but it is less consistent than the Malaysia. This less consistency reveals the late implementation of the strategic plans for the enhancement of the Islamic banking operations in Pakistan. Thus we accept our H2 as well.

1.9 Limitations

This research is based on the documented progress and plans about the roles of government of Pakistan and Malaysia for the development of Islamic banking. Islamic banking developments in the Muslim countries portray their intentions for the islamization of their economies. Islamic history is full of the sources that affirm the use of Islamic modes of financing in the Muslim states with great success. With the passage of time as the strength of Muslim states become weaker the western financing was introduced to counter the Islamic financing. In west, conventional interest based economies were introduced that supports the use of interest based banking structures. In Islam interest in any form is prohibited for Muslims. Both Quran and Sunnah restrict the Muslims from the use of interest by the name of riba.

The progress control authorities of both the countries could not be physically visited due to the lack of time and lack of monetary resources available. The available results are based on the documented reports of the concerned authorities of Pakistan and Malaysia. Thus the scope of the research is limited to the available information that is available on the websites, publications and the periodicals of the concerned authorities.

Islamic financing is newly introduced concept in the modern world. In the short span of time it has touch the great heights of success. There is a very little amount of literature available on the topic. Like modern economies and their key factors, there are no theories available for the assistance of the system. However the proofs of prohibition are available in the Quran, Sunnah and the historical records of the Muslim empires. The scope of the research is limited to the use of secondary information obtained from several sources. Certain information is obtained from the Central banks of both countries that have issued their future strategic plans. Analysis for future developments has been made on the timely implementation of these strategic plans. In Malaysia and Pakistan development of Islamic banking is still in progress. The main difference among them is the more and less development. Based on the model implementation of Malaysia, the development progress of Pakistan is framed with success.

DEVELOPMENT OF ISLAMIC BANKING IN PAKISTAN

In 1947 Pakistan was developed in the name of Islam. Elimination of riba was considered as an important objective of the state policy which was incorporated in all the constitutions of Pakistan. Article 38 of the constitution of Pakistan provides “The state shall eliminate riba as soon as possible”. Islamic banking emerged in Pakistan as a response of both religious and economic needs. The efforts taken to find the alternative ways of interest based system can be seen in council of Islamic ideology (CII).

After a long period of twenty years, authorities of Pakistan have now made their decision to shift the traditional economy into Islamic economy structure through stepwise changes without obtaining any further disruption. In January 2002 Meezan Bank Limited (MBL) received the first Islamic commercial banking license from State Bank of Pakistan (SBP). MBL had a network of 10 branches in Pakistan with total deposits of about US \$ 130 million at the end of 2003. In 2003 state bank of Pakistan also issued detailed instructions regarding subsidiary and stand alone Islamic banking branches settled by the commercial banks. Thus six commercial banks including one foreign bank were allowed to operate through separate Islamic banking branches.

2.1 Capital Markets

Developments in capital market have been also mentioned with regard to islamization. Number of companies also issued Term Finance Certificates (TFC) to provide returnable capital on the Islamic concept of musharika. The sharing of returns obtained by the TFC holders totally depends upon the performance of the TFC issuing company. Security of exchange commission of Pakistan (SECP), permitted mudariba companies to start floating the musharika based TFCs in 2002. Other developments include the permission that was given to setup ‘SME mudariba’ with the participation of 20 mudariba companies to take SME mudariba business in smaller town and distant areas in 2003. Islamic banking industry is enjoying tremendous growth of 30% in its assets annually with a network of 5 complete Islamic banks and 14 commercial banks Islamic branches are operating in Pakistan. In 2013 Islamic banking has assets of Rs 1014 billion and deposits of Rs 868 billion with 1304 branches in total.

2.2 International Associations

Pakistan has joined several international Islamic financial institutions as an active member, these include;

- Islamic financial services board (IFSB)
- Accounting and auditing organization for Islamic financial institutions (AAOIFIs)
- International Islamic financial market (IIFM)

The concerned authorities of Pakistan associated with these institutions have proved to be very helpful for the progress and development of shariah ruling and standards for the growth of Islamic banking and finance industry of the country.

The development of Islamic financing in Pakistan was not imaginable without the efforts and the infrastructural privileges provided by the federal government and the Central Bank of Pakistan. An independent Islamic banking department was also developed in the State bank to look after the functions performed by the Islamic banking institutions and reframing the legal and shariah framework accordingly. The instructions and guidelines issued to the commercial banks in 2008 are also revised in April 2014. The main purpose to revise these guidelines and instruction is to make the overall shariah compliance environment supportive to the Islamic banking and finance industry of the country and to redefine the duties and obligations of various concerned departments along with the Executive Management (EM), Shariah Board (SB), Board of Directors (BOD), Shariah Compliance Departments (SCD) and lastly internal & external Islamic banking auditors of all the Islamic banking institutions.

DEVELOPMENT OF ISLAMIC BANKING IN MALAYSIA

The main objective of the Bank Negara Malaysia was to develop a new banking system which would work parallel to the traditional banking system. In the start there was only one Islamic bank BIMB which was providing Islamic goods and services. Only one Islamic bank was not enough to serve the entire nation, to enhance the Islamic banking operations in the country; Islamic banking scheme IBS was introduced. IBS allowed the conventional banks to provide products and services with their existing infrastructure and branches in accordance with sharia law. In the ending months of 2003, the number of banking institutions under the Islamic banking scheme (IBS) reached to 36 in which 14 were commercial banks (4 foreign banks), 10 finance companies, 5 merchant banks and 7 discount houses.

3.1 Capital & Money Markets

To achieve further improvements in Islamic banking industry the government considers the development of both the Islamic capital market and Islamic money market. In 1983, Malaysian Government Issued bonds for the development of Islamic banking industry. Islamic private debt securities were also issued for further developments. In 2000, the total private debt securities issued were 22,935 out of which 6,278 were Islamic bonds. Malaysian berhed bank (BIMB) established their securities in 1994; it was the first step towards the Islamic equity market.

3.2 Islamic Market Index

A separate Islamic index was also settled by the Malaysian government in which 179 halal stocks were listed in Kuala Lumpur stock exchange. This Islamic index provided an ease for the Muslim investors to freely invest in halal stocks. In July 1996 total 633 stocks were listed in Kuala Lumpur stock exchange among which 364 stocks were declared as halal. Sharia index was launched in 1999 in Kuala Lumpur stock exchange (KLSE) to facilitate the Islamic investors to invest in line with sharia law.

3.3 Islamic Banks

Strong efforts of the government for establishing and strengthen the measures to develop the Islamic banking in Malaysia prove to be a great success. Market players have also played a major role to achieve this success. The market share of Islamic banking institutions showed the positive interest of the public in the industry. In 2000 the assets of

Islamic banking sector were 6.9%, deposits were 7.4% and financing were 5.3%. Malaysia is a country with the half of its population is Muslims and they are governed by the coalition of Muslim base party. Irrespective of the half of the Muslim nation, the assets/market share of Islamic banking system is small as compare to conventional system which shows the unwillingness of the public to accept this system.

3.4 Other Financial Institutions

Strong desire to establish the Islamic financial system influences the non-bank Islamic intermediaries to offer products and services under Islamic banking scheme. These non-bank Islamic intermediaries are takaful companies, saving institutions and developmental financial institutions.

ROLES OF PAKISTANI GOVERNMENT IN THE DEVELOPMENT OF ISLAMIC FINANCIAL INSTITUTIONS

4.1 State Bank Of Pakistan

State Bank of Pakistan (SBP) is the central Bank of Pakistan. In 1974 the Bank was nationalized for the first time after the issuance of Bank nationalization Act 1974. This nationalization Act has increased the range of duties and authorities of the State Bank of Pakistan and it was fully authorized to regulate the Islamic banking sector in the country. In 2000, State Bank tooled up the initial steps for the Islamization of the banking sector and as a result of this Meezan Bank was registered in 2002 as the first Islamic bank of Pakistan. SBP has planned a three step policy for the development of Islamic banking. The main features of this policy were:

- Encourage the establishment of fully fledged Islamic banking in the country.
- Permits conventional banks to set up stand alone Islamic banking branches in Pakistan.
- Permits Islamic banks to open their subsidiaries anywhere in the country.

