

Full Length Research Paper

An overview of the operations/products offered by Islamic banks in Pakistan

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Islamic banks are striving to capture the maximum number of customers to compete with conventional banks by providing a large number of products as an alternative for interest based products. There is a clear difference between operations/products offered by Islamic and conventional banks. Islamic banks are offering interest free products according to Shariah principles to promote business and trade in the country. This study presents an overview of operations and products offered by Islamic banks especially in Pakistan. Islamic banks provide a variety of products according to principles of Shariah to cope with the challenges of the recent age. These products may be categorized as short-term, medium-term and long-term according to their specific characteristics. It also reflects a brief picture regarding performance of Islamic banks in Pakistan since 2002. This study contributes a lot towards existing literature by beautiful reflection of operations and products of Islamic banks as bank-customer relationship for provision of quality services. It also presents the popularity and progressive products offered by Islamic banks in Pakistan. It could enhance the understanding of customers, bankers, policy makers and academicians. This study provides an insight regarding products/operations of Islamic bank that enables the researchers, academicians and policy makers to explore the ways to realize the potential benefits of Islamic banking.

Key words: Islamic banking, operations, products, Pakistan.

INTRODUCTION

Banks play a vital role in mobilizing funds and stimulating investment for productive ventures. They accept deposits from the general public and advance loans to the entrepreneurs to enhance investment activities that are inevitable for a healthy economy. Banks develop a link between surplus and deficit units to promote the trade and business activities. Islamic banks have opened new avenues for acceptance of deposits on interest free-basis and extend credit facilities excluding interest, e.g. Qarz-e-Hasana etc. (Najajmabadi, 1991). It was found that relationships with bank personnel are important criteria for selection of bank (Abratt and Russell, 1999).

Islamic banks affect monetary system by adjusting the demand and supply forces for money. It is found that

Islamic banking system is superior to conventional banking system as it ensures more stable financial sector (Khan, 1986). In another study, it was empirically verified that Islamic banking system showed excellent performance by supporting financial sector in Tunisia (Darrat, 1988). There is an empirical evidence to find out the influence of Islamic banking practices on monetary stability of Iran. The study showed mixed results, both for some evidences in favor or to support and stabilize monetary system and somewhat against it (Yousefi et al., 1997).

Wilson (1990) remarked the success of Islamic banking that compelled the many commercial banks to provide Islamic banking products to their clients. It is reported that profit and loss sharing system generates more profits. On the other hand, interest based system focus on credit-worthiness. Profitability is a more efficient measure for allocation of funds as compared to credit worthiness.

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Similarly, profit sharing system would be more stable as compared to interest-based system (Al-Jarhi and Iqbal, 2001).

OPERATIONS AND PRODUCTS OF ISLAMIC BANK

Islamic banks are trade oriented financial institutions that provide interest free deposits and investment opportunities for the people. It accepts deposits from general public under general investment fund and specific investment fund that is clearly mentioned in the agreement between the bank and the customer while opening their bank accounts. It deals with different types of customers (depositors, borrowers and service users). Figure 1 reflects operations of bank for the provision of service to customers.

Islamic bank actively performs several operations to provide a variety of products according to customers' requirements. It provides credit facilities; financing products; funds transfer facilities and other services according to customers' needs. Financing products offered by Islamic banks are presented in Table 1

Acceptance of deposits

Islamic banks are striving to capture the maximum number of customers to compete with conventional banks by providing a large number of products as an alternative for interest based products. Islamic banks supervise deposits (as Mudarib or investment manager). Profit or loss is shared between banker and the customers according to an agreed ratio. It is found that customers are rapidly moving from conventional banks to Islamic banks due to growing trust in the Islamic banking products and practices. There are different types of customers (individuals, households, corporate bodies, financial institutions as well as government and private organizations) that are eager to engage in long term relationships with the Islamic banks (SBP, 2007). The comparison of various contributors to deposits of Islamic banks is given in Figure 2. Service experiences may create positive or negative feelings and perceptions among customers. If they have positive feelings regarding bank services as satisfied customers, they may repeat their transactions with the bank. On the other hand, dissatisfied and unhappy customers may want to switch to other bank. An empirical study was undertaken regarding the structure and performance of Pakistani banking sector. The findings showed that equity capital and loans have a positive impact on the bank's profitability, while deposits affect it negatively (Arby, 2003).

