

Strategic Directions for Developing an Islamic Banking System

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I. INTRODUCTION

Islamic banking generally referred to as interest free banking has been gaining popularity in the recent past. The main pillar of Islamic finance is prohibition of interest. Unlike conventional banking where interest is an integral part of the banking system, Islamic banking avoids interest in all bank transactions [Samad and Hassan (1999)]. The banking system in Pakistan is undergoing a transition from conventional model of banking to the new concept of Islamic banking, based on principles of Islamic economics. The new system should not only eliminate interest-based transactions but also introduce the concept of “Zakah” a contribution to the poor [Molla, *et al.* (1988)]. The prohibition of Riba is based on the arguments of social justice and equality.

Elimination of interest in Islamic Banking does not mean zero-return on capital; rather Islam forbids a fixed predetermined return for a certain factor of production [Ahmad (1994)]. The main idea is that there should not be any predetermined benefit attached to the capital. Islam permits profit sharing, though profit sharing ratio is predetermined, the ratio of return is not predetermined. Highlighting Islamic Banking principles Khan (1986) in IMF staff paper states that the Islamic model of banking based on principles of participation bears a striking resemblance to proposals made in the literature for reforms of banking systems in many countries. The Islamic System may well prove to be better suited to adjusting to shocks that result in banking crises and disruption on payment mechanism of the country [see for details Khan (1986), p. 19].

Scharf (1983), while propagating the case of Islamic Banking states that Islamic banks could make a useful contribution to economic growth and development particularly in a situation of recession, stagnation and low-growth-level because the core of their operations is oriented towards productive investment. It is further argued

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that Islamic system based on the principles of Shariah is not only feasible but also profitable [see for details Scharf (1983)].

Western countries are also realising the truth that interest is an unbearable burden for the developing countries. Canada has waived off all interest and Australia has made similar moves. President Mitterrand of France has officially suggested in the Group-7 meeting that at least 30-35 percent of the present interest element of the debt should be waived off [see Ahmad (1994), p. 188]. The purpose of Islamic banking is to develop a financial system the very basics of which revolve around justice and morality [Ayub (2002)].

In view of the surging wave of Islamic banking throughout the world, the Government of Pakistan introduced interest-free banking on nation-wide scale in the late 1970s (the detail is followed in Section II). A national level strategy was devised to implement the plan, but in view of the mammoth task, it was decided to Islamise the banking system in phases.

Despite the apparent government efforts, Islamic financing in Pakistan could not be practiced in its true spirit and many challenges are still faced by the banking sector in its implementation.

The paper at hand, attempts to explore the strategic policy orientation needed for the promotion of Islamic banking in Pakistan. It is hypothesised that the current policy directions are not facilitating Islamic Banking in Pakistan and a number of rational impediments are hampering the progress of the system.

The paper is divided into different sections. Section II discusses the evolution of Islamic banking in Pakistan focusing on the progress made in the sector. It also identifies factors impeding the development of the Islamic banking in Pakistan. Section III explores the strategic directions and presents the views of the bankers related to the obstacles in the execution of Islamic principles in the banking sector. Tabulated results along with graphical sketches are discussed in detail. Section IV finally concludes the study and gives some policy implication.

II. ENVIRONMENTAL ANALYSIS

Analysis of operating environment is extremely important for determining organisational directions. The organisation must be true to its objectives and it must show progress towards achieving these objectives, it must also be economically stable and have sustainable growth in an open environment. The following section attempts to investigate these basic issues with respect to Islamic Banking in Pakistan.

II.1. Islamic Banking in Pakistan

The era of 1981 earmarked the formal implementation of interest free banking in Pakistan on profit and loss sharing (PLS) basis. From July 1, 1985, all commercial

banking in Pak Rupees was declared by the Government to be made interest-free. From the date, no bank in Pakistan was allowed to accept interest-bearing deposits and all existing deposits in a bank were labeled to be on the basis of profit and loss sharing. Foreign banks however, were exempted. The State Bank of Pakistan had specified 12 modes of non-interest financing classified in three broad categories [see for details, the Report of State Bank of Pakistan (2000)].