State Bank of Pakistan (SBP) is taking various steps in regulating an admirable Islamic banking industry in Pakistan. Some worth mentioning initiatives taken by the State Bank of Pakistan (SBP) are discussed below:

4.1.1 Establishment Of Islamic Banking Department In State Bank Of Pakistan

Pakistan was among the first three countries who tried to implement interest free banking at national level. Several steps were taken by the government to introduce interest free banking in Pakistan. State Bank of Pakistan Act 1956, Banking Companies Ordinance 1962, Recovery Laws, Companies Ordinance 1984, Negotiable Instrument Act 1881 etc were all applied to support the profit oriented banking system in the country. The newly born industry has been provided with specific time to shift its conventional system into Islamic banking system but all these struggles and hardships failed to bring the desired outcome because of the unapplied shariah compliance framework. The strategic planning by the central bank and the efforts made by the financial institutions lacked the capability to enhance the operations that could assist this sudden shift.

Islamic banking was re-launched in 2001; the government of Pakistan decided to enhance the Islamic banking in phase manner, parallel to the traditional interest oriented systems. On 15th Sep 2003, the Islamic banking department was established in SBP with an intension to develop and strengthen the regulatory and shariah supportive framework for the Islamic banking industry; through taking the initiatives for the enhancement of Islamic banking and financial system parallel to the traditional banking practices. The department has been working aggressively to establish a sound, progressive and uniform shariah compliant Islamic banking structure. In order to make strong regulatory and shariah compliance framework for Islamic financing activities in the country, the department is considering upon the adoption of Islamic standards issued by IFSB and AAOIFI.

4.1.2 Establishment Of Islamic Banking Branch Networks

Islamic banking in Pakistan is working parallel with the conventional banking. SBP allowed the conventional banks to offer the Islamic banking facilities either through specialized branches or through separate windows. Currently there are five Islamic banks working in Pakistan along with fifteen Islamic branches of conventional banks. Annual report of SBP for 2010 showed an increase of Islamic banking branches from 649 to 751 but the total number of Islamic branches in Pakistan reached to 1335 branches in 2015. These include 5 full fledged Islamic banks that are:

- Al Barka Bank Pakistan Limited
- Bank Islami Pakistan Limited
- Burj Bank Limited
- Dubai Islamic Bank Pakistan Limited
- Meezan Bank Limited

Conventional bank branches operating Islamic banking are:

- Askari Bank Limited
- Bank Al Habib Limited
- Bank Alfalah Limited
- Faysal Bank Limited
- Habib Bank Limited

- Habib Metropolitan Bank Limited
- Muslim Commercial Bank Limited
- Soneri Bank Limited
- National Bank Limited
- Silk Bank limited
- Standard Chartered Bank limited
- Summit Bank Limited
- United Bank Limited
- The Bank of Khyber
- The Bank of Punjab

Other than these banks the following Bank have also operated their Islamic sub branches in the country. These are:

- Habib Bank Limited
- Askari Bank Limited
- United Bank Limited
- Bank Islami Pakistan Limited
- Al-Barka Bank Pakistan Limited

4.1.3 Shariah Supervisory Board

The shariah board was formed in the SBP to guide the central bank of Pakistan and Islamic financing industry. The banks in Pakistan are permitted to market products and services on the basis of Islamic means of financing under the Banking Companies Ordinance 1962. Shariah board of the central bank have approved the essentials of model agreement and Islamic modes of finance, these were previously used as a guideline for Islamic banking institutions and now they have been included as a part of recently issued instructions for shariah compliance in Islamic Banking Institutions (IBIs). Every Islamic banking institution is conditioned to appoint a shariah advisor in their IBIs, who is responsible to provide approvals regarding shariah compliance of all products offered by Islamic banking institutions and also provide shariah rulings. The shariah board of SBP advises the State bank of Pakistan in the formation of regulation for Islamic financing institutions. If the conflict arises between the opinion of shariah supervisory board of

SBP and the shariah consultant of Islamic financial institutions then the decision taken by the shariah board of SBP is taken as the final choice.

The role of shariah supervisors of SBP is very difficult to the Islamic finance industry; State bank of Pakistan established a shariah compliance mechanism board which is responsible for the shariah compliance of emerging products. The establishment of this shariah supervisory mechanism was the basic need for Islamic financial system which is purely based on Islamic principles. The three steps of shariah supervisory mechanism established by SBP are as followed:

- Shariah board formed at SBP to verify shariah authenticity of new products, policies and procedures.
- Development of an audit system to verify the shariah compliance of products, procedures and policies.
- All the banks dealing in Islamic banking through whole bank or Islamic branch instructed to keep shariah advisors in order to receive guidance from these shariah supervisors.

Members of shariah board belong to the various fields; such as Islamic shariah, law, accounting, banking and other related fields. The board must have minimum five members in it; among whom at least two members should be shariah scholars, one should be chartered accountant, one should be lawyer and the last one should be a banker.

4.1.4 Accepted Islamic Modes Of Finance

Under the banking companies ordinance 1962 (BCO 1962) Islamic banks were allowed to provide services on the basis of sharih means of financing. Some changes were made in Companies Ordinance 1984 which permits the Islamic banks to offer retail services which are the most essential part of Islamic modes of finance. The Accepted Islamic modes of finance by SBP are:

- Ijara
- Murabaha
- Musawamah
- Salam
- Istisna
- Tawarruq

- Mudaraba
- Musharika
- Diminishing Musharika
- Wakalah
- Kafalah
- Qard
- Assignment of Debt
- Equity Participation in form of shares in a corporate entity

4.1.5 Liquidity Management Program

Liquidity management in Islamic institutions is more unique and difficult as compare to conventional institutions because the most available instruments for liquidity management are interest based and are not shariah compatible. There can be limited development of Islamic interbank money market due to absence of shariah compatible instruments. The money market is the most important component for liquidity management framework as it is the first place to borrow and lend the short term funds. Islamic banks cannot lend their extra liquidity on the basis of interest nor can they (Islamic institutions) borrow from central bank or other banks on rediscounted basis.

To overcome this problem the SBP is working in collaboration with the internal and external stakeholder to develop a comprehensive liquidity framework which includes development of short term liquidity management instruments, Islamic interbank money market and availability of shariah compliant discount window for Islamic banking institutions (IBIs).

Mr. Yaseen Anwar the governor of State bank of Pakistan (SBP) disclosed that SBP has been working at an advanced level of comprehensive liquidity management solutions for IBIs. These liquidity management solutions include:

- Development of Islamic interbank money market
- Development of Islamic interbank offered rate (IIBOR) for using it as a benchmark for pricing Islamic financial goods.

- Allowing Islamic banking institutions to place their surplus liquidity with central bank and get some reward on it based on the earning of State bank shariah compliant assets and investments.
- Transformation of conventional sovereign debt into shariah compliant debt.
- To facilitate the Islamic banks, the State bank of Pakistan (SBP) arranged separate criteria for SLR (Statutory liquidity reserve) and for CRR (Cash required reserve). A task force is also formed by the State bank of Pakistan (SBP) to sort out some new shariah compliant products in order to maintain liquidity issues of Islamic banking sector and they are also issuing some short term government instruments to manage their liquidity problems.

4.1.6 Affiliation Of State Bank Of Pakistan With Pioneering International Institutions Of Islamic Finance

State bank of Pakistan (SBP) is in affiliation with well known international organizations in order to achieve their goals as an active member of Islamic finance industry. SBP is making a strong relationship with central banks of other countries which are good in Islamic finance. They analyze the policies adopted for Islamic finance by those banks and try to replicate them for the development of Islamic finance in Pakistan. Islamic banking department of SBP issued a report which analyze the Islamic finance industry and regulations of some prominent countries in Islamic finance like Kuwait, Malaysia, and Indonesia and made a plan to replicate those policies in Islamic finance industry of Pakistan.

- **Audit & Accounting Organization For Islamic Financial Institutions (AAOIFI)**

Audit and Accounting Organization for Islamic Financial Institutions (AAOIFI) is an Islamic international autonomous not for profit corporate body that prepares auditing, Islamic governance, accounting, corporate ethics and shariah standards for Islamic financial institutions and industry. Audit and Accounting Organization for Islamic Financial Institutions (AAOIFI) is one of the main standard setting bodies for Islamic finance which follows religious principles such as pure monetary speculation and it restricts the interest.

Pakistan adopts AAOIFI standards for investment in sukuk (Islamic bonds) which could help the issues of Islamic banking industry of Pakistan and it will help to attract investment from foreign institutions of gulf and other countries. State Bank of Pakistan (SBP) is a trustee of AAOIFI and Pakistan adopted three AAOIFI shariah standards up till now in accordance with the legal and regulatory framework of the country.

- **Islamic Financial Service Board (IFSB)**

Islamic Financial Service Board (IFSB) is an international standards formulating organization that aims to elevate and supplement the stability and soundness of the Islamic financial service industry by developing international prudential standards and guiding material for Islamic financial industry.