FINANCING PATTERN OF ISLAMIC BANK

Islamic banks provide a variety of financing products according to principles of Shariah to cope with the

challenges of the recent age. These products may be categorized as short-term, medium-term and long-term according to their specific characteristics. Islamic banks provide short-term products like Murabaha; Istisna; Salam and Muajjal etc. to meet running finance requirements of different business units. Ijarah and Ijarah-Walqtina are a medium term financing options offered to the customers. Long-term financing options consist of Musharika, Mudariba and Diminishing Musharika. It inspires the people to deal on the basis of profit and loss to enhance the spirit of cooperation. It is observed that Murabaha and Ijarah financing are very popular among people. But Mudarbaha is a least preferred option with 0% weight-age. It may be due to lack of supportive financial environment. Increasing contribution of diminishing Musharika shows the banks' vigilance to diversify their portfolio by attracting a maximum number of customers (SBP, 2007). The financing contribution of each option is reflected in Figure 3.

Islamic banks are successfully competing with the conventional banks by capturing a reasonable share of the market. Islamic banks enjoyed tremendous growth within a shortest possible time. Similarly assets, deposits, financing and customers became manifold within few years. Financing products offered by Islamic banks became popular among people due to flexible terms and conditions. The impressive growth of Islamic banks can be associated with the introduction of new financing products according to principles of Shariah as an alternative for Riba-based financing products offered by conventional banks. It is reported that service quality perception of Islamic banks is greater than conventional bank in Pakistan due to popularity of IB products (Ahmad et al., 2010). The performance of the Islamic banks is given in the Table 2

Khan (1985) reported that Islamic bank could participate in productive activities by the provision of funds on profit and loss basis to different industries, e.g. manufacturing and agriculture etc. In the agriculture sector, Islamic banks could participate by: the provision of inputs to farmers; financing the purchase of inputs; provision of funds at a crucial stage of harvesting; provision of funds for supportive activities like effective marketing of farm output. Similarly, Islamic banks are required to focus on the quality of its services to retain its customers for greater benefits. It is reported that there is a strong direct relationship between service quality and customer satisfaction in case of Islamic banks as compared to conventional bank in Pakistan (Ahmad et al., 2010).

CONTRIBUTION OF THE STUDY

This study examines the working structure of Islamic banks especially in Pakistan. It explains the main operations/products offered by Islamic banks in Pakistan and its popularity among masses. This study presented a

