CONTEMPORARY PRACTICES OF ISLAMIC FINANCING TECHNIQUES

AUSAF AHMAD*

This paper examines the current practices of contemporary Islamic banks in sources and uses of funds. It investigates how Islamic financing techniques are used by various Islamic banking institutions in different countries. The study also takes note of significant departures and major applications. The paper is divided into six sections including introductory and concluding sections. Section Two presents the current common practices of Islamic banks with respect to sources of funds. Section Three provides a survey of Islamic financing techniques with respect to uses of funds. Sections Four and Five describe the Islamic financing techniques used in Pakistan and Iran respectively and not covered in earlier sections. The last section concludes with suggestions with respect to further research.

1. INTRODUCTION

During the last decade and a half, Islamic banking has made significant progress. At present, more than 50 Islamic banking institutions are working in different parts of the world and at least three countries have declared their intentions and also taken some necessary steps to reorganize their entire banking system along Islamic lines. The successful operation of Islamic banks in several parts of the world has led to a growing interest in Islamic financing techniques. Do Islamic banks really have something new to offer? Are the functions, activities and techniques of Islamic banks any different from those of conventional commercial banks? If yes, in what respect do they differ? What are the similarities or dissimilarities with respect to these activities among Islamic banks themselves? These and similar questions are generally raised whenever the subject of Islamic banking is mentioned.

The *raison d'être* of Islamic banking is derived from the Islamic injunction against *rib_* (interest). Islam prohibits interest on loans regardless of their nature or purpose. During the late nineteenth and early twentieth centuries when the Muslim world first came into contact with industrialization and such related economic and financial institutions as commercial banking, some attempts were made to dilute the strong injunction against *rib_*. It was argued that *rib_* which is condemned and

*Islamic Research and Training Institute, Islamic Development Bank, Jeddah, Saudi Arabia.

prohibited by the Quran is really usury and not interest which is the basis of modern banking. It was also held that the prohibition of *rib_* is mainly aimed at eliminating the excesses and exploitation involved in the consumption loans when given on interest. Since banks primarily grant loans for productive purposes, the prohibition of *rib_* may not cover bank loans. However, these views were held by a small minority in Muslim countries and were not accepted by the majority of Muslims who had serious reservations about the correctness of these positions and the permissibility of interest.[1]

In contrast to interest-based banking, Islamic banking is not based on the notion of a predetermined fixed return on capital. The Islamic prohibition against interest does not imply in any way that capital is free of charge or that it should be made available without any cost or that there should be absolutely no return on capital. In fact, Islam allows a return on capital, provided that capital participates in the productive process and is exposed to business risk.

Muslim economists have generally held that commercial banking in an Islamic state should be organized on the basis of some form of profit sharing, represented by *mudarabah* and *musharakah.*[2] However, Islamic banking as it has developed and is developing is not solely based on *mudarabah* and *musharakah.* It also uses a number of other contracts permissible by Islam in order to conduct its banking business. The elaboration and explanation of these techniques is the subject of this paper.

According to theoretical models developed by Muslim economists, Islamic banking based on the principle of *mudarabah* claims to be superior to interest-based commercial banking in terms of equity, efficiency, stability and growth. In comparison with other financial systems, Islamic banking will be more just because the contract of *mudarabah* is based on the principles of justice and equity. It will be more efficient as it will help attain a more rational and balanced allocation of financial resources among the competing projects because the main consideration in the allocation of funds under Islamic banking would be the profitability of relevant projects and not the safe return of the principal amount as in the case of conventional banking. In other words, bankable projects would be selected on the basis of profitability and not on the criterion of creditworthiness. Islamic banking will also safeguard against business fluctuations as it has more potential of being linked to the productive capacity of the economy. Hence, the cost of capital as well as the amount advanced for further investment would adjust themselves in accordance with changes in the business environment. Furthermore, it will also promote growth as it would increase the supply of risk capital for investment.[3]

While much discussion has taken place and a good deal of literature has accumulated on the justification of the prohibition of *rib_* in Islam and various conceptual issues of Islamic banking,[4] the practical and operational aspects have not received as much attention.[5] The present work makes an attempt to describe and analyze the actual business practices of contemporary Islamic banks.

In a study of this sort, it is possible to adopt either a country-based or an institution - based approach. However, on account of the limited nature of the available information, neither of these approaches has been adopted. Instead, an attempt has been made to use both of these approaches in a way that yields the maximum amount of information.

