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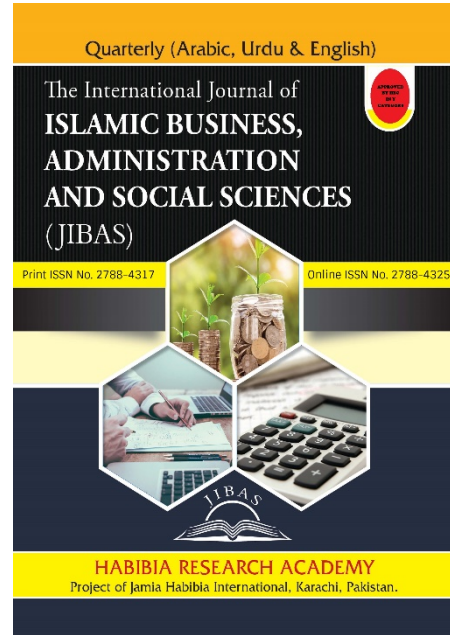
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TOPIC:

**AWARENESS OF ISLAMIC BANKING PRODUCTS AMONG MUSLIMS:
IN PAKISTAN**

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**AWARENESS OF ISLAMIC BANKING PRODUCTS AMONG MUSLIMS:
IN PAKISTAN**

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ABSTRACT:

The purpose of this study is to analyze Pakistani Muslims' awareness of profit-and-loss sharing financial instruments. A sample of 300 Pakistani Muslims was surveyed. The survey utilized a short questionnaire containing specific questions relating to the willingness of respondents to purchase profit-and-loss sharing Islamic banking products. The results indicate that the majority of the Pakistani Muslim population sample would be willing to purchase Islamic banking products, but are not properly informed about profit-and-loss sharing instruments. The results further hint towards a lack of understanding of the principles of Islamic finance. This was deduced from the fact that a section of the population stated that they would not be willing to purchase Islamic banking products if credit facilities were not available, or if the banks shared losses as well as profits.

KEYWORDS: Islamic Banking, awareness of Islamic finance, profit and loss sharing, Pakistani Muslim's awareness Islamic Banking.

INTRODUCTION:

The concept of interest free financing was practiced by Arabs prior to the advent of Islam, and was later adopted by Muslims as an acceptable form of trade financing. While the system had been used on a small-scale for centuries, its commercial Application began in the 1970"s. Since then Islamic financing has experienced worldwide acceptance, and by early 2003, there were at least 176 Islamic banks around the world, with deposits in excess of \$147 billion. While Islamic financing has become popular in both Muslim and Non-Muslim countries, the system has not achieved wide spread success among Muslims in Pakistan. The main reason for this has been the lack of awareness about the principles of the system among the population.

Pakistan is a Muslim country, and based on the requirement of Shari'ahi, one would expect an increase in demand for Islamic financial products. This has certainly been true in the case of other Non-Muslim majority nations like the UK, where the increase in demand for Islamic products has convinced bank regulators to provide permission for the operation of a purely Islamic Bank. According to the one major survey of the population conducted in 2004, there are more than 10 million Muslim in Pakistan, which is equivalent to 10% percent of the total Pakistan population.

The Islamic Financing System:

Islamic financing is based upon the principle that the use of Riba (interest) is prohibited. This prohibition is based upon Shari'ah ruling. Since Muslims cannot receive or pay interest, they are unable to conduct business with conventional banks. To service this niche market, Islamic financial institutions have developed a range of halalii interest-free financing instruments that conform to Shari'ah ruling, and therefore are acceptable to their clients.

The idea of Islamic banking goes back to as early as the seventh century, but it was only commercially implemented in the last century. As the end of the colonial era approached, some of the newly formed and independent Muslim states reassessed their economic policies on the basis of Shari'ah principles. This marked the beginning of the present-day revival of Islamic finance. Small scale limited scope interest-free institutions were unsuccessfully tried in the mid 1940's in Malaysia and 1950's in Pakistan. From 1946 onwards, research by Muslim scholars gradually produced principles for banking practices that were likely to be acceptable to the banking and Islamic communities. The first successful application of Islamic finance was undertaken in 1963 by Egypt's Mit Ghamr Savings Bank, which earned its income from profit-sharing investments rather than from interest. By the 1970's, the push for Islamic finance had gained momentum. In 1973 the conference of foreign ministers of Muslim countries decided to establish the Islamic Development Bank with the aim of fostering economic development and social progress of Muslim countries in accordance with the principles of Shari'ah. This marked the first major collective step taken by Muslim countries to promote Islamic finance.