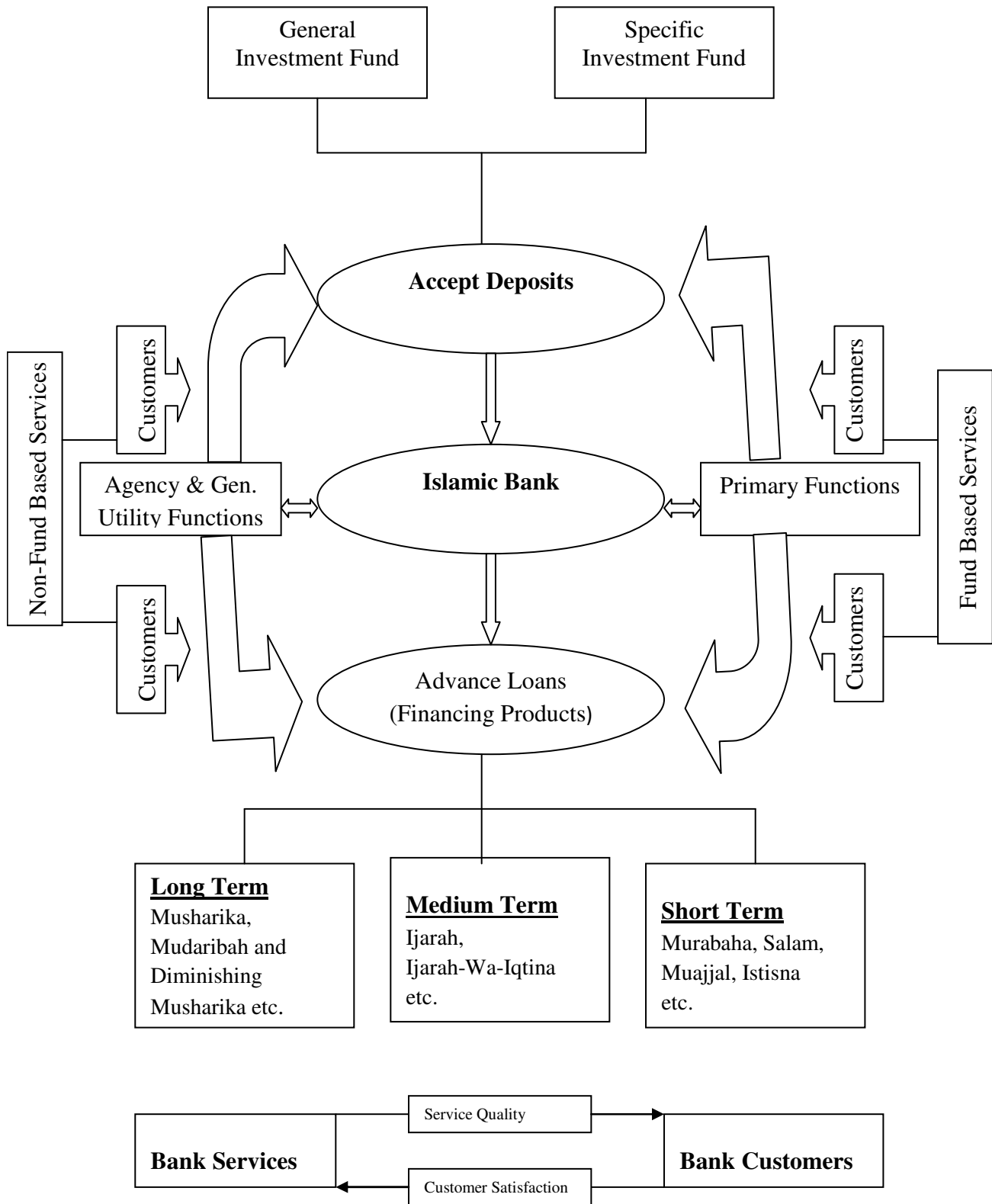
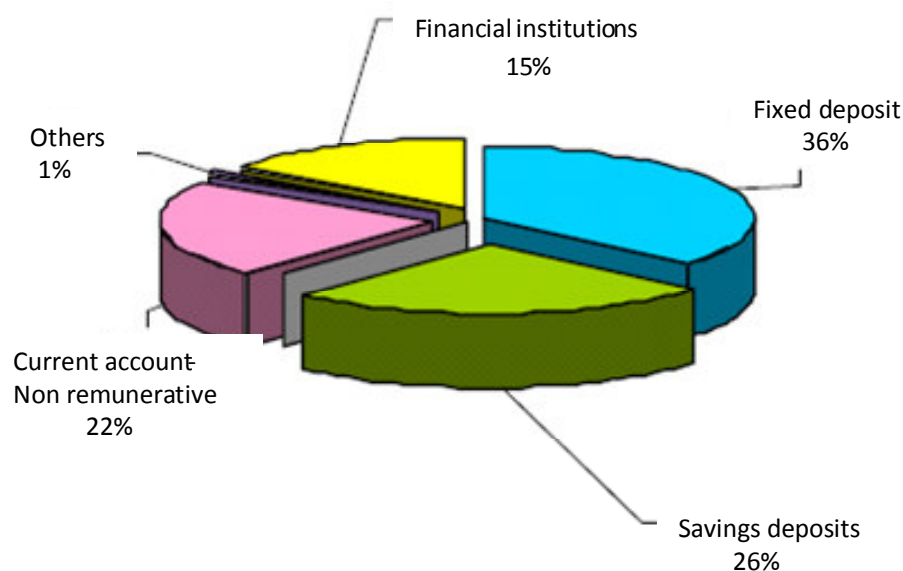


Figure 1. Operations of Islamic bank.

Table 1. Financing products offered by Islamic banks (%).

Financing Product	FY03	FY04	FY05	FY06	FY07	FY08*
Murabaha	79.4	57.4	44.4	48.4	38.9	38.7
Ijarah	16.5	24.8	29.7	29.7	25.4	24.2
Musharka	-	1	0.8	0.8	0.9	1.3
Diminishing Musharka	1.2	5.9	14.8	14.8	25.1	24.8
Salam	1.6	0.7	1.9	1.9	1.4	1.6
Istisna	-	0.4	1.4	1.4	0.9	2.4
Qarz/Qarz-e-hasna	-	-	-	-	-	-
Others	1.3	9.8	3	3	7.1	6.7

Source: Economic Survey of Pakistan (2007-08). *(March, 2008).

**Figure 2.** Contributors towards deposits of Islamic bank. Source: SBP (2007).

enhance the awareness regarding working pattern of Islamic banks. It could be compared with the deep rooted conventional banks providing traditional interest based products.