Furthermore, keeping in mind the diverse and complex nature of Islamic banking, it may not be useful to describe the Islamic financing techniques used by each bank. Further, these techniques are not yet standardized to the extent that their description in general terms might stand for all institutions using them. Hence, the best course of action was to give a description of each of the Islamic financing techniques which depicts the reality at most of the institutions where these techniques are being used. It is also necessary to mention that significant departures, if there are any, have been noted.

The ownership structure of Islamic banking today is complex. It is possible to distinguish between Islamic commercial banks in the private sector, Islamic banks in the public sector, and international Islamic financial institutions. Commercial banks in Pakistan and Iran operate along Islamic lines but are in the public sector.[6] Most of the Islamic banks operating in the Middle East and elsewhere are joint stock companies working in the private sector, while the Islamic Development Bank is an international financial institution with 46 member countries.

Among private Islamic commercial banks, a number of banks belong to certain holding companies. There are two major holding companies: D_r-al-M_l-al-Isl_m_ (DMI) Group and Al Baraka Group. The DMI Group is a holding company registered under the laws of the Bahamas. It was established in 1981 with an authorized capital of U.S.$ 1 billion divided into 10 million shares of equal value.[7] At present, the DMI Group operates in 14 different countries through 22 institutions which include Islamic investment companies, Islamic banks, and Islamic insurance companies.[8] The Al Baraka Group was established in 1982. It has 12 affiliates and financial interests in three other sister institutions.[9] There are certain Islamic banks in the Gulf, such as the Dubai Islamic

Bank, the Qatar Islamic Bank and Kuwait Finance House which do not belong to any one of these holding companies. Furthermore, there are some Islamic banks operating in other Islamic countries such as the Bank Islam Malaysia and the Islami Bank Bangladesh Limited which have been established with the active support of the governments of these countries. In addition to these institutions, certain conventional banking institutions also operate the so-called "Islamic Windows" through which they offer their clients certain services using various Islamic financing techniques.

Islamic financing institutions conduct their business activities in conformity with Islamic laws and refuse to indulge in any such activity or practice which is repugnant to Islamic values. However, working in different countries and in different socioeconomic environments, they are also obliged to work under their respective national laws. These considerations leave us no option but to adopt the approach which has been described above.

The plan of the remainder of this paper may be described as follows:

Section Two presents the current common practices of Islamic banks with respect to sources of funds. Section Three provides a survey of Islamic financing techniques with respect to the uses of funds. Sections Four and Five describe the respective Islamic financing techniques used in Pakistan and Iran, particularly those which have not been covered in earlier sections. The last section presents the conclusions of the study and makes some suggestions for further research.

2. COMMON PRACTICES OF ISLAMIC BANKS IN THE SOURCES OF FUNDS

The common practices of Islamic banks in the sources of funds may be described as follows:

2.1 Current Accounts

All Islamic banks operate current accounts on behalf of their clients: individuals and business firms. These accounts are operated for the safe custody of deposits and for the convenience of customers. There is little difference between conventional banks and Islamic banks as far as the operation of current accounts is concerned. However, the main characteristics of these accounts, as operated by Islamic banks, are listed below:

i)Current accounts govern what is commonly known as call deposits or demand deposits. These accounts can be opened either by individuals or companies, in domestic currency or in foreign currency, if the bank is allowed to operate in the foreign exchange market and the holding of current balances in foreign currency is legal under the law of the land.

ii)The bank guarantees the full return of these deposits on demand and the depositor is not paid any share of the profit or a return in any other form.

iii)Depositors authorize the bank to utilize funds at the bank's own risk. Hence, if there is any profit resulting from the employment of these funds, it accrues to the bank and if there is any loss, it is also borne by the bank.

iv)There are no conditions with regard to deposits and withdrawals.

v)Usually, account holders have a right to draw checks on their accounts.

There are two dominant views about current accounts. One is to treat demand deposits as *am_nah* (trust). This view is adopted by the Jordan Islamic Bank which operates a "Trust Account" instead of a current account. A trust deposit is defined by the Jordan Islamic Bank as "cash deposits received by the bank where the bank is authorized to use the deposits at its own risk and responsibility in respect to profit or loss and which are not subject to any conditions for withdrawals or depositing".[10]

Thus, these deposits are handed over to the bank by depositors as a Trust and the bank does not have the authority to use them without first obtaining the specific permission of the owner of the funds.