Central Bank of Pakistan (SBP) is playing an active role as a member of IFSB. Dr. Shamshad Akhtar the former governor of SBP has been remained the deputy chairperson of the IFSB for the year 2007. State Bank of Pakistan hosts many workshops and council meetings for IFSB in order to facilitate the Islamic banking sector by the implementation of market discipline standards, capital adequacy standards and transparency.

- **Islamic Development Bank (IDB)**

Islamic Development Bank is a multilateral development financial institution which is located in Jeddah. With the support of king of Saudi Arabia IDB was founded in 1973 by the finance ministers at the first organization of the Islamic conference which is now called as the organization of Islamic cooperation.

Pakistan joined the Islamic Development Bank (IDB) in 1974 as a founding member. Pakistan is a member of all group entities of Islamic development bank (IDB) like ICD, IRTI, ICIEC, and ITFC. All these group entities played an important role in the countries socio-economic development.

- **International Islamic Liquidity Management (IILM)**

International Islamic liquidity management is a Malaysian based corporation formed to develop liquidity management solution for Islamic banking and finance industry in collaboration with governments and central banks of member countries. Pakistan is also planning to acquire membership of International Islamic liquidity Management

Corporation to develop shariah compliant liquidity management solutions for Islamic banking industry in Pakistan.

4.1.7 Arrangement Of Training Programs

In Pakistan Islamic banking started in 1977 and the process of islamization helped to increase the popularity of interest free banking. In the starting period there were few banks who incorporated the concept of Islamic banking in Pakistan and due to this the need for employees with proper background in Islamic banking was not that much necessary. In 2007 the trend towards Islamic banking increases which boost the need for newly trained and skilled employees with pure Islamic banking background. In 2010 the market for Islamic banking expended throughout the country and this increase gave birth to the new challenges and the need for employees with Islamic background becomes a real challenge.

State bank of Pakistan is paying serious attention toward this issue of “lack of awareness about Islamic finance” and conducting a number of seminars in order to train the employees with the concept of Islamic finance. To provide skilled and trained people in the field of Islamic finance, SBP arranged a training course through National Institute for Banking and Finance (NIBAF) which is subsidiary of State bank of Pakistan (SBP). A certificate with the name of “Islamic banking and finance certificate” is issued to the trainees of this program. Islamic banking certificate provided by National institute for banking and finance (NIBAF) is currently in high demand because of its reputation as one of the best training programs in Islamic banking.

Along with these certificate programs NIBAF also assist INCEIF (International centre of education in Islamic finance) Malaysia in conducting chartered Islamic financial professional (CIFP). Recently NIBAF also arranged some short courses in collaboration with International Islamic University Islamabad for Islamic banking professionals. In December 2012 NIBAF arranged the training programs for the trainers of Islamic banking and also arranged some awareness sessions in different universities of Sindh and Punjab to enhance the training efforts of the SBP.

4.1.8 Monetary & Fiscal Policy Implication

Central bank of Pakistan has played the major role for the development of the Islamic banking industry to gain the recognition in both local and international markets. It is a regulatory authority that has introduced and implemented comprehensive legal rulings and infrastructure for the Islamic banking and financing industry. It regularly evaluates the international regulatory standards and practices for their customized implementation in the country. It has announced a five year strategy plan for the improvement of the Islamic financing institutions. This plan includes the suggestions for the fiscal and monetary policy implications in the country. The strategies planned in this plan if successfully implemented would increase the operations of industry in Pakistan. It will also help the industry to shift from the initial stage to the next stage of stability and innovations of the industry.

ROLES OF MALAYSIAN GOVERNMENT IN THE DEVELOPMENT OF ISLAMIC FINANCIAL INSTITUTIONS

5.1 Bank Negara Malaysia

Bank Negara Malaysia was established on 26 January 1959 as Bank Negara Malaya. Bank Negara Malaysia is governed by the central bank of Malaysia act 2009. The main purpose of this bank is to issue currency and to act as an advisor and banker to the government of Malaysia and to regulate the monetary policy, financial institutions and credit system. Headquarter of this bank is situated in Kuala Lumpur (the federal capital of Malaysia).

Monetary policy of bank Negara Malaysia maintains the price stability in the economy while supporting the growth pattern of the economy. Consistent uniformity of the financial system is also the responsibility of the Central bank of Malaysia. This stability is achieved by the development of sound, diversified and progressive financial sector which helps to support the real sector of the economy. Bank Negara Malaysia also provides advisory services for the macroeconomic policies and management of public debt as a banker and advisor to the government. BNM is the only authority which manages the international reserves and issues the national currency.

5.1.1 Establishment Of Islamic Department In Bank Negara Malaysia

Malaysia started Islamic banking in 1963 with the establishment of Perbadanan Wang Simpanan Bakal- Bakal Haji (PWSBH). It was set up with the ideology to provide the saving opportunity for the Muslims to perform the Hajj and cover its expenses. It is then merged with the Pejabat Urusan Haji in 1969 and formed Lembaga Urusan Dan Tabung Haji (LTH). The optimum goal of the Malaysian Islamic financial model is to function parallel with the conventional financial system of the country. Islamic banking act was introduced to provide the legal framework. Further rules like Takaful act and rules relating to Islamic interbank money market were also issued. In March 1993, central bank of Malaysia introduced profit oriented banking scheme as Skim Perbankan Tanpa Faedah (SPTF) which later turned to the Islamic Banking scheme (IBS) in 1998. In October 1996, Bank Negara of Malaysia has issued a formal financial model that helps in the fair representation of financial statements of the Islamic banking operations. In 1997, a National sharia advisory council was established by the central bank of Malaysia to

resolve the differences in the opinions regarding the functionality of the Islamic banks in the country.

5.1.2 Establishment Of Islamic Banking Branch Network

Bank Islam Malaysia Berhad (BIMB) was the first Islamic bank that started its operations in Malaysia. After the ten years of BIMB formation the central bank of Malaysia (BNM) allows the conventional banks to offer Islamic banking services by using their existing infrastructure and networks in 1993. The government allows the conventional banks to offer Islamic services from 'Islamic windows' because they think it is more effective and efficient way to increase the number of Islamic institutions that offer the Islamic service in the country. Currently there are 17 Islamic banks operating in Malaysia. These are as follows:

- Affin Islamic Bank Berhad
- Al Rajhi Banking and Investment Corporation (Malaysia) Berhad
- Alliance Islamic Bank Berhad
- Amislamic Bank Berhad
- Asian Finance Bank Berhad
- Bank Muamalat Malaysian Berhad
- Bank Islam Malaysian Berhad
- CIMB Bank Islam Berhad
- EONCAP Islamic Bank Berhad
- Hong Leong Islamic Bank Berhad
- HSBC Amanah Malaysia Berhad
- Kuwait Finance House (Malaysia) Berhad
- Maybank Islamic Berhad
- OCBC Al-Amin Bank Berhad
- Public Islamic Bank Berhad
- RHB Islamic Bank Berhad
- Standard Chartered Saadiq Berhad

5.1.3 Shariah Advisory Council

Shariah Advisory council (SAC) of Bank Negara Malaysia was formed in the May, 1997. This SAC has been given the authority for the ascertainment of Islamic laws for the purpose of takaful business, Islamic financial business, Islamic banking business, Islamic development financial business and any other business which is based on shariah principles and are supervised and regulated by the Bank Negara Malaysia. SAC is accountable for approving all the Islamic banking and takaful products in order to assure its compatibility with the shariah principles.

The mandates of SAC available under the section 52 of central bank Malaysia Act 2009 are as follows:

- Ascertain the Islamic law on any financial matter and issue a ruling upon reference made to it.
- Advise the bank on any shariah issues related to the Islamic financial business and the activities or transaction of the bank.
- Provide advice to any Islamic financial institution or any other person may be provided under any written law.

Members of SAC are qualified professionals and have sufficient knowledge and experience in law, economics, finance, banking and application of shariah.

An important progressive measure under the Central Bank Malaysia Act 2009 is the necessity of the arbitrator and the shariah court to consider the rulings of shariah advisory court (SAC) and for any issues related to shariah can be consulted through SAC. Previously the rulings of shariah court are only binding on arbitrator but after this development in the Act the rulings are binding on both the arbitrator as well as the court.