The Federal Shariat Court (FSC), however, declared the procedure un-Islamic adopted by banks in Pakistan since July 1, 1985. The court's original ruling in 1999 clearly declared all forms of interest charged during the financial transactions falls into the category of "Riba", which is forbidden in Islamic teachings and ordered the government to abolish the interest charges.

A number of financial institutions warned the government the new system was not viable and some of the foreign banks even hinted that they might have to shut down their operations in the country. Hence, the government and some other financial institutions made appeals to the Shariat Appellate Bench (SAB) of the Supreme Court of Pakistan. The SAB delivered its judgment on December 23, 1999 rejecting the appeals and directing that laws involving interest would cease to have effect finally by June 30, 2001. In this judgment the Court concluded that the present financial system had to be subjected to radical changes to bring it into conformity with the Shariah [State Bank of Pakistan *Annual Report FY2002*].

The Commission for Transformation of Financial System (CTFS) was constituted in January 2000 in the State Bank of Pakistan to prepare model agreements and financial instruments for the new system. Two Interim Reports of the CTFS were submitted in October 2000 and May 2001. The objective was to identify a number of prior actions to prepare the ground for transformation of the financial system and to identify major Shariah compliant modes of financing. The Commission submitted its final report to the government in August 2001.

According to the Commission, preparatory works for introduction of Shariah compliant financial system briefly included creating legal infrastructure conducive for working of Islamic financial system, launching a massive education and training programme for bankers and their clients and an effective campaign through media for the general public to create awareness about the Islamic financial system.

Meanwhile, the Shariat Appellate Bench (SAB) of the Supreme Court, in its short judgment dated June 24, 2002 set aside the previous verdicts on Riba by the Federal Shariat Court in 1991 and the verdict by the SAB in 1999 and referred the issue back to the Federal Shariat Court for rehearsing. The verdict is still awaited.

II.2. Performance of Islamic Banks

A number of empirical studies revealed the profitable business of Islamic banks in different countries. The performance of the Islamic banks has been judged

by using different key ratios like profitability ratios, liquidity ratios, risk and solvency ratios [see Sarker (1999); Samad and Hassan (1999)].

For example, Iqbal (2001) made trend analysis to depict the overall performance of the Islamic banks as compared to the conventional banks. According to him, Islamic banks in general are fairly stable, profitable and well capitalised. Their profitability ratios compare favourably with international standards in banking.

Alam (2000) undertook a case study to examine the contribution of Islamic Bank Bangladesh Limited (IBBL) towards small and rural sector. The study revealed that IBBL succeeded in attracting both deposits and investment positions since it started its activities. For instance, the deposit figure rose to Taka 10,418 million in March 1995 from Taka 144.20 million as on March 1983, registering an increase of Taka 10,273 million. It was observed from the response of few small-scale industrialists that the remarkable advantages they get from the bank are easy formalities of obtaining loan and quick action in processing loan activities.

Samad and Hassan (1999) evaluated the performance of Islamic bank in Malaysia in terms of its profitability, liquidity, risk and solvency. Financial ratios were applied to measure these performances. A comparison between the Islamic bank and eight other conventional banks was also made. The study revealed that Islamic bank made significant progress on return on assets and return on equity during 1984-1997. The comparison of Islamic bank and the group of eight conventional banks revealed that there was no difference in economic participation between them.

Sarker (1999), used "Banking Efficiency Model" to judge the performance of Islamic banking in Bangladesh. He concluded that Islamic banks could operate with certain level of efficiency even within the presence of conventional banking.

Halim, Hamid and Nordin (2001) conducted a study on the Malaysian Islamic Bank in perspective of Islamic banking education. They showed that the shareholder's funds of the Islamic bank and then interest-free banking fund amounted to RM 1.3 billion, while profit before taxation and zakat amounted to RM 153 million in 1997. Total financing of Islamic bank registered 39.6 percent increase in the second half of 1997.