The other view is to treat demand deposits as *qard hasan* (interest-free loan). This view has been adopted by Iranian Islamic banks which call the current account "*qard hasan* current account".[11] According to this view, money deposited in these accounts is a benevolent (or interest free) loan *(qard hasan)* from the depositor to the bank. The bank is free to utilize these funds at its own risk without any return to the depositor and without needing any authorization because in the case of *qard hasan,* the debtor does not need the specific permission of the creditor to use the borrowed funds. The debtor owes the creditor only the principal amount borrowed. This condition is fulfilled as the amount deposited in these accounts is fully underwritten by the bank.

2.2 Savings Deposits

Although all Islamic banks operate saving accounts, there are some differences in the operation of these accounts. A typical example is that of the Bank Islam Malaysia, which defines savings deposits in the following way:

"The Bank accepts deposits from its customers looking for safe custody of their funds and a degree of convenience in their use together with the possibility of some profits in the form of Saving Accounts on the principle of *Al Wad_a.* The bank requests permission to use these funds so long as these funds remain with the bank. The depositors can withdraw the balance at any time they so desire and the Bank guarantees the refund of all such balances. All the profits generated by the Bank from the use of such funds belong to the portion of the Bank. However, in contrast with the current account, the Bank may, at its absolute discretion, reward the customers by returning a portion of the profits generated from the use of their funds from time to time".[12]

It must be pointed out that any return on capital is Islamically justified only if the capital is employed in such a way that it is exposed to a business risk. If savings depositors are guaranteed that their amounts will be refunded in full, if and when they want them, as is the case with traditional banks, then, they are not participating in a business risk. Under these circumstances, it has to be made clear that savings depositors are not Islamically entitled to any return. If an Islamic bank refunds some portion of the profits generated from the use of saving deposits to the depositors, it is absolutely at the discretion of the bank concerned and it must be treated as a gift. It is quite clear from the above quotation that this is exactly the course of action adopted by the Bank Islam Malaysia.

In contrast to this, the Bahrain Islamic Bank calls these accounts "Savings Accounts with Authorization to Invest". Depositors provide the bank with an authorization to invest their money. Depositors have the right of withdrawal, but profits are calculated on the basis of the minimum balance maintained for a month.[13]

Similarly, savings accounts at the Dubai Islamic Bank operate as follows:

i)Savings accounts are opened with the condition that depositors provide the bank with an authorization to invest.

ii)Depositors have the right to deposit and withdraw funds.

iii)The profits in savings accounts are calculated on the minimum balance maintained during the month. Depositors participate in the profits of savings accounts with effect from the beginning of the month following the month in which the deposits are made. Profits are not calculated with effect from the beginning of the month in which a withdrawal is made from the account.

iv)A minimum balance has to be maintained in order to qualify for a share in profits.[14]

The Iranian Islamic banks include saving accounts in *"Qard Hasan Accounts"* and call them *"Qard Hasan"* deposits. The operation of these accounts is similar to that of savings accounts in the conventional system as far as the deposit and withdrawal of money by means of a savings account passbook is concerned. Although no dividends are due in the case of *qard hasan* depositors, Iranian banks use different promotional methods in order to attract and mobilize deposits. These include giving the following incentives to depositors:

i)Non-fixed bonus either in cash or in kind.

ii)Exempting depositors from or granting discount thereto, in the payment of commissions and/or fees.

iii)According priority to customers in the use of banking facilities.[15]

The Jordan Islamic Bank has adopted yet another way to operate savings accounts. It includes the savings deposits into an investment pool called joint investment accounts.[16]

The foregoing discussion makes it clear that Islamic banks adopt one of the following practices in operating savings accounts:

a)Accepting savings deposits on the principle of *Al Wad_a* (trust) requesting depositors to give permission to the bank to use these funds at its own risk, but guaranteeing full return of deposits and sharing any profits voluntarily.

b)Accepting savings deposits with an authorization to invest and share profits in an agreed manner for the period in which a required balance is maintained.

c)Treating savings deposits as *qard hasan* from depositors to the bank and granting pecuniary or non pecuniary benefits to depositors.

d)Accepting savings deposits as part of an investment pool and treating them as investment deposits.