5.1.4 Accepted Islamic Modes Of Finance

The accepted Islamic modes of finance in Malaysia are:

- Mudariba
- Musharika
- Murabaha
- Bai Bithaman Ajil (deferred payment sale)
- Ijara (leasing)
- Ijara thumma al bai (lease purchase)

- Salam
- Istisna
- Qard hasan
- Tawarruq
- Bai Inah
- Hibah
- Kafalah
- Ibra

5.1.5 Liquidity Management Framework

An efficient liquidity management framework is essential/necessary for a stable Islamic financial system. Such a framework is very important and basic component in conducting funds and investment activities for the operations of Islamic financial institutions. With the significant growth in Islamic banking deposits, the liquidity management system has become very important. The growth in deposits of Islamic banking is higher than the conventional banking by almost three times; Islamic deposits are growing at a 10 years average annual rate of 17.6% as compare to 7.1% for the conventional deposits.

There are six key components which are focused in this liquidity management framework that support more effective liquidity management. These components are:

- Introducing wide range shariah compliant instruments.
- Establishing an efficient infrastructure to facilitate the issuance of Islamic financial instruments.
- Ensuring a sound regulatory, supervisory and shariah framework.
- Promoting an active secondary market.
- Putting in place robust institutional policies and procedures,
- Securing a strong financial safety net.

Malaysia's liquidity management framework encompasses all the necessary components in its framework to enable the stable and efficient functioning of the Islamic financial system. Now the Malaysian government is working collaboratively with the other central banks to secure a robust liquidity management infrastructure, ensuring a conducive

environment for the issuance of foreign currency instruments and promoting the development of globally accepted Islamic liquidity instrument.

5.1.6 Affiliation Of Bank Negara Malaysia With Pioneering International Institute Of Islamic Finance

Bank Negara Malaysia is in affiliation with different international institutes of Islamic finance. Bank Negara Malaysia (BNM) has issued guidelines that are based on AAOIFIs standards and pronouncements. BNM is also a member of IFSB and Bank Negara Malaysia's governor Dr. Zeti Akhtar Aziz was appointed as the chairperson of IFSB for the year 2008. IFSB and BNM also organize seminars on Islamic microfinance. INCEIF (International centre for education in Islamic finance) was established by the central bank of Malaysia, BNM to produce professionals for the global Islamic finance service industry. MFTC (managerial and financial training center) signed an agreement of cooperation with the Malaysian based international centre INCEIF to produce high caliber professionals for the Islamic finance service industry through chartered Islamic finance professionals (CIFP).

5.1.7 Arrangement Of Training Programs By Bank Negara Malaysia

Islamic finance and banking is currently representing the fastest growing sectors of the global financial system. Sustaining this growth level and the availability of vastly skilled and educated human workforce is very important which can derive the future developments and innovations of the industry. Accordingly to MIFC (Malaysian international Islamic financial centre) report estimated 1 million professional will be needed internationally for Islamic financing by the start of 2020 in which Malaysia alone requires an additional work force of 56,000 financial professionals and experts for both Islamic and conventional banking industries.

Malaysian financial system has been developed very impressively over the last decades and it turned its sector into more advanced and proficient sector of the Islamic financial system. Un till the end of 2011 the Islamic financial and banking industry of Malaysia has contributed 22% to the total monetary assets as compare to 6.9% in the year 2000 with the employment of 11% of human workforce. As mentioned previously from MIFC that 56,000 finance professionals will be needed by the start of 2020 in which 22,400 would be independently required by the Islamic finance industry.

In this regard the government of Malaysia has taken many steps that could take the country on the superior track to become a global leader in providing skilled and knowledgeable workforce in Islamic finance. In 2005, Bank Negara Malaysia has introduced first fully devoted international Islamic finance university to achieve this purpose. Another institution named International Centre for Education in Islamic Finance (INCEIF) also offers postgraduate master's and PhD degrees along with the professional chartered qualification, chartered Islamic finance professional (CIFP). In 2010 almost 2,000 students were enrolled in the Islamic finance courses from more than 80 countries in INCEIF and they were presented by the Malaysian Prime Minister with a status of "Project of National Interest".

INCEIF is in collaboration with the World Bank, Islamic Financial Services Board and University of Reading (UK) in order to synergize exploration, learning and innovation. Malaysia has several universities that provide a large variety range of academic training programs in Islamic ways of financing. Islamic finance related courses are offered by more than 30 private and public institutes of Malaysia.

Malaysian government has also formed an endowment fund that amount to 200 million RM to achieve the goals of boosting knowledge, academic explorations and talent grooming in the arena of shariah and Islamic finance.

5.1.8 Monetary & Fiscal Policy Implication

Bank Negara Malaysia has a major responsibility to promote and establish monetary and financial stability. Its monetary policy defines the maintenance of price stability by supporting the economic growth. It primarily provides the assistance for the growth related issues by enhancing the formulation of credit and monetary policy. It helps in the stability of monetary measures and also to enhance the economic growth. It has also developed sound and sustainable financial infrastructures for the financial sector stability. Thus fiscal rulings help for the positioning of Malaysia as an Islamic financial sector for Muslims and enhance the financial capacity of consumers.

COMPARISON OF BOTH GOVERNMENT'S ROLE

Both Pakistan and Malaysia have started the promotion of Islamization of their economies in almost same year. Irrespective of their hard work and efforts Malaysia has succeeded to attain the better results. Islamic financing in Malaysia has a past of almost thirty years where as in Pakistan after the re-launch, the operations of Islamic financing were initiated nearly thirteen years ago. The main reason behind this is the incompetent authorities who have initiated the Islamic financing program in Pakistan. Although Islamic financing is growing in Pakistan with remarkable growth rates but still there is a huge difference between the roles played by both countries.

6.1 Legislative & Taxation Facilitation

Pakistan is far behind the Islamic banking sector development of Malaysia. In Malaysia Islamic Banks are registered under the “Islamic Banking Act 1983”. This law itself defines the rules for the full fledged operations of the Islamic banks with the necessary requirements. It also assists to avail the tax credits in certain Islamic banking transactions. In Pakistan all the banks are registered under “Banking Companies Ordinance 1962”. However an amendment was made in November 2002, it comprises of a clause that permitted the banking business to strictly operate in conformity with the rules of Islam as laid down in Holy Quran and Sunnah. Central Bank of Pakistan has issued a detailed structure in January 2003; it describes all the registration and eligibility criteria for the establishment of Islamic banks. However a specific regulation for Islamic banking is still in process that would allow tax credit and other legal and monetary benefits to the stakeholders of the industry.

6.2 Professionals Development & Retention

Malaysia is very aggressively taking interest in the development of trained professionals and experts for Islamic banking industry. The major steps taken by the Bank Negara Malaysia includes the notifications signed with the major universities of Malaysia to include Islamic banking courses in their curriculum. In several universities the education boards also take assistance from the Banking board to provide them the requirements of the market to obtain efficient employees. After the education completion Islamic banks are suggested to offer internship programs for the Islamic financing related degree holders. In Pakistan the Central Bank of Pakistan has launched the Islamic financing

related courses with the help of Higher Education Commission of Pakistan. Currently almost all the universities are offering these courses to the finance students. In most cases only single introductory course is offered to the students. This is the reason that currently only few Islamic graduates are available in Pakistan. Those who have learnt Islamic financing during their degrees are not offered internships where as the old employees with a week trainings are asked to operate in Islamic banks in Pakistan.

6.3 Product Innovation & Research

Islamic products available in Malaysia are more than available in Pakistan. These products are highly customer attractive. Malaysian government launched Islamic banking with an objective to move it on parallel stream with conventional banking. Thus the products available in Malaysia cater the same needs that were catered by conventional banking before. However Malaysian government has taken further steps to take its Islamic banking industry on one further step. In this way they have benefited even their non saving depositors to enjoy the benefit of Mudarabah and ultimately pure profits. In Pakistan due to strict shariah rules the product development process is merely slow. In Pakistan the Islamic banks are trying to differentiate their products with conventional counterparts. In this way with strict shariah ruling they are not able until now to provide a new and innovative product in the market. In Pakistan the deposits for saving and deposits other than saving are both treated separately. Saving account holders in Islamic banks enjoy the benefit of earning profits whereas the non saving depositors use to pay the fee for maintaining their accounts. However Pakistani government is currently working on the product that could provide the profit sharing benefit to the non saving depositors as well.

6.4 Shariah Conciliation

Islamic banking in both the countries operates under the supervision of the shariah governance. Shariah Supervisory Boards decides on the operations of banking industry. They describe the rules for operations to perform. They have the authority to limit or ban the product if that proves to violate any shariah rule. In Malaysia the shariah supervisory board is innovative and industrial supportive. They allow the use of products on the basis of their need of the country. This is the reason that two of their newly launched products are being restricted and cast prohibited by the Jeddah council of Fiqh. In Pakistan the

shariah rules are so strict and as defined in previous section it is the main reason for slow development of new products in the market. However this strictness leads the Pakistan to be considered under the best and strong shariah supportive country. However, the shariah supervisors in Pakistan are still working to find out the window to produce a perfect product that could gain the common shariah acceptance and comply with the rules defined by the international Fiqh councils.