Since the inception of Profit and Loss Sharing (PLS) mode in Pakistani banking sector, the volume of total deposits did not decline. Total PLS deposits of all scheduled banks increased from Rs 370,281 million to 1,005,738 in 1992 and 2001 respectively thus registering on average a growth rate of 4 percent per annum (Table 1).

In the light of the above-mentioned studies it could be argued that there is no question of the profitability, viability or efficiency of the Islamic banking system. Islamic banks are equally as profitable as any of the conventional banks. The basic issue is the implementation of the Islamic banking in its true spirit.

Table 1

PLS Deposits in Scheduled Banks of Pakistan

Year	Total Deposits Rs Million	Annual Growth
1992	370,281	–
1993	407,921	10%
1994	505,457	23%
1995	567,4409	12%
1996	633,701	11%
1997	690,182	8%
1998	743,923	8%
1999	821,297	10%
2000	931,991	13%
2001	1,005,738	8%

Source: State Bank of Pakistan (1998, 1999, 2000, 2001) *Statistical Bulletin*.

II.3. An Overview of Impediments Faced by Islamic Banks in Asia

Many obstacles are realised in the implementation of Islamic banking in different countries. For instance, Sarker (1999) while mentioning the problems faced by the Islamic banks in Bangladesh gives a list of 30 problems at Macro level operations and 23 relating to Micro operation level. A few interesting factors are:

- insufficient legal protection;
- lack of unified shariah rulings;
- shortage of supportive and link institutions; and
- shortage of skilled and trained manpower in islamic shariah banking.

Among 23 other problems in ‘Micro Operation’, Sarker (1999) states the following:

- lack of shariah manual or guidelines;
- lack of linkages with other islamic banks and islamic ngos for extending micro credit;
- lack of linkages with training institutes and shariah supervisory bodies; and
- lack of management’s commitment in strictly following the shariah guidelines.

Khan (2001), while commenting on Banking regulations and Islamic Banks in India, recommends that the Islamic Banks in India should diversify instruments of investment and set up training institutes on Islamic banking that should impart training to borrowers and other public. This would increase the clientele of the Islamic banks. Khan (2001) also suggests that the Islamic banks should earmark

some funds to finance the poor people and should provide them job training so that they can create employment. Such practices are being successfully implemented in Tamil Nadu by English missionaries.

While giving the Malaysian experience in Islamic banking, Halim, Hamid, and Nordin (2001) stressed the importance of the educational system and its role in developing an Islamic banking system. They drew attention towards low awareness of Islamic Financial system in general public and consider it to be one of the major factors hindering the efforts towards the development of Islamic banking system.

II.4. Factors Affecting Islamic Banking in Pakistan

In the light of the literature review and with especial reference to Pakistan, a number of factors have been taken into consideration in the questionnaire to analyse in depth the challenges and problems faced by the Islamic banking system. These are:

(a) *Legal Framework.* Legal framework and support impart a positive impact on the effective working of Islamic banking. Lack of Legal support may hamper the Islamisation process of banking. Sarker (1999) has pointed out insufficient legal protection as an important problem faced by the Islamic banks in Bangladesh.

(b) *Knowledge Sharing.* Sharing of knowledge is essential for developing a successful economic system as it is impossible for a single person or a small group of individuals to accumulate all knowledge needed for designing such system [Hayek (1945)]. Presently, knowledge sharing on Islamic banking issues is very low, the countries working to develop the system are working in almost isolation. Hence this factor is taken into account in the analysis.

(c) *Research and Development (R&D).* The purpose of sharing knowledge (above) basically, is to aid the R&D efforts in Islamic banking and to reduce the expenses. R&D is essential for the banks so that they could offer new services that are "Shariah compliant" in spirit.

(d) *Public Awareness:* The public should be made aware of the cultural impact that an Islamic banking system would have. They should be educated on the social benefits that the society would gain from adopting the system. Issues of poverty, basic public services in health, education etc. can be addressed by drawing strength from such a banking system.

(e) *Political Resolve.* Political resolve may be regarded as the most important issue from the followers of democratic school of thought. Beer (1981) argues from his years of research on Viable System Model (VSM) and Espejo and Harnden (1985) stress on the role of strategic and policy issues in working of any system in business, non-profit and Government organisations. Political commitment and leadership is needed for developing the Islamic Financial System and allocation of resources to substantiate governments resolve needs to be placed at the top.