2.3 Investment Deposits

Investment deposits are Islamic banks' counterparts of term deposits or time deposits in the conventional system. They are also called Profit and Loss-Sharing (PLS) Accounts or Participatory Accounts. However, they can be distinguished from traditional fixed term deposits in the following manner:

i)Fixed term deposits in the conventional system operate on the basis of interest, while investment accounts in Islamic banks operate on the basis of profit sharing. Instead of promising depositors a predetermined fixed rate of return on their investment, the bank tells them only the ratio in which it will share the profits with them. How much profit each depositor earns depends on the final outcome of the bank's own investment.

ii)While fixed term deposits are usually distinguished from each other on the basis of their maturities; investment deposits can be distinguished on the basis of maturity as well as on the basis of purposes, as it is possible to give special instructions to the bank to invest a particular deposit in a specified project or trade.

The main characteristics of investment deposits can be described as follows:

i)Investment accounts can be opened by individuals or companies either in domestic or foreign currency provided that the bank is allowed to operate in foreign exchange.

ii)Deposit holders do not receive any interest. Instead, they participate in the share of the profits or losses.

iii)Usually these accounts are opened for a specific period, e.g. three months, six months, one year or more.

iv)The return on investment is determined according to actual profits from investment operations of the bank and shared in an agreed proportion by depositors according to the amount of their deposits and the period for which they are held by the bank. As an accounting practice, the amount held in the account is multiplied by the period for which it has been employed and profits are distributed on a pro rata basis.

v)Generally speaking, depositors do not have the right to withdraw from these accounts as is customary in time deposits in conventional banks.

However, withdrawals may be made under special circumstances with the depositor forfeiting his share of the profit for the withdrawn amount.

vi)Usually, banks insist on a specified minimum amount to open and maintain the investment account.

vii)Most banks issue an investment certificate to depositors stating the terms and conditions of the deposit.

Islamic banks have been experimenting with different kinds of investment deposit schemes in order to satisfy the needs and requirements of different kinds of investors. some of these are described in this paper, but it is necessary to mention that most of these innovations are bank-specific. Hence, all of the different kinds of investment deposit may not be found in any given bank.

Joint/General Investment Account

The most prevalent practice among Islamic banks is to establish some kind of investment pool in lieu of fixed term deposits. The investment pool takes the form of a general investment account in which investment deposits of different maturities are put together. These are not tied to any specific investment project but are utilized in different financing operations of the bank. Profits are calculated and distributed at the end of the accounting period, which is either three months, six months or one year.

Another variation of the investment pool is the establishment of a "Joint Investment Account" which is defined by the Jordan Islamic Bank as "cash deposits received by the bank from persons desiring to participate with the bank in multilateral and continuous investment and financing operations, whereby such deposits will receive a certain percentage of annual profits realized in accordance with the conditions of the account under which they are entered".[17]

Furthermore, Section 13(A) of the Law governing the Jordan Islamic Bank states that "cash deposits in investment accounts opened by the bank shall constitute part of the total cash resources of the bank to be used in financing operations" and shall be designated as "Joint Investment Account.[18] Joint investment accounts of the Jordan Islamic Bank are further classified into savings accounts, notice accounts and fixed term accounts.[19] It is also necessary to mention that profits and losses relating to financing from joint investment accounts are kept separate as an accounting practice from other income and expenditure resulting from other activities and services offered by the bank.[20]

Limited Period Investment Deposits

These deposits are operated by the Bahrain Islamic Bank and the Kuwait Finance House. Investment deposits under this scheme are accepted for a specified period which is mutually determined by the depositor and the bank. The contract terminates at the end of the specified period but profits are calculated and distributed at the end of the financial year.[21]

Unlimited Period Investment Deposits

These investment deposits differ from limited period deposits in that the period is not specified. Deposits are automatically renewable unless a notice of three months is given to terminate the contract. No withdrawals or further deposits are permitted in this kind of contract, but customers are allowed to open more than one account. The profits are calculated and distributed at the end of the financial year.[22]

Specified Investment Deposits

Some Islamic banks have developed an investment deposit scheme with specific authorization to invest in a particular project or trade. In this case, only the profits of this particular project are distributed between the bank and its customers according to mutually agreed terms and conditions.

In the case of specified investment accounts, Islamic banks function as an agent on behalf of depositors. This is evident in the provisions of the Jordan Islamic Bank which declares that the bank will accept cash deposits into specific investment accounts "from persons desiring to appoint the bank as agent for investment of these deposits in a specific project or in a specific manner on the basis that the bank will receive a part of the net profits realized but without liability for any losses which are not attributable to any violation or default by the bank".[23]

Investment Deposits in Iran*

*The information reported here was collected in 1988 and describes the situation as it prevailed between 1984 and 1988. However, there is no evidence available to the author, which might suggest that these practices have either been abandoned or modified.