6.5 Recording & Assessment Techniques

Malaysia has a broader history of Islamic banking as compare to Pakistan. Thus it has more affiliation with accounting and legislative bodies as compare to Pakistan. In Malaysia the recording of accounts in Islamic banking is made according to the standards provided by the AAOIFI. In Pakistan up till now only two standards are regulated where as one more will be regulated soon. Other than these standards Malaysia has issued BASEL 3 guidelines for the risk management of their Islamic banks. On the other hand in Pakistan the BASEL 1 is being planned to be implemented. Islamic center for education are also not available to provide the human capital that could implement the new and advanced forms for the Islamic banking operations in Pakistan. Currently State Bank of Pakistan has planned to open their education center at IBA Karachi to fulfill the need of the Islamic banking supportive programs.

MERITS & DEMERITS OF PAKISTANI GOVERNMENT

Pakistan was initially considered as the primary source for the Islamic financial thought but now it is far behind the number of other countries. The reason behind this is the excessive efforts made by other countries for the development of Islamic banking and finance industry. According to the Islamic Finance Country Index (IFCI) 2014, Pakistan failed to defend the 8th position as per 2013 index and received the 9th position. The project of the development of Islamic banking in Pakistan is provided by the government to the State bank of Pakistan. State bank solely provides the guidelines, regulations and supervises the functions of Islamic banking institutions. Despite of the fact of having several strengths most importantly shariah compliance, Pakistani government has failed to make the country a leader of the Islamic banking and finance. Following are the merits and demerits of the country towards Islamic financing.

7.1 Merits

7.1.1 AAOFI Accounting Standards

Accounting and auditing organization for Islamic financial institutions has issued 26 accounting standards for the standardization of accounting records of the Islamic financial institutions. Several countries are adopting these standards according to their ease areas. Pakistan by now has successfully issued three accounting standards related to Ijarah, Murabaha and Profit & loss sharing of deposits. Institute of Chartered Accountants of Pakistan (ICAP) along with Securities and Exchange Commission of Pakistan (SECP) and active role played by State Bank of Pakistan (SBP) has issued the accounting standards to Endeavour the interest free transactions. These three standards have been notified by the SECP and instructed by SBP to be implemented by financial institutions offering shariah complaint products and services.

7.1.2 Timely Achievement Of Goals

In September 2001, a meeting held between the officials and concerned authorities for the implementation of interest free economic structure in Pakistan. In that meeting it was agreed that the required goal would be achieved by the mean of gradual and phased manner without causing interruption in the ongoing processes. SBP was allowed to provide three options to the financing institutions to achieve the goal.

- Setting up Subsidiaries by the commercial banks for the sole Islamic services

- Specifying branches by the commercial banks for the Islamic services
- Setting up new full fledged Islamic banks for the Islamic services

These options lead to the development of Islamic Banking Division (IBD). With the keen hard work of IBD all three options are now implemented. Recently Muslim Commercial Bank (MCB) had been granted a license by the SBP for the development of very 1st Islamic Banking Subsidiary in Pakistan. It is expected that other commercial banks would also pursue for the development of their Islamic banking subsidiaries.

7.1.3 Timely Implementation Of Conventional Strategies

Micro financing is one of the most important tools used by banks to elevate their resource base. It is not being used by the Islamic financial institutions in their routine operations. In 2009, SBP has announced the adoption of microfinance strategies of the conventional banking structures and implement them with required modifications. It has already issued the guidelines in this regard that defines the arrangements of various types of institutions for the provision of Islamic microfinance service. Recently SBP has achieved its target by the launch of first Islamic microfinance bank operations in Pakistan. National Rural Support Program (NRSP) Microfinance bank has been provided formal approval to start their Islamic microfinance operations by opening their Islamic microfinance branch in Bahawalpur. It is due to the supportive role of SBP that Pakistani based microfinance institution; Wasil Foundation has won the global contest of innovative shariah compliant financial products.

7.1.4 Shariah Compliance Support

Shariah compliance is the competitive essence of the Islamic financing. The trust on the IBI's are not only dependent on their institutional performance but upon their consistency with shariah. SBP has developed a complete and comprehensive shariah compliance structure for the development of Islamic banking system in Pakistan. It is essential for every IBI to work under the supervision of the shariah advisor. The selection of shariah advisors are based on the Fit and Proper Criteria regulated by the SBP. This not only helps in the minimization of the conflicts but also enhanced the objectivity in the evaluation criteria. SBP continually review their Shariah compliant structures. Recently SBP has circulated a detailed Shariah Governance Framework (SGF) to provide the strength to the overall shariah compliance structure of the IBI's. This strong shariah

compliance structure is the reason for the achievement of the most regulated shariah compliance structure.

7.1.5 Education & Research Enhancements

Pakistan is among the countries that are formed in the name of Islam. In the constitution of 1973 it was mentioned to bring all the laws of the country with the conformity of Islamic laws as required and mentioned in Quran and Sunnah. Interest free economy is the part of this revolutionary step taken by the Government of Pakistan. It is the main reason for the development of Islamic banking throughout the country. Implementation of any system requires a certain mass education to make them aware of the ongoing processes. In this regard several steps are taken by the government of Pakistan to educate the people regarding Islamic financing. SBP in collaboration with HEC has introduced the Islamic financing and banking in the Finance courses of the students. SBP has now announced that educational institutes are being encouraged to initiate work and research on Islamic banking. SBP is also in continuous contact with the Institute of Business Administration (IBA) for the establishment of center of excellence on Islamic banking in Karachi which will later be established in other major cities of the Pakistan.

7.2 Demerits

7.2.1 Taxation & Legal Issues

Introduction of Islamic banking in the conventional system is not practicable until and unless the supporting actions from related departments is not received. Islam is supportive of Zakat from Muslims to be used as taxes. The current taxation systems thus should be molded in such a way that helps to implement Islamic banking easily. Initially SBP has raised the issue of double taxation on the Murabaha transaction in front of Central Board of Revenue (CBR) that is Federal Board of Revenue (FBR) now days. It also proposed certain amendments in the taxation system which was adopted in 2004-05 budget of Pakistan. According to this amendment in sales tax, goods delivered under Murabaha financing approved by SBP and SECP would not be treated as supply. In income tax ordinance minimum turnover taxes and lately in Finance bill 2007 it is confirmed to tax the Shariah compliant Islamic banking as par with conventional banking.

Currently there is a need to remake the taxation policies for the implementation of Islamic banking. Stamp duties must be relaxed to enhance asset based financing and reduce the transaction cost. Investors in Islamic banks serve as the partners of the Islamic Financial institutions. Thus the taxation on the profits must be provided with the tax credit incentives for their investors. Lastly and most importantly policies for the capital requirements and regulatory reserves must also be relaxed for the Islamic banks.

7.2.2 Issues In Liquidity Management

The main objective of money market is to maintain the short term liquidity requirements. Banks with deficits can borrow from the banks with surpluses through this medium to fulfill their money requirements. Islamic money market also uses the same medium for their short term liquidity requirements. Rather than interest based instruments Islamic banks use surplus sharing instruments. Islamic banking can only enjoy the benefit of Islamic money markets with the option of surplus sharing but the conventional banks have the option to share the benefits from both the money markets through their Islamic windows. Thus it is the keen concern of the SBP to maintain the returns of the both money markets at homogeneous rates. Islamic banks in Pakistan require serious attention for the development of Islamic money market instruments and the financing rates matching on uniform basis. Currently available Islamic financial instruments are either fixed or long term in nature that creates the problem of mismatch. In case of medium and long term projects, Islamic banks use short term deposits on variable rates for the financing.

7.2.3 Lack Of Professional Human Capital

Every system requires its professionals to implement it to gain optimum utilization. Islamic financial institutions lack those professionals that have proper understanding of Islamic banking services and their practical implementation. In this regard SBP has taken certain steps that require the IBI's for appropriate training of their staff. They are also bound to provide trainings for their employees before getting the Islamic banking license from SBP. Currently few universities and training institutes are offering the Islamic finance courses but still they are not that much competent to conduct the Islamic finance training. At the professional level there are very few scholars who have required knowledge and expertise in the field of Islamic finance. Thus the total dependency of the

Pakistan's Islamic banking is on few shariah scholars which make difficulties for them to assist all the matters in proper time. Thus Islamic religious schools combining with the business schools should introduce new shariah scholars that can cater the future needs of Islamic industry in Pakistan.