The market leaders in this industry are Citigroup, HSBC, J.P. Morgan, and Standard Chartered who provide Islamic financing products through the use of Islamic windows (special facilities offered by conventional banks to provide services to Muslims who wish to engage in Islamic banking).

While a number of Islamic financial products are now available, the most widely recognized profit-and-loss sharing instruments are Mudaraba (finance trusteeship) and Musharaka (equity partnership). Mudaraba is an agreement between two parties, where one provides finance to another for utilization in an agreed manner. The financier of the venture is known as the Rabb-ul-mal, and the entrepreneur responsible for the management and execution of the project is referred to as the Mudarib. The parties achieve their returns by sharing in the profits of the venture, which are divided on a proportional basis. Under a Mudaraba agreement, returns cannot be provided as a lump sum, and cannot be guaranteed. To fulfill the requirements of this contract the parties must decide on a rate for sharing of the profits prior to the commencement of the business activity.

After the business is completed the financier receives the principal and the pre-agreed share of the profit. The remainder of the profit is the entrepreneur's compensation for their ideas and services. The other profit-and-loss sharing instrument is Musharaka which refers to a partnership formed for conducting business in which all partners share the profit according to a specific ratio while the loss is shared according to the ratio of the contribution. The two profit-and-loss sharing instruments described above are the oldest form of interest-free financing found in ancient Arabia. Prior to the advent of Islam, wealthy Arab merchants financed the caravan trade and would share in the profits of a successful operation but could also lose all or part of their investment, if, for example, the merchandise was stolen, lost or sold for less than its cost. After the introduction of Islam, this system was permitted to continue and was legitimized as a finance instrument. For this historical reason, scholars consider profit-and-loss sharing financial Instruments to be the most authentic and

most promising form of Islamic contracts. Yet, partly due to the high risk involved, while the Islamic Banks are expected to grow at an annual rate of around fifteen percent, profit-and-loss sharing constitutes only a small part (about five percent) of their activities. To ensure that Islamic financing continues to follow the concept of linking returns to risks, many scholars have argued for a greater use of the profit-and-loss sharing products. Achieving this requires a deeper understanding and acceptance by the Muslim population of the principles of profit-and-loss sharing financing and the available alternatives.

Methodology:

As the main focus of this research is to examine the level of perceived awareness of halal banking among Pakistani Muslims, a short questionnaire was formed containing specific questions relating to the willingness of respondents to purchase Islamic banking products. Also, questions were picked to distinguish between respondents that believe they were well informed about profit-and-loss sharing agreements, and those who had previously owned (or currently own) a halal stylized banking product. Originally, a pilot study was carried out utilizing a host of questions on a small sample of individuals. These questions were conditional in nature and were used to determine the selection of sample population. The next step was to develop a short questionnaire that would be easy to understand and require minimal time to complete, six specific questions were chosen that; provided maximum coverage of the research questions we were interested in answering; (a) and (b) were not co-related questions. Specifically, this second point deals with the need for most questionnaires that ask a multitude of questions to undertake factor analysis to determine the relative groupings that constitute the framework of the questionnaire. Sometimes, however, factor analysis fails in as much as a subjective element is incorporated into this methodology in setting the appropriate number of latent factors inherent within the data. To avoid this issue, questions that were chosen were specifically selected to ensure the correlations between the variables were low, thereby ensuring each variable specifically targeted a question that could not easily be proxies by another. The questionnaires were distributed simultaneously by 3 trained people to 300 respondents after Friday prayers at 3 different mosques during December 2017 in the city of Karachi, Pakistan. The number of people available for the survey was far greater, but only those people meeting specific selection criteria were asked to complete the six questions. The selection criteria was devised to ensure only those people who (a) came from a Muslim background, and were practicing Muslims, (b) currently owned a bank account in Pakistan, (c) were interested in halal banking products, and (d) gainfully employed were selected (18 years and over). By default, 100% of the respondents were male. This led to a sample dataset of respondents with highly specific demographics. Our dataset therefore analyses the awareness and willingness of this specific cohort of the population for undertaking halal accounts. This cohort also represents the demographic of most likely people any profit and loss sharing account would be catering for and so provides an

interesting study on how well halal-banking practices would sell under current informational conditions.