Under the system of usury-free banking introduced in 1984, Iranian banks are authorized to accept both short - and long-term investment deposits.

The duration of short-term investment deposits is three months and long-term deposits have a duration of one year or more. According to prevailing practices, short-term deposits are left with the banks for an initial period of three months which can subsequently be extended by one month. The duration of long-term investment deposits is extendable by a multiple of three months. A minimum balance of Iranian Riyal 2,000 and 50,000 is required for short- and long-term investment deposits respectively.[24] Investment deposits are used by Iranian banks in any one of the following ways:

i) Banks can combine their own resources, i.e. their capital, with investment deposits to finance an investment project. In this case, the resulting profits are shared between the depositors and the banks. In calculating the return to depositors, the required reserves are subtracted from the base amount. The banks announce their profit rates every six months. The share of profits to depositors is also distributed accordingly. No profits are earned by depositors if the amount is either withdrawn before the required time or falls below the required minimum.[25]

ii) Iranian banks are only allowed to invest their depositors' funds, i.e. without mixing these funds with their own resources. In this case, the bank acts only as an agent on behalf of the depositors and the profits earned as a result of the bank's investment of such funds are distributed among the depositors after the deduction of the bank's fees for acting as an agent. Furthermore, the return of the principal of these deposits is guaranteed by the bank.[26]

It is also worth noting here that according to Article 4 of the Law for Usury Free Banking of 1983, "banks ..... may undertake and/or insure the principal of the term investment deposits".[27]

Deposit Management in Pakistan

Commercial banks in Pakistan began accepting deposits from the public on the basis of Profit and Loss Sharing (PLS) in 1981 when the Islamization of banking was made compulsory for nationalized commercial banks.[28] However, in the initial stages, Pakistani banks continued to accept interest bearing deposits in addition to PLS deposits. From July 1985, banks in Pakistan were asked not to accept any interest bearing deposit.

From that date, all deposits (other than foreign currency deposits held in Pakistan) accepted by Pakistani banks were to be on the basis of participation in profit and loss.[29]

The main features of deposit management under the Islamic banking system in Pakistan may be described as follows:[*]

i) Deposits in current accounts continue to be accepted as before. No interest or profit is allowed on such deposits.

ii) Deposits, other than current accounts, are classified into three categories: special notice deposits, savings deposits and fixed term deposits. Under the Islamic banking system adopted in the country since 1985, all deposits are accepted only on the PLS basis.

iii) Special notice deposits are further classified into two types: those requiring a notice of 7 to 29 days and those requiring a notice of 30 days or more. Savings deposits also are of two types: with checking facilities and without. There are seven types of fixed or term deposits classified on the basis of their duration ranging from three months to five years or more. Thus, 11 different types of PLS deposits are offered by nationalized banks in Pakistan.

iv) In March, 1986, PLS deposits constituted 65 percent of the total banking deposits in Pakistan.[30]

v) All banks and development finance institutions accepting PLS deposits are required to declare rates of profit on a half-yearly basis on various categories of deposits after obtaining the necessary clearance from the State Bank of Pakistan which is the central bank of the country.

vi) Only non-interest income earned by the banks is distributed to PLS deposit holders.

vii) Banks are required to maintain separate accounts for interest and non-interest operations. Establishment expenses, provisions for bad and doubtful debts, etc. are divided between interest and non-interest incomes in the ratio that the two incomes bear to each other.

viii) The non-interest income of the bank, after making the above and other appropriate deductions, is first distributed among various types of deposits accounts and then to individual depositors using a specific formula developed by the State Bank of Pakistan, which assigns different weights to different deposit categories.[31]

[*] The information reported here relates to year 1986.

3. COMMON PRACTICES OF ISLAMIC BANKS IN THE USES OF FUNDS

The practices of Islamic banks with regard to assets mark a more significant departure from conventional banks than their practices with regard to liabilities which have been discussed above. This is so for obvious reasons. Conventional banks usually resort to lending on interest in order to satisfy a variety of financing requirements. This mode of financing is not available to Islamic banks because of the prohibition of *rib_* (interest). Hence, Islamic banks had to develop financing techniques which not only satisfy different financing requirements of various clients but also bring a safe and reasonable return to the amount invested.