7.2.4 Lack Of Customer Affiliation

Every new concept faces the natural dynamics when it is introduced in the markets. In the early stage only few people accept the new concept but later on with the great efforts it becomes recognizable by everyone. Failure of the attempt of islamization of economy also played a keen role in the non recognition of Islamic finance and banking industry in Pakistan. Several steps had been taken by the SBP by conducting a successful awareness program for the stakeholders of Islamic banking services. The unsatisfactory practices in the name of Islamic banking in the past have broken the trust of the Islamic banking customers about the authenticity of the Islamic banking practices. Most of the customers' opinions are based on misinformation and lack of understanding of Fiqh issues. One of the greatest challenges of Islamic banks is to change these perceptions of the stakeholders through collective efforts made by all concerned authorities. In this regard SBP has launched some media campaigns, seminars, general meetings to enhance the awareness of people regarding Islamic banking.

7.2.5 Operational Issues

The investors of present days have become more materialistic these days than past. They are more concerned with the nature of return. In the case of Islamic banking in Pakistan, the rates being used are the same as used in conventional banking. The nature of Islamic banking is differing from the conventional line of banking by the way of profit making institution and not the interest charging and sharing institutes. Thus the use of the KIBOR in the Islamic banking activities distorts the philosophy of Islamic banking. The use of KIBOR also creates the customers and banks dependency on the interest based money markets. Thus it is essential to change the benchmark for Islamic banks. In this regard some banks have taken the initiative for the development of Islamic benchmark rate. Non availability of Islamic benchmark not only reduces the clients of Islamic banking but also resist the potential clients from availing the benefits of the Islamic banking.

MERITS& DEMERITS OF MALAYSIAN GOVERNMENT

Malaysia is among the countries that are more progressively developing their Islamic financial structures and promoting Islamic financing. It was taken as a challenge by the Malaysian government to impose Islamic system in parallel to the conventional financing. According to Islamic Finance Country Index, Malaysia succeeded to retain its 2nd position in 2014 as well. Malaysia is considered as the role model for the adoption of Islamic financing throughout the Islamic countries. Malaysian Islamic institutes are far ahead then Pakistani Islamic institutes because of the early steps taken by the Malaysian government for the development of Islamic financing. Islamic finance was introduced in Malaysia with the development of Tabung Hajji and Bank Islam Malaysia Berhad with an objective to use as alternative to the conventional financing structure. Even now with the vast developments and improved infrastructures it has some issues also. Following are the merits and demerits of the country towards Islamic financing.

8.1 Merits

8.1.1 Legal Framework

Islamic banking industry has a past 30 year experience in Malaysia. This strong based of Islamic financial institutions is gained by the early development of Islamic Banking Act 1983 and Takaful Act 1984. These two Acts provide sound foundations for the development of Islamic banking and insurance industry in Malaysia. Islamic financing has grown remarkable since the first inception in 1970's. On the other hand Takaful industry has also touched the remarkable growth with both Muslim and non Muslim client circles. Later on in 2013, Islamic Financial services Act was introduced by the Malaysian Government to set out the financial uniformity and to follow the Shariah rules. IFSA imposes the obligations on the IFI to ensure the Shariah standards following. It provides the regulatory framework for the end to end implementation of shariah compliance by the Islamic financial institutions.

8.1.2 Shariah Governance

Bank Negara Malaysia has put great efforts to ensure the Shariah compliance in all over the Islamic financial system in the country. This has been done with the development of two way Shariah governance system. One providing their services in the IFI's and other is managing and controlling above them. Shariah Advisory Council of BNM is formed

under the section 51 of Central Bank of Malaysia Act 2009, according to which it has the supreme authority to settle the matters relating Islamic financing. The obligations of internal Shariah committees of their respective IFI's are to assist them in Shariah matters. The objectives of Shariah board comprise of the research and innovations in the IFI's operations as well other than their operations assessments. It is the prime responsibility of each IFI in Malaysia to develop a doubt free Sharaih governance framework to ensure its effective implementation.

8.1.3 Capital Adequacy & Financial Reporting

The capital adequacy framework was firstly introduced in Malaysia in 1989 with amendments and further requirements and was lastly updated in 2012. Islamic banks are profit sharing institutions thus they are more risk bearer then the conventional financial institutes. This framework helps to set out the approach for computing the regulatory adequacy ratios and all other ratios at which Islamic financial institutions are required to operate. This framework has been developed by the Basel Committee on banking supervisions. It is use to be considered together with the Capital Adequacy Framework for Islamic Bank which assists to settle out the requirements for computing risk weighted assets. On the other hand Malaysia has also replaced its financial reporting standards with the international financial reporting standards in 2012. It has played a great advantage for the Malaysian Islamic financial institutions in compiling their records under all the legal frameworks provided.

8.1.4 Human Resource Building

Bank Negara Malaysia after seeing the need of continuous development of talented high professional experts for Islamic financing developed a result oriented strategy. This strategy encompasses two important measures. Firstly by the way of making alliance between IFI's and higher education institutes, enhanced knowledge on Islamic banking and takaful should be obtained. Secondly it was agreed to introduce subject of Islamic banking in the usual courses of schools and higher education. This proves to be a great success for the Malaysian Islamic financial infrastructures. Islamic financial institutions provide the internship opportunities to the fresh graduates to implement their Islamic financial knowledge. Other than this in few universities the bank management also plays

major role while setting the course structure for Islamic finance students. This step has resolved the mismatch issue of Malaysian Islamic finance human capital.

8.1.5 Islamic Financial Market

Islamic financing in Malaysia has emerged into a comprehensive and influencing Islamic financing marketplace. The Malaysian International Islamic Financial Center is the result of the hard work done by the Malaysian Financial market regulators and relevant government agencies. It was launched in 2006 by the engagement of industry and government with dedication to develop Malaysia's Islamic finance market. Malaysia by this way became able to possess the world's most advanced Islamic financial market. It is worth of around one trillion USD in assets now. In 2009, Malaysian banking industry was awarded as the "Islamic Finance Hub of The Year" at the Triple A Islamic finance awards by the Asset Magazine. Recently Malaysia International Islamic Financial Center was pointed out as an ideal international Islamic finance center, at the 3rd annual London Sukuk Summit Awards of Excellence.

8.2 Demerits

8.2.1 Misconception Regarding Islamic Banking

Islamic banks are the one of the source to get into the Islamic financing. People in Malaysia comprises of both Muslim and non Muslim community in almost half ratio. Thus it is much important for Malaysian Islamic banks to not only cater the Muslim customers but also to attract the potential non Muslim customers as well. Non Muslims in Malaysia are aware of the ongoing Islamic banking operations but they are less aware of the nature of operations. They believe that this system is only for the Muslims because no profits could be gain without charging interest. Thus it is the responsibility of the IFI's to create awareness among their non Muslim clients by defining the differences and the better value they can generate for their customers. Same is the case with the corporate sector of Malaysia which is not yet targeted by the IFI's of Malaysia. This is the reason of the below potential results of the Malaysian Islamic banking industry.

8.2.2 Usage of Shariah Principles

There are two type of main Shariah principles, one is strongly Islamic that includes Musharakah and Mudarabah, second is weakly Islamic that includes all other ways of Islamic financing. Thus the scholars of Malaysia had put strong pressure on the Islamic banks to use the profit sharing mechanism for deposits and financing funds. The implementation of this system is not satisfactory up till yet. Most of the banks are using fee charging mechanism because of the high risks in profits and loss sharing systems. Deposits are also charged with fee and are not used as earning source for both bank and depositor. The commercial banks require new set of technical and risk management capabilities to implement the profit and loss sharing system. A new regulatory and supervisory framework is also required to assist the IFI's for the maintenance of the records of the investments.

8.2.3 Differences In Shariah Views

Islamic financing has a keen essence of the Shariah compliance. Shariah describes the rules and regulations for the acceptance and rejection of the operations that are to be used in the Islamic financing. These Shariah rules are defined under supervision of the four basic Islamic schools that are: Hanafi, Shafi, Maliki and Humbli. In Malaysia there are certain products being used that are renounced by the Fiqh academy of Jeddah being prohibited according to the Shariah rules. These products are extremely criticized by the Islamic scholars on the ground of Fiqh rules. Malaysia has started using Islamic bill and bonds in 1991 under the name of Mudarabah, Bai Bithaman Ajil, Bai Al-Dayn and Dha'Wa'Ta Ajjal. These are used as the discounting of bills and issued to the importers and exporters to use against the conventional counterpart of letter of credit. Another unsettled issue lies with the use of Bai Al-Inah for personal financing. Thus the regularity of Shariah rules must be followed by each country under one specified rule to avoid confusion and misconception.