III. DETERMINING STRATEGIC DIRECTIONS

Strategic planning is long-term planning that focuses on organisation as a whole, what must be done in the long term (three to five years) to attain organisational goals. The present study attempts to blend theoretical knowledge and field experiences to determine impediments in development of Islamic banking and find-out practical solution of the problem. Incorporating insight of policy-makers in the banking community is extremely important for the study. Based on the experiences of developing interest-free banking system in other countries as well as in Pakistan, a questionnaire is developed and vetted with experts to perceive the “Bankers view” on some vital issues. As the investigation is related to policy matters, top management at president and vice president, and some senior management of banks were interviewed.

The critical success factors identified are:

- (a) the Islamic spirit in present Islamic banking system and its importance in developing a true Islamic banking system;
- (b) competitiveness of the present Islamic banking system and its importance in developing a future system;
- (c) the state of present “supervisory and regulatory” system in supporting Islamic banking in Pakistan and its importance in developing Islamic banking system in future.

III.1. Incorporating CoP Insight

Insight into the issue from bankers’ CoP (Community of Practice) was obtained by interviewing senior management of major national and international banks operating in the country. Interviews were conducted from 30 Executives, selected randomly, assuming that top Executives of banks are in a position to conceive the constraints of implementing interest-free banking in the country.

Firstly, frequency distributions are made from the data collected by interviews, and then Strategy Mapping via radial graphs is adopted to compare the present status of the selected factors and the importance attached to these factors by CoP. The gap between the present status and importance attached to these factors would indicate the area in which efforts are needed.

The perception of Banking CoP is given as Table 2 and Table 3. From Table 2 it is clear that 29 percent opined the Islamic Banking highly competitive. The “Islamic spirit” in the prevailing Islamic banking is considered low by 32 percent of the respondents. The status of present Supervisory and regulatory mechanism supporting Islamic banking is considered very low (i.e. inadequate) by almost 42 percent of the respondents.

Table 2

Key Factors Regarding the Present Islamic Banking System in Pakistan

	Very				Very	Decline
	Low	Low	Medium	High	High	Answer
If we compare Islamic Banking System with interest based banking within Pakistan—How Competitive is Islamic Banking?	19.4%	25.8%	16.1%	29%	9.7%	0%
To what extent the present Islamic System in Pakistan has “Islamic Spirit”?	29.0%	32.3%	16.1%	6.5%	6.5%	9.7%
To what extent the present “Supervisory and regulatory” mechanism developed/ effective to support Islamic banking in Pakistan	41.9%	19.4%	22.6%	9.7%	0%	6.5%

Table 3

Importance that Must be Attached to Key Factors

	Very				Very	Decline
	Low	Low	Medium	High	High	Answer
Do you think that a true Islamic Banking system would be competitive in open market	6.5%	9.7%	29%	25%	29%	0%
To what extent a system that is to be labeled as “Islamic Banking System” should be true in Islamic spirit	9.7%	6.5%	22.6%	19.4%	38.7%	3.2%
What importance do you give to “Supervisory and regulatory” mechanism for Islamic banking in Pakistan	9.7%	9.7%	6.5%	32.3%	41.9%	0%

Table 3 shows the importance that CoP attaches to the key factors for developing an Islamic Banking System. The table shows that 29 percent of respondents recommend that the Islamic banking system should be “Highly Competitive” in an open economy. 39 percent recommend that there should be a “Very High” presence of “Islamic spirit” in the Islamic system. The importance of Supervisory and regulatory mechanism is also recommended as “Highly” by 42 percent of the respondents.

Table 4 has two columns, where column “A” displays the response of CoP to questions regarding the status of the present Islamic Banking System working in the country and column “B” display the importance that CoP attach to these factors for developing Islamic banking system in the country. The idea is to determine the gap between the current system status and the recommended level.