The Islamic financing techniques most commonly used by various Islamic banks, as well as those practiced by commercial banks in Pakistan and Iran, have been summarized in Table 1. It can be seen that there are basically six techniques which are used as alternatives to interest-based financing by most Islamic banks: (i) *Murabahah* (financing on the basis of mark-up or cost plus financing), (ii) *Musharakah* (partnership), (iii) *Mudarabah* (sleeping partnership), (iv) *Ijarah* (leasing), (v) Direct Investment and (vi) *Qard Hasan* (interest-free loans). Most of these techniques with little or no variation are used in Pakistan and Iran. However, there are some other financing techniques which are also used in Pakistan and Iran. In Pakistan, the State Bank of Pakistan has approved a package of 12 non-interest based financing techniques. In Iran, ten Islamic financing techniques are used. In the following, the six basic techniques are described. The other financing techniques used in Pakistan and Iran are discussed in subsequent sections.

Table 1

CONTEMPORARY PRACTICES OF ISLAMIC FINANCING TECHNIQUES

	Islamic Banks		**Iran**		**Pakistan**
				(A)	Trade-Related Modes
1.	*Murabahah*	1.	*Musharakah*	1.	Purchase and Resale of Goods on Markup
2.	*Mush_rakah*	2.	Direct Investment	2.	Leasing
3.	*Mudarabah*	3.	*Mudarabah*	3.	Hire purchase
4.	Leasing	4.	*Salaf* Transactions	4.	Development Charges
5.	Direct Investment	5.	Installment Sale	5.	Purchase of Trade Bills
6.	*Qard Hasan*	6.	Lease Purchase	6.	Buy-back Arrangements
		7.	*Jo'alah*	(B)	Investment-Related Modes
		8.	*Muzara'ah*	7.	*Mush_rakah*
		9.	*Musaqat*	8.	Equity Participation
		10.	*Qard Hasan*	9.	Participation Term & *Mudarabah* Certificates
				10.	Rent Sharing
				(C)	Loan-Related Modes
				11.	Loans with Service Charges
				12.	*Qard Hasan*

3.1 *Murabahah*

Murabahah is one of several Islamically permissible contracts of sale and purchase which are increasingly being used in the financial sector by various Islamic banks.

Islamic bank use the concept of *murabahah* sale to satisfy the requirements of various types of financing, such as financing of raw materials, machinery, equipment and consumer durables as well as short-term trade financing. As an illustration, a typical *murabahah* transaction at an Islamic bank may be described as follows:

i)The client approaches the Islamic bank with the request to finance his specific requirement, be it the purchase of capital goods, raw materials, machinery, equipment or a consumer durable.

ii)The client not only gives the specifications of the goods but also provides information about the price, nature and availability of the goods in the market. The bank, after being convinced of the viability of the project, informs the client of the margin of profit the bank would like to make on the original price. The bank may reserve the right to use its own or independent sources to check the information provided by the client. If the terms and conditions are acceptable to both parties, a request for a *murabahah* transaction is signed. In some banks it is referred to as a "Promise to Buy/Sell" document. It may be mentioned here that under Islamic law, a promise is not legally enforceable in the same sense as a contract. The client has a right to change his mind and may decide not to go ahead with the transaction after all. Since the bank takes further steps to complete the transaction acting upon this request or promise, the possibility that the client may go back on his promise introduces an element of risk in the transaction which is borne by the bank.

It may also be mentioned that, although a promise is not legally binding, Islam strongly encourages its followers to keep the promises they make. Hence, the probability of a breach of promise is indeed low, if the contracting parties are motivated by Islamic morality.

iii)Acting upon this request (or promise), the bank purchases the goods specified and requested by the client, paying the seller directly on a cash basis, either in full or in part.

iv)At this stage, a contract of *murabahah* sale is signed between the bank and the client.

v)The client undertakes to purchase the goods against a profit margin which has been agreed upon by the client and the bank. The payment of the final price of the commodity, which includes the price of the commodity paid by the bank to the original seller and the bank's profit, is deferred to a later date. In certain cases, banks may agree to accept this payment on an installment basis. In such cases, the client is made aware of the number of installments, the amount of each installment, the date each installment is due, etc., beforehand.