Islamic banks are new entrants in the Pakistani banking sector. A large number of people are facing lack of awareness regarding working pattern of Islamic banks. Banks make heavy investments to attract the customers and they should also address the specific needs of different segments of the economy. This study also presented a glossary of different products and its acceptance among different stakeholders of the Pakistani Industry. The Figure 1 reveals the importance of customers as every operation and product of Islamic bank has a direct link with the customer. So banks must consider their demographic profile to offer quality products according to their expectation.

Similarly, this study provides a snapshot regarding financing products of Islamic banks as short, medium and long term. The study enables the reader to compare

the products of both banking systems (Islamic and conventional banking) to make choice for greater benefits. This study is an effort to present an overview and summary of main banking activities as Mudariba as well as Wakalah along with different products in the absence of existing literature in Pakistan.

This study contributes a lot to existing literature by beautiful reflection of operations and products of Islamic banks in Figure 1 as bank-customer relationship for provision of quality services. It also presents the popularity and progressive products offered by Islamic banks in Pakistan in Tables 1 and 2. A look at Figures 2 and 3 could enhance the understanding of customers, bankers, policy makers and academicians.

SUMMARY AND CONCLUDING REMARKS

The primary objective of Islamic banking practices is to offer interest-free products to meet the financial need of

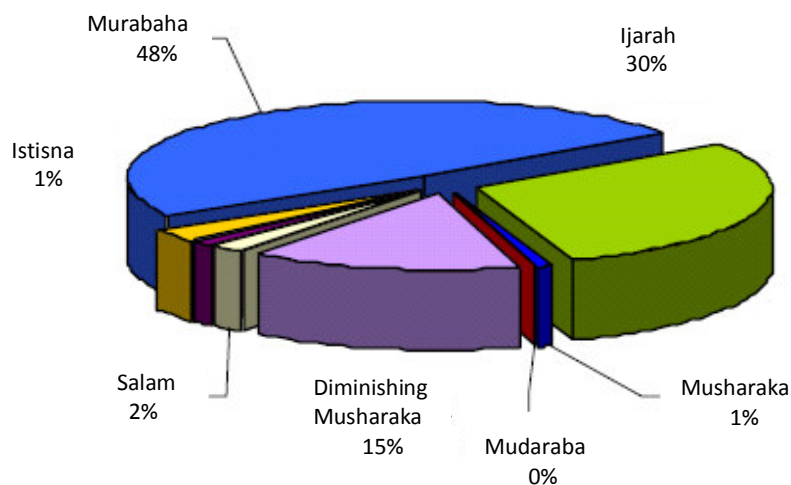


Figure 3. Contribution towards financing products of Islamic bank. Source: SBP (2007).

Table 2. Performance of Islamic banks in Pakistan (Rs. in billion).

Description	December 07	December 06	December 05	December 04	December 03
Total assets	206	118	72	44	13
Percentage of banking industry	4.3	2.9	2.1	1.4	0.5
Deposits	147	83	50	30	8
Percentage of banking industry	4.1	2.8	1.9	1.2	0.4
Financing and Investment	138	72	48	30	10
Percentage of banking industry	3.6	2.4	1.8	1.3	0.5
Number of full fledge Islamic banks	6	4	2	2	1
Conventional banks with IB branches	12	12	9	7	3
No. of branches	289	150	70	48	17

Source: Islamic Banking Bulletin by SBP (2007).

the economy according to their expectations. Islamic banks are new entrant in Pakistani banking industry at the inception of 21st century. This century came with a number of challenges in the financial sector, especially in the banking sector due to Islamic banking initiatives in the existence of the conventional banking in the market. There is clear difference between operations/products offered by Islamic and conventional banks. Islamic banks are offering interest free products according to Shariah principles to promote business and trade in the country.

This study presents an overview of operations and products offered by Islamic banks especially in Pakistan. It also reflects a brief picture regarding performance of Islamic banks in Pakistan since 2002. This study provides an insight regarding products/operations of Islamic bank that enables the researchers, academicians and policy makers to explore the ways to realize the potential

benefits of Islamic banking.

This study contributed a lot to the existing literature due to its implications. This study could enhance awareness among general public, and may inspire other banks for provision of innovative products according to Shariah principles. Similarly, it may provide a mechanism to assess the main operations of Islamic banks to cope with the challenges of recent age to relate bank and customer relationship for provision of service quality according to customers' expectations.

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