IMPLICATIONS:

The findings indicate that the population would be receptive to the idea of purchasing Islamic financial products as long as the organization that is providing the service is well known, and benefits such as ATM access, phone banking and so on, are provided. This provides a great opportunity for Pakistani financial institutions. If Pakistani organizations can build on their experience and reputation in the financial world, and can provide Islamic financial products in Pakistan, they can aim to gain a growing customer base of the population, some of who may have previously stayed away from dealing with the conventional financial institutions due to the use of interest. The findings also highlighted the lack of awareness in regards to the basic rules and principles of Islamic financing. The results indicate that a number of respondents would not take up halal financing options if credit facilities were taken away. In the Islamic financial system money is not lent out, instead its an asset-backed system where financial institutions invest in projects. Therefore, financial institutions deal in equity, not debt. Providing credit facilities contravenes this principle. To counter this limitation, some financial institutions have started issuing “debit” cards. These cards are similar to the credit cards except for the fact that they use the client’s own funds instead of reliance on any credit. Another issue is that of sharing profits and not losses. The results of the survey indicate that a number of respondents who had held a halal banking product were not aware of the loss sharing concept. This would indicate that some financial institutions have been Guaranteeing profits. This contravenes the basic law of Islamic finance that is, linking rewards to risk. Gains made on investment without risk is merely interest rather than profit.

In order to understand how the Islamic system differentiates between profit and interest, one has to look at the differences in economic ideology. In capitalist theory, capital and entrepreneurs are treated as two separate factors of production where the former gets interest and the latter is entitled to profit. It is assumed that interest is a fixed return for providing capital, and profit can only be earned after distributing the fixed return to land, labor and capital (in the form of rent, wage and interest). In contrast, the Islamic economic system does not consider capital and entrepreneurs as separate factors of production. It believes that every person who contributes capital in the form of money to a business venture assumes the risk of loss and therefore is entitled to a proportional share in the actual profit. The system is protective of the entrepreneur, who in a Capitalist economy would have to make fixed interest repayments even when the venture is making a loss. Capital has an intrinsic element of entrepreneurship, so far as the risk of the business is concerned and therefore, instead of a fixed return as interest, it derives profit. The more the profit of the business, the higher the return on capital. With no fixed interest repayments, the profit would be higher. In this way, the profits generated by the commercial activities in the society are equally distributed amongst those who have contributed capital to the enterprise.

Leading scholars in the area of Islamic Finance have declared that guarantees made by institutions that customers will receive a set rate of return without having to incur losses are illegal and unethical. Yet, not only are financial institutions continuing the practice but government agencies in Muslim countries are also offering investment opportunities with guaranteed profits. Considering that the Muslim governments are responsible for supervising the system in order to combat the illegal practices of financial institutions, by offering guaranteed returns the governments are seen to be condoning the behaviour of the financial institutions.

Although these actions may help Islamic Banks grow in the short-run, the long-term costs (harm to reputation and authenticity) will outweigh the benefits. Such moves also provide ammunition to the critics of the system who are already questioning whether the system is nothing more than an interest-based system operating under the guise of profit.

CONCLUSION:

As competition intensifies, financial institutions increasingly must be able to deliver personalized and customized financial solutions. Therefore, it is important for institutions to understand the dynamics of customer segmentation, build customer relationships and address requirements and preferences of specific segments of the market. It is therefore important that financial institutions invest in new products to meet Islamic customer needs and demands. Equally important is the need to develop an effective communication plan that goes beyond just marketing and advertisement. As the results of this study show, institutions also need to educate customers to adapt to the new ways of doing banking transactions, and understanding that Islamic finance involves the sharing of both profits and losses.

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