It is noteworthy that the profit margin charged over the purchase price is mutually agreed between the client and the bank. Furthermore, the sale item has to be in the possession of the bank before it is sold to the client on the basis of *murabahah.*[32] This is reflected in the practice of *murabahah* at the Faisal Islamic Bank of Egypt where the method adopted is as follows: The client requests the bank to purchase a certain commodity with well-defined specifications. The total cost of the commodity is determined in detail, including the purchase price, custom duties, if any, and other expenses. The itemization of cost is brought to the knowledge of the client. The two parties come to terms regarding the margin of profit to be added to the cost to determine the final selling price, the place and conditions of delivery and the methods of payment. The bank proceeds once the request to undertake the *murabahah* operation is signed.[33]

Murabahah-based financial operations are practised by Islamic financial institutions under such various names as: mark-up, cost plus financing, production support programs, short-term financing or even, simply, sale-purchase contract. For example, the communique on special finance houses issued by the Under Secretariat of the Treasury and Foreign Trade of the Republic of Turkey, which governs the Al Baraka Turkish Finance House and other special finance houses in Turkey, defines a "sale-purchase contract" as "a contract regulating the purchase of raw materials, semifinished goods, equipment, machinery, land and buildings from a third party in cash and the selling of these on credit to the applicants".[34] Turkish law permits the simultaneous completion of purchase and sale contracts.

More light is thrown on the nature of *murabahah* transactions by the contract forms used for such transactions in the Al Baraka Bank of Sudan. According to this contract, the client requests the bank to purchase a commodity as per his specifications and to resell it to him. When the bank has purchased the specified commodity, the two parties enter into a contract of *murabahah.*[35] The cost of the commodity, the margin of profit charged over the original price and the final price are all made clear. The final payment is in monthly installments of equal amounts and the contract includes the total number of installments, the dates on which they fall due, as well as the date of the commencement of payment. The client has to provide a bank/real estate/personal guarantee. In the case of a dispute over the interpretation of different clauses in the contract, the matter is referred to a three-member arbitration committee. Each party to the contract nominates one committee representative and both parties have to agree on a third arbitrator who becomes the chairman of the committee. The arbitration committee resolves the dispute in accordance with the injunctions of Islamic *shari'ah.*

Application of *Murabahah* to Letter of Credit

An interesting application of *murabahah* sale is in the issuing of a letter of credit (L/C).[36] At the Dubai Islamic Bank, letters of credit are opened in the following manner:

i)The customer requests the bank to open a letter of credit to import goods from abroad through an application enclosing a proforma invoice and providing all the necessary details and information.

ii)After securing the necessary guarantee and scrutinizing the application, the bank opens a letter of credit in favor of the client and sends copies to the correspondent bank abroad and to the exporter.

iii)The customer endorses a "Promise to Buy" the merchandise. The cost of the goods and the conditions of delivery are negotiated.

iv)The exporter makes arrangements to export the goods and delivers the documents to the correspondent bank abroad. The shipment of the goods takes place and the correspondent bank advises the bank and sends the documents.

v)After the confirmation of the bank's ownership of the goods in question through the acquisition of related documents an Agreement of Sale is signed with the client.

Other Applications of *Murabahah*

Murabahah has become one of the most popular financing techniques among Islamic banks. It has been estimated that 70 to 80 per cent of the total finance provided by Islamic banks is through *murabahah.*[37] The technique is widely used by Islamic banks to satisfy different financing requirements of such various sectors of the economy as: industry, agriculture, domestic trade, construction and real estate, transportation, international trade, etc. In this section, some interesting applications of *murabahah* practised at the Jordan Islamic Bank are described:

i)At the Jordan Islamic Bank, *murabahah* sale is used to finance the purchase of goods, such as cars, that are subject to mortgage. The individual submits an application to the bank requesting the purchase of a motor car. He promises to buy it at a later stage. The bank issues an invoice to the seller who registers the motor car in the name of the bank. The seller submits the required document to the bank and receives his payment. The bank sells the car to the purchaser, with the registration in the name of the purchaser, on a deferred payment basis after getting an appropriate guarantee. The guarantee condition may stipulate the mortgage of the car to the bank. *Murabahah* is also applied to the purchase of land and buildings in a similar manner.[38]

ii)The Jordan Islamic Bank also provides finance to individuals in order to enable them to purchase goods which are not subject to mortgage, such as household equipment, electrical appliances, etc. The method is essentially the same, the difference being that in the case of goods which cannot be mortgaged, payment by the purchaser is deferred on the strength of a promissory note which is regulated by the bank in accordance with the conditions of the *murabahah* contract. The merchandise is delivered to the client by the bank.[39]

Looking at the success of Islamic banking particularly in mobilizing resources and using them in a profitable way through *murabahah*-based techniques, conventional banks in several countries have started taking advantage of Islamic financing techniques by opening what is popularly known as an "Islamic Window". Grindlays Bank in Pakistan and Bank Misr in Egypt are among such banks. The National Commercial Bank (NCB), which is the largest bank in the Kingdom of Saudi Arabia, has established an International Trade Fund which operates on the principle of *murabahah*. It operates in the following manner: The Fund collects money by selling units to investors. Each unit represents a share of the Fund's investment. Resources of the Fund are used in *murabahah*-based trading transactions by purchasing commodities from suppliers and selling them to buyers on a deferred payment basis. The profits generated from this activity are added to the Fund increasing the value of each unit. The fund essentially provides short-term finance as the maximum period allowed for any single transaction is one year. The Fund's portfolio has an average life of approximately three months.

3.2 Deferred Sale

Deferred sale in Arabic is known as *Bay‘Mu’ajjal* or *Bay‘Bithaman al Ajil*. It is held that it is Islamically permissible, in a sales contract, to make provisions for an immediate delivery of goods while postponing the payment of the price to a later date. In such an event, it is permitted to charge a higher price than the prevailing market price.

Some Islamic banks, though not all, use this technique. Zakariya M_n reports the practice of deferred sale at the Bank Islam Malaysia in the following way:

" ... the bank first determines the requirements of the customer in relation to the duration and manner of repayment. The bank, then, purchases the assets and subsequently sells the relevant assets to the customer at the agreed price which comprises of (a) the actual cost of the asset to the bank; and (b) the bank's margin of profit which varies according to the value and type of the project, especially in the case of housing".[40]

The Council of Islamic Ideology of Pakistan includes deferred sale as one of the possible financing alternatives in an interest-free banking system. Nevertheless, the Council also expresses its reservations by holding that:

" ... this system commends itself for its relative simplicity as well as the possibility of some profit for the banks without the risk of having to share in the possible losses, except in the case of bankruptcy or default on the part of the buyer. However, although this mode of financing is understood to be permissible under the *shari'ah,* it would not be advisable to use it widely or indiscriminately in view of the danger attached to it of opening a back door for dealing on the basis of interest".[41]

Notwithstanding this warning, the deferred sale technique is being widely used by commercial banks in Pakistan. (Some of the modifications of this form of financing will be discussed in section 4.1). This financing technique operates in the following manner: The client approaches the bank for financing the purchase of goods, raw materials, inputs, inventories, etc. The bank purchases the required goods and resells them to the customer at an agreed price to be paid later. The agreed price includes the cost of goods to the bank plus the bank's margin of profit. The customer is required to pay the agreed price on the due date.[42]

3.3 *Musharakah*

The word *musharakah* is derived from the Arabic word *sharikah* meaning partnership. Islamic jurists point out that the legality and permissibility of *musharakah* is based on the injunctions of the Holy Quran, *sunnah* and *ijma'* (consensus) of the scholars.[43]

It may be noted that Islamic banks are inclined to use various forms of *Sharikat-al-'Inan* because of its built-in-flexibility.[44] At an Islamic bank, a typical *musharakah* transaction may be conducted in the following manner: One, two or more entrepreneurs approach an Islamic bank for the finance required for a project. The bank, along with other partners, provides complete finance. All partners, including the bank, have the right to participate in the project. They can also waive this right. The profits are to be distributed according to an agreed ratio which need not be the same as the capital proportions. However, losses are shared in exactly the same proportion in which the different partners have provided the finance for the project.[45]

Permanent and Diminishing *Musharakah*

Most Islamic banks participate in the equity of companies in the following manner:

A) Permanent *Musharakah*

In this case, the bank participates in the equity of a company and receives an annual share of the profits on a pro rata basis. The period of termination of the contract is not specified. This financing technique is also referred to as continued *musharakah*.

B) Diminishing *Musharakah*

Digressive or diminishing *musharakah* is a special form of *musharakah* which ultimately culminates in the ownership of the asset or the project by the client. It operates in the following manner: The bank participates as a financial partner, in full or in part, in a project with a given income forecast. An agreement is signed by the partner and the bank through which the bank receives a share of the profits as a partner. However, the agreement also provides payment of a portion of the net income of the project as repayment of the principal financed by the bank. The partner is entitled to keep the rest. In this way, the bank's share of the equity is progressively reduced and the partner eventually becomes the full owner.[46]

This method of diminishing partnership has been