POSITIVE ROLE OF THE GOVERNMENTS IN THE DEVELOPMENT OF ISLAMIC FINANCIAL INSTITUTIONS

Islamic finance is derived from the teaching of Quran and Sunnah. In almost all the countries where Islamic financing is initiated, it is operated under the shariah supervisory councils. These councils make their decisions on the approval and disapproval of certain activities to be Islamic on the basis of rules defined by the international fiqh council. Islamic finance is not merely a concept to be applied in isolation; rather it is a complete source of operating an economy. In Islam all the concepts are interrelated with each other. Thus to initiate an Islamic concept in conventional economic structure is severely dangerous. It not only limits the framework of Islamic financing but also creates ambiguity in the minds of the stakeholders of the Islamic financing industry. Thus the positive roles are not determined on how much the growth this industry has achieved but on the roles the government played to make its foundations strong. Foundations of Islamic financing systems lies with the changes required in the legal, taxation, monetary, education and market systems.

9.1 Legal System Development

The hard work of the nation of Malaysia and its commitment towards the eager of implementation of Islamic financing leads to the several developments. In Malaysia several legal steps were taken by the government to facilitate the Islamic financing structure. These steps include the development of the shariah board to handle the routine operations of the Islamic banking industry of the country. However the area of their authority and freedom of decision is vast as compare to other countries. Other than this to strengthen the Islamic financing industry structure they have launched the separate legal laws that describe the framework for the institutions to be operated in the country. In Pakistan although the government has successfully achieved the milestone of strengthening the shariah board but still the legal rules are missing for the Islamic banking industry in Pakistan. After 1983 no specific laws are issued by the Pakistani government that specifically deals with the Islamic industry. Although the framework for Islamic industry is provided by the shariah board in Pakistan that should be further enhanced to the next stage.

9.2 Monetary Development

Malaysia is successfully developing its Islamic banking industry. In this regard Malaysian government has also implemented the Islamic currency concept in their economy. Shifting the economy from paper currency to any other form is very difficult. Thus they have introduced the Islamic currency in specific regions and industry to gather the results for their feasibility of use in the current economic and need structures. These coins are at success because of their high value and common demand. The Islamic banks have even introduced the coin deposit machines in the country to facilitate their clients. However in Pakistan there are no steps taken by the government to cater the difficulties of their monetary system.

9.3 Taxation Development

Taxation systems in Malaysia are also amended for the Islamic banking clients. Islamic banking deals with the profit sharing modes and thus the Islamic banks are the seller of products and not the money. Thus they buy commodities for their clients upon whom they pay tax to the government and when these commodities are sold to the clients they are taxed again. Thus in Malaysia government has provided ease to the customers of Islamic banking industry by facilitating them from tax credits in several Islamic banking transactions. However in Pakistan these amendments are still in process. Government is working with the State Bank of Pakistan to come up with a breakeven point.

9.4 Market Development

Markets are the main place for the sale of the products. Markets define the rates and provide the stability to the industry. Islamic finance markets in Malaysia are strong relatively stable then Pakistan. They are successfully floating their Sukuk Bonds in the market. Other than these bonds several other Islamic bonds and products are traded in the market. It is expected that in some time Malaysian government is planning to issue its Islamic market rate to replace the existing profits rate. In Pakistan Islamic markets are not strong enough. However Pakistani government is planning to float its Islamic sukuk bonds in the international markets to raise the funds for the Islamic banking industry. It is also expected that in 2016 Pakistan will launch its profits rate to replace the KIBOR.

CONCLUSION & SUGGESTIONS

The movements of islamization of the economy in Pakistan and Malaysia were initiated in almost the same time; however the progress of Islamic banking industry in Malaysia is far better than Pakistan. The weak introduction in Pakistan was the reason of the weak political structure in the country. Islamic banking was the one of the tool for the development of interest free economy in Pakistan. Unregulated bodies and political influence in the monetary systems resulted in the great failure of early implemented Islamic banking structures in the country. Manipulation of the Islamic infrastructure by the political parties for the personal gains was filed in the judiciary court by the Ulama's and later it was proved in the favor of them. Later with the help of Ulama's the banking structure was reformed in Pakistan and it was successfully introduced in the 2002 with the development of first Islamic bank in Pakistan.

Government has handed over the project of the formation of Islamic banking industry in the hands of the State Bank of Pakistan. State Bank is playing its role in the development of Islamic banking industry whole heartedly. Primarily state bank had developed its initial goal to establish full fledged Islamic banks, Islamic bank subsidiaries and Islamic bank windows in conventional banks. These goals were achieved by the stepwise development and establishment of compulsory authorities. In this instance initially an Islamic bank development department was established in the State Bank of Pakistan. This department started its obligations by the development of shariah advisory council of Pakistan. Later framework for the Islamic banks was developed and thus initiated the Islamic banking industry in Pakistan. After the launch of Islamic banking, mass media campaigns were launched to increase the customers of the Islamic banking industry. The Islamic scholars played their role for the teaching of people regarding Islamic banking in Pakistan. As the time passes the industry has shown the growth and development above expectation. This growth initiated the need for the professionals and experts of Islamic banking industry. In this regard State Bank held meetings with Higher Education Commission to produce the desired Islamic scholars with strong knowledge of Islamic banking industry.

After the successful launch of the industry several new dimensions are opened now. Islamic banking concepts are totally equity based that leaves no room for the interest

earning. Thus being a profit oriented system it requires several changes in the legal and taxation systems of the country. Amendments were introduced in the Banking Companies Ordinance 1962 for the initial start of the Islamic banking industry. Thus same taxation and legal rules apply to the both conventional and Islamic banks in Pakistan. However the operations among the both industries are totally different. State Bank is still working with the concerned authorities to provide the changes for the Islamic banking industry to improve their stability. On the other hand for continuously development of the industry, State Bank is also consulting the international Islamic finance development bodies to strengthen the Islamic finance infrastructure in Pakistan. Further more recently State Bank has launched the five year strategic plan with complete list of plans to be implemented. All the related authorities along with the State Bank are working hard to achieve this plan on time and take the Islamic banking industry of Pakistan into the new stream.

In Malaysia, Islamic banking was initiated in 1983 with an objective to serve as an alternative to the conventional banking system. Malaysian government has provided to their banking industry with strong legal base. Separate Islamic banking regulations were introduced to solely deal with the Islamic banking industry in Malaysia. Bank Negara Malaysia along with concerned authorities implemented certain successful plans that help them to become a role model for the entire Muslim countries. Malaysian Nation along with the government is working hard to make Malaysia a central hub for the Islamic finance. The main reason for the development of Islamic banking in Malaysia is the more innovative and improved product developments to satisfy their customers need. However these vast developments represent the efforts of their experts and professionals but some of those products are not completely shariah compliant. Irrespective of this problem they have achieved the second position in the Islamic banking industry between all the international Islamic banking industries. After the successful stability of the industry, Malaysian government has changed its direction towards the development of Islamic economic structure. In this regard they have implemented old Islamic currency in the certain regions and industries of Malaysia on the experimental basis. Government of Malaysia is also working on the development Islamic taxation and Islamic punishment

systems. There are certain discrepancies in the Islamic banking model of Malaysia upon which their scholars are continuously working to make it defect free.

From the above discussions we have found that Pakistani government is playing positive job in the establishment of Islamic banking industry in Pakistan. The pace of the development is slow as compared to the Malaysia. This is so because of the weak political structure of the country. Making plans is not solution to the problem, timely implementation of the plan is necessary. Pakistan was considered to become the Islamic finance hub for the Muslim ummah. However due to inefficient authorities, development process is very slow. Many more milestones are to be achieved to facilitate the operability of Islamic banking industry in Pakistan. First of all the effective and supportive rules and taxation policies must be introduced by the Pakistani government. Later on other sections of the Pakistani economy must be considered. Level of education provided in universities regarding Islamic finance should be enhanced. Introduction of Islamic banking index, Islamic money markets introduction and currency improvements must also be taken into account. These changes will not only strengthen the Islamic financing infrastructure but will also open the doors for the innovative products and services for the Islamic markets.