Table 4

Factors Affecting the Development of Islamic Banking System in Pakistan

Factors	“Column A” Present Status (%age)*						“Column B” Importance that must be given to these Factors (%age)*					
	Very Low	Low	Medium	High	Very High	Decline Answer	Very Low	Low	Medium	High	Very High	Decline Answer
	Legal framework (at Government level) for supporting Islamic banks	36	39	13	10	0	3	7	7	3	16	68
A system for Shariah audit in financial institutions	55	29	7	0	0	10	10	7	3	42	39	0
Shariah compliant government economic laws	55	32	0	0	3	10	7	7	23	13	52	0
Research and development in the field of Islamic finance and economics	36	32	29	0	0	3	10	3	7	16	65	0
Sharing of Knowledge between Islamic Banks national and international level	45	32	16	0	0	7	7	7	3	23	61	0
Public awareness about Islamic economic system	52	36	7	0	0	7	13	3	3	36	45	0
Social and Cultural factors of the public	16	16	23	19	23	3	13	0	13	36	39	0
Political resolve of successive governments for Islamisation of economy	55	32	3	7	0	3	19	0	3	26	52	0

* It may not be equal to 100 due to rounding effect.

III.2. Graphical Representation

Radial diagrams are used to present the data shown in Tables 2, 3, and 4. Radial Diagrams give the advantage to view the issue in multiple-dimensions and it is particularly useful for exploring strategic directions. It is assumed that respondents that have marked on “Very High” column fully agree with the question, those who have marked on “High” are about 75 percent in agreement. Similarly “Medium” and “Low” are 50 percent and 25 percent respectively in agreement with the question posed. An index is calculated on the aforementioned basis and graphs are plotted. The index will always fall in the interval 0 to 1 interval (Annex 1).

Indices have been computed as:

$$Index = \frac{\#Y_0 + \#Y_1*0.75 + \#Y_2* 0.50+ \#Y_3* 0.25}{\#cat}$$

$\#Y_0$ = number of respondents in the category who answered Very High.

$\#Y_1$ = number of respondents in the category who answered High.

$\#Y_2$ = number of respondents in the category who answered Medium.

$\#Y_3$ = number of respondents in the category who answered Low.

$\# cat$ = number of respondents in the category.

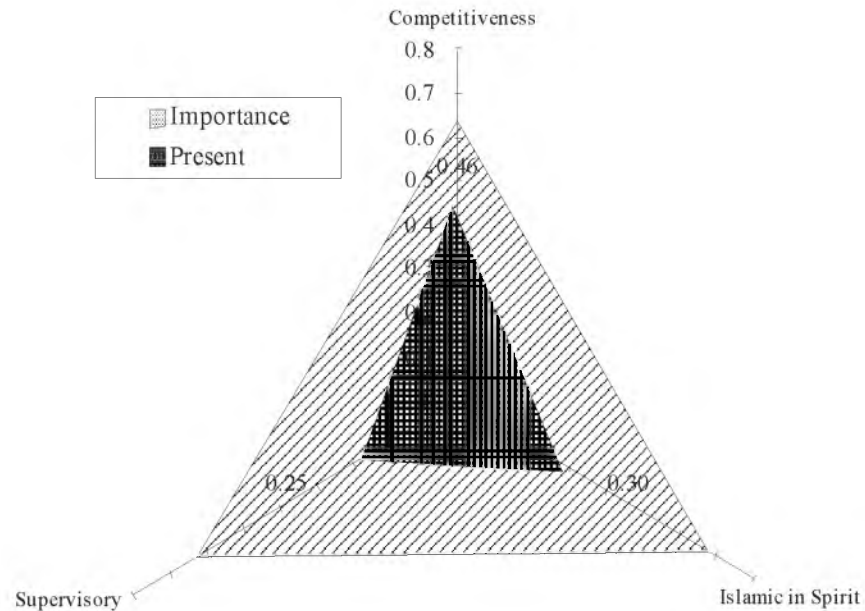
Diagram 1 gives us a view on three issues (Competitiveness, Islamic Spirit and supervisory system) in the present Islamic Banking systems and CoP recommendations for the same three issues in one diagram. Whereas Diagram 2 enables us to view eight issues relating to Islamic Banking system and the importance attached to these issues by CoP in the same diagram.

III.3. Analysis of Diagram 1

Diagram (1) gives CoP perception on critical factors from Table 1, regarding Islamic banking system in Pakistan. It is observed that the present system is focused on competitive and viability but it is relatively weak on supervisory mechanism and Islamic spirit. It is interesting to note that the maximum number of “declined answers” by the respondents were on the issue of rating Islamic spirit in the prevailing banking system, 9.7 percent respondents preferred not to answer this question, followed by 6.5 percent declining to answer the question related to effectiveness of supervisory and regulatory mechanism (see also Table 4).

Diagram (1) also displays the importance that CoP gives to these factors for developing Islamic banking. The highest importance is given to the need for “Supervisory and Regulatory mechanism” closely followed by “Competitiveness of system”. Importance of Islamic spirit in banking laws is also identified as a vital success factor.

Diagram 1. Showing the present status and importance of some critical success factors for Islamic banking system



III.4. Analysis of Diagram 2

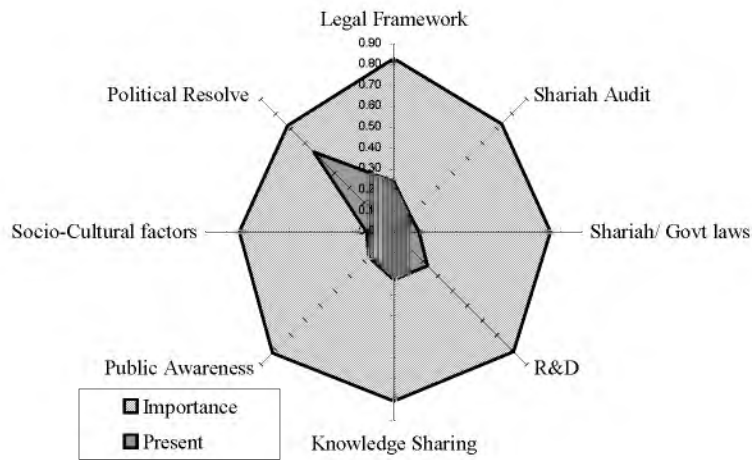
Diagram (2) displays the status of the prevalent Islamic Banking System in Pakistan and the importance that should be given to these factors for developing an Islamic Banking system. It is evident that improvements are needed on all issues.

The prevailing system is rated lowest on Shariah related issues like “Shariah Audit and “Shariah compliant Government Laws”. Sarker (1999) has pointed out the similar problem faced by the Islamic banks in Bangladesh.

The present status of Public awareness, Sharing of Knowledge between Islamic banks on domestic as well as international level is also rated low. Halim, Hamid and Norden (2001) emphasised on the need of educating people of the Islamic financial system in Malaysia.

Another important information that can be derived from the responses is the “Gap” identified by CoPs on these issues. Sorting response data firstly on “importance” and then according to the “Gap”, we see that the bankers have identified the need of “Legal Framework” at the top followed by Public awareness, R&D and Sharing of Knowledge. Then come the “Shariah compliance in Government economic laws”, and lastly the Political resolve.

Diagram 2. Showing the importance and present status of issues relating to the development of islamic banking system



Low score to “Political resolve” on the importance index, was rather unexpected, a reason for this low priority could be that CoPs are of the point of view that Government is already quite keen in developing the Islamic Financial System, and the present level of commitment should be sufficient to maintain future development pace. The views of management on “Social and cultural factors” responsible for the development of Islamic Banking are diverse, the index calculated shows that social and cultural factors facilitating Islamic Financial System in the country presently are low, the CoPs also recommend that the issue should be focused as it has a vital role in success of the system.

IV. CONCLUSION AND POLICY IMPLICATIONS

A system is able to survive in an environment if it is able to maintain its distinguishing features and provides something that is useful to the environment in which it is working [Beer (1979)]. On the basis of the results it is concluded that some of the keys factors are a major obstacle in the implementation of the Islamic Banking System in Pakistan.

The study proposes two recommendations at the Strategic level.

- There is an urgent need for “Knowledge Sharing” on Islamic Banking System within the countries working to develop the system.

- Secondly, the R&D effort; for developing new services, compliant with Islamic teachings, needs to be improved.

While tactical initiatives needed to achieve the above strategic objectives are:

IV.1. International Conferences on Islamic Banking

International Conferences on Islamic Banking must be held frequently and with wider publicity, as this will provide scholars a better opportunity to share their ideas and to gain from one another's insight.

IV.2. Networking of Scholars and Bankers

Linkages should be developed between the Research Centres working on Islamic Banking in different Universities of the world and Banking organisations. Research conducted by one University should be available to other Universities, this would reduce R&D costs and at the same time quality of research would improve due to wider audience.

IV.3. Knowledge Portal

Developments in ICT (Information and Communication Technology) have dramatically changed working of organisations, connecting globally remote places into networked organisations. A central repository of knowledge on Islamic banking can help researcher and scholars working in their native countries. Online collaboration software and discussion groups can also be used to create synergy in the efforts made by researchers in this field. Knowledge portals can provide a ground to develop a consensus in interpretation of Shariah as it is applied to Banking System.

IV.4. R&D to Develop Better Services

Islamic Banks would have to facilitate the requirements of digital economy. This implies that individual banks would have to offer new services that are compliant to Islamic laws and at the same time fulfill the requirements of the modern businesses. R&D would also be needed to improve harmony between the Islamic Banking laws and Government legislation so that Banks could perform properly. Bankers have given the highest priority to the need for developing Legal Framework for the Islamic banking and expressed their dissatisfaction with its present status. Considering the present state of Islamic banking system, effective Legal Framework for the system is possible only through extensive R&D by a combined effort of banking and Shariah experts.

IV.5. Socially Responsible Investments

Islamic banks should invest in socially responsible projects only, when approving finances for a project; the banks should scrutinise social implications of the project. For example the bank should ensure that the project will not cause any kind of environmental degradation in its vicinity or that a proper wastage handling is incorporated in the project. The HSE (Health Safety and Environment) or Social compliance is ensured in the project. In short organisations funded by Islamic banks should be concerned about the well being of society in which they are working.

IV.6. Community-oriented Projects

The Islamic Banks should prefer to invest in community-oriented projects, so that communities at large should benefit from the working of the bank. Project designed to help the financially deprived class must be financed at a priority level.

IV.7. Educating Bank Personnel and Society

Training of bank personnel and creating awareness among society about the true nature of Islamic banking is essential. The public should be made aware of the cultural impact that an Islamic banking system would have on them. The educational institutions may be helpful in spreading knowledge of Shariah as well as principles of finance. Awareness programmes on mass media and discussion forums would also help in forming public opinion on the issues.

IV.8. Enhancing Annual Reports of the Islamic Banks

Last, but a key recommendation is on enhancing the presentation of Annual reports of Islamic Banks. The Annual Reports are a strong media available to the banks for communication. The Annual report briefs bank stockholders on the performance of the institution and its future vision. Annual reports of Islamic banks should be different than the reports published by the conventional banks. It should contain vision of the bank as envisaged under Islamic principles. This approach will develop confidence of the investors, that their money is being invested according to the provisions of Islamic law.

Annex I

Calculating Index

	Present					# cat	Index *
	Very Low	Low	Medium	High	Very High		
Multiplying Factor	0.00	0.25	0.50	0.75	1.00		
Q1	15	21	13	23	8	80	0.46
Q2	23	26	13	5	5	72	0.30
Q3	33	16	18	8	0	75	0.25
Importance							
Multiplying Factor	0.00	0.25	0.50	0.75	1.00		
Q4	5	8	23	21	23	80	0.65
Q5	8	5	18	15	31	77	0.68
Q6	8	8	5	26	33	80	0.71
Factors–Present Status							
Multiplying Factor	0.00	0.25	0.50	0.75	1.00		
Q7	29	31	10	8	0	78	0.24
Q8	44	23	5	0	0	72	0.11
Q9	44	26	0	0	2	72	0.12
Q10	29	26	23	0	0	78	0.23
Q11	29	25	23	0	0	77	0.23
Q12	36	25	13	0	0	74	0.17
Q13	41	29	5	0	0	75	0.13
Q14	13	13	18	15	18	77	0.54
Factors–Importance							
Multiplying Factor	0.00	0.25	0.50	0.75	1.00		
Q15	6	5	2	13	54	80	0.83
Q16	8	5	2	34	31	80	0.73
Q17	5	5	18	10	42	80	0.75
Q18	8	2	5	13	52	80	0.81
Q19	8	2	5	13	52	80	0.81
Q20	5	5	2	19	49	80	0.82
Q21	10	3	2	29	36	80	0.74
Q22	10	0	10	29	31	80	0.72

$$* Index = \frac{\#Y_0 + \#Y_1 * 0.75 + \#Y_2 * 0.50 + \#Y_3 * 0.25}{\#cat}$$

$\#Y_0$ = number of respondents in the category who answered Very High.

$\#Y_1$ = number of respondents in the category who answered High.

$\#Y_2$ = number of respondents in the category who answered Medium.

$\#Y_3$ = number of respondents in the category who answered Low.

$\# cat$ = number of respondents in the category.

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Comments

No doubt, the topic selected by the authors is very interesting and pertinent. Islamic banking in Pakistan has come to an age of more than twenty years. If it is not so successful yet, strategic directions need to be devised to make it a success. Otherwise people will lose faith in practicality of Islamic banking. To prepare the list of strategic directions, the authors have not given their own judgment of the present-state of Islamic banking in Pakistan; rather they have conducted a field survey to get first-hand opinion of 30 senior bank officials. To this extent, the authors have followed, in my view, a professional approach.

However, after that, their attitude has not been so professional for following reasons:

- They have asked few and very general questions from bank officials. For example, whether Islamic banks are competitive with conventional banks and whether Islamic banking in practice is true in spirit? The bank officials were asked to agree or disagree with such questions and they were not encouraged to give their own mind and insight of Islamic banking.
- Looking at the caption, a reader can rightly expect that authors evaluate the performance of Islamic banking *vis-à-vis* conventional banking on the basis of financial ratios like operating revenue over total assets that shows efficient use of bank assets; net profit margin on bank advances and on bank services that shows efficient pricing of bank liabilities, bank assets and bank services; and equity multiplier that shows efficient use of bank equity.¹ They have not undertaken any such analysis.
- Similarly the true spirit of current Islamic banking should have been judged by identifying empirically the frequent modes of bank advances and then taking view of the selected bank officials *vis-à-vis* contemporary Islamic scholars on the degree of Islamicity of those modes. In this regard, it should be noted that although advances on the basis of mark-up are not illegitimate in Islamic law, yet many Muslim scholars have not favoured such advances to be the dominant mode for bank advances. For example, Siddiqui, a pioneer of current interest-free banking, opines on this issues:
I would prefer that Bai-Moajjal (a variant of mark-up and buy-back arrangement) be removed from the list of permissible methods altogether. Even if we concede its permissibility in legal form we have the over-riding

¹Some important financial ratios to evaluate the performance of a financial intermediary in general and a commercial bank in particular are given in Rose (2002) and Saunders (2003).

legal maxim that anything leading to something prohibited stands prohibited. It will be advisable to apply this maxim in order to save interest free banking from being sabotaged from within [Khan (1991), p. 65].

Rather it has been hypothesised in the last paragraph on p. 4 of this paper that “[T]he current policy directions are not facilitating Islamic banking in Pakistan and a number of impediments are hampering the progress of the system”.

As a result of inadequate financial analysis in this paper, the two main recommendations made at the end are extremely general. One, there is an urgent need for ‘knowledge sharing’ on Islamic banking system and the other, Islamic banks should devote more funds for research and development in order to invent new Shariah compliant services. These recommendations also by pass the importance of financial ratio analysis for future development of Islamic banking.

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