10.1 Action Plan

- The Islamic Banking Department should meet with the government authorities and portray them the urgent need of the development of separate Islamic banking Ordinance for the Islamic banking industry of Pakistan. This ordinance will not only provide an infrastructure for the operations of the Islamic banking but will also help to redesign laws related to this industry in the country. Currently the recovery laws are the same as in conventional banks and the taxation laws also not supportive to this industry. Thus a separate banking ordinance will provide an Islamic base for the entire operations of the Islamic banking industry in Pakistan.
- The awareness and educational programs must be enhanced. In this regard State Bank of Pakistan should meet with the officials of the HEC and other education institutes. The State Bank officials must convince the education authorities to make advancements in their Islamic education syllabus. The new degree programs

with specialization in Islamic banking and related subjects must be introduced. This would help to move to the next level from the basics of Islamic knowledge.

- Islamic banking department should also meet with the government authorities to ask for the development of Islamic money and capital market in the country. Islamic banks are equity sharing banking organizations thus it is difficult for them to fulfill the reserve requirements of the State Bank of Pakistan. In this case there must be last resort developed by the government for the Islamic banks. The development of money and capital market for Islamic banking industry in Pakistan could be easily ascertained by the assets and the deposits of the Islamic banking industry. It would also help in the development of the Islamic banking exchange and trade rates for the customers.
- Government should announce the policies for the development of new and innovative products for the Islamic banking industry in Pakistan. HEC should encourage the final projects and thesis of the master's and bachelor's degree students about Islamic financing. A reward policy should be introduced by the HEC for those students who come up with new idea for the industry. Scholarships and study tours of the Islamic developed banking countries should be provided.
- Islamic banking department should also meet with the income tax authorities of Pakistan. The taxation that lies on Islamic banking of Pakistan is not according to Islamic ethics and Islamic perspective of business. Islamic banks provide the service of middleman in the business transactions for the purchase and sale of assets. Thus the assets are not the property of the banks but they are charged with the taxes on them. The taxation authorities should introduce new taxation amendments that could solve the double taxation issue and provide tax credits for the Islamic banking industry.

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APPENDIX A

AAOIFI = Accounting and Auditing Organization Islamic Financial Institution

BCO = Banking Companies Ordinance

BIMB = Bank Islam Malaysia Berhad

BIS = Bank for International Settlement

BMMB = Bank Muamalat Malaysia Berhad

BNM = Bank Negara Malaysia

BOD = Board of Directors

CBR = Central Board of Revenue

CIFP = Chartered Islamic Financial Professional

CII = Council of Islamic Ideology

CRR = Cash Required Reserve

EM = Executive Management

FBR = Federal Board of Revenue

HBFC = House Building Finance Corporation

HECP = Higher Education Commission of Pakistan

IBA = Institute of Business Administration

IBD = Islamic Banking Division

IBI = Islamic Banking Institution

IBS = Islamic Banking Scheme

ICAP = Institute of Chartered Accountants of Pakistan

ICIEC = Islamic Corporation for Insurance of Investments and Export Credits

ICP = Investment Corporation of Pakistan

IDB = Islamic Development Bank

IFCI = Islamic Finance Country Index

IFI = Islamic Financial Institutions

IFSB = Islamic Financial Services Board

IIBOR = Islamic Interbank Offer Rate

IIFM = International Islamic Financial Market

IILM = International Islamic Liquidity Management

INCEIF = International Centre for Education in Islamic Finance

IRTI = Islamic Research and Training Institute

ITFC = Islamic Trade Finance Corporation

KIBOR = Karachi Inter Bank Offer Rate

KLSE = Kuala Lumpur Stock Exchange

LTH = Lembaga Urusan Dan Tabung Haji

MBL = Meezan Bank Limited

MCB = Muslim Commercial Bank

MIFC = Malaysian International Islamic Financial Centre

NIBAF = National Institute for Banking and Finance

NIT = National Investment Trust

NRSP = National Rural Support Program

PLS = Profit and Loss Sharing

PTC = Participation Term Certificate

PWSBH = Perbadanan Wang Simpanan Bakal Haji

RM = Malaysian Ringgit

SAB = Shariah Appellate Bench

SAC = Shariah Advisory Council

SB = Shariah Board

SBP = State Bank of Pakistan

SCD = Shariah Compliance Department

SECP = Securities and Exchange Commission

SGF = Shariah Governance Framework

SLR = Statutory liquidity Reserve

SME = Small and Medium Enterprise

SPTF = Skim Perbankan Tanpa Faedah

TFC = Term Finance Certificate

UAE = United Arab Emirate

USD = United States Dollar

APPENDIX B

Bai Al Dayn = Sale and Purchase transaction of Quality Debt

Bai Bithaman Ajil = Deferred Payment Sale

Bai Inah = Contracting a Loan

Dha Wa Ta Ajjal = Take Less for Accelerating Payment

Diminishing Musharika = Increase in the Share of Ownership by Partial Payments

Fiqah = Islamic school of Thought

Fiqh = Deep Understanding

Fiqh Ul Muamalat = Islamic Rules on Transactions

Hadith = Statements of Muhammad Sallallahu Alae He Wasallam

Halal = Permitted

Haram = Forbidden

Hibah = Gift Distribution

Ibra = Law for free from responsibility

Ijara = Leasing

Ijara Thumma Al Bai = Lease Purchase

Ijma = Consensus of Muslims

Istisna = Purchase of Manufacture able Item on deferred Delivery

Kafalah = To Guarantee

Mudariba = Profit and Loss Sharing

Murabaha = Sale with The Disclosure of Cost Price

Musawwamah = Sale without the Disclosure of Price

Musharika = Joint Partnership

Qard = Loan

Qard Hasan = Loan at No Profit

Qiyas = Analogical Reasoning

Quran = Holy Book

Riba = Interest

Salam = Sale on Deferred Delivery

Shariah = Islamic Laws

Sukuk = Islamic Bonds

Takaful = Islamic Insurance

Tawarruq = Easily Saleable Product Purchases on Marked Up Price at Deferred Payment

Ulama = Islamic Scholars

Ummah = Muslim Nation

Wakalah = Agency Contract

APPENDIX C

Year	Total Assets (Rs. In Bill)	% Of Banking Industry	Deposits (Rs. In Bill)	% Of Banking Industry	Investments (Rs. In Bill)	% Of Banking Industry	No. Of Branches
2003	13	0.50%	8	0.40%	10	0.50%	17
2004	44	1.50%	30	1.30%	30	1.30%	48
2005	72	2.00%	50	1.80%	48	1.70%	70
2006	119	2.80%	84	2.60%	73	2.30%	150
2007	206	4.00%	147	3.80%	138	3.50%	289
2008	276	4.90%	202	4.80%	186	4.30%	515
2009	366	5.60%	283	5.90%	226	4.50%	651
2010	477	6.70%	390	7.20%	338	6.20%	751
2011	641	7.80%	521	8.40%	475	7.40%	886
2012	837	8.60%	706	9.70%	626	8.10%	1097
2013	1014	9.60%	868	10.40%	709	8.50%	1304
2014	1089	9.80%	932	10.60%	682	7.80%	1335

APPENDIX D

Year	Malaysian Assets (In Bill)	Rupee To Ringgit Exchange Rate	Malaysian Assets Converted to Rupee (In Bill)	Growth Ringgit In	Growth in Rupee
1984	0.551	6.78	3.73578	0	0
1985	0.779	5.24	4.08196	41.37931	9.266605635
1986	0.874	5.31	4.64094	12.19512	13.69391175
1987	1.224	5.74	7.02576	40.04577	51.38657255
1988	1.262	7.41	9.35142	3.104575	33.1018993
1989	1.368	7.44	10.17792	8.399366	8.838229916
1990	1.395	7.04	9.8208	1.973684	-3.50877193
1991	1.357	8.89	12.06373	-2.72401	22.83856712
1992	1.607	10.61	17.05027	18.42299	41.33497683
1993	1.892	11.32	21.41744	17.73491	25.61349468
1994	5.1	10.85	55.335	169.556	158.3642116
1995	6.2	11.66	72.292	21.56863	30.6442577

Year	Malaysian Assets (In Billion)	Pakistani Assets (In Billion)	Rupee To Ringgit Exchange Rate	Malaysian Assets Converted To Rupee
2003	83.1	13	15.04	1249.824
2004	95	44	15.66	1487.7
2005	111.8	72	15.79	1765.322
2006	131.91	119	17.24	2274.1284
2007	156.81	206	18.5	2900.985
2008	192.68	276	22.64	4362.2752
2009	233.66	366	24.39	5698.9674
2010	267.6	477	27.83	7447.308
2011	328.65	641	28.3	9300.795
2012	375.95	837	31.76	11940.172
2013	433.52	1014	32.04	13889.9808
2014	453.16	1089	30.73	13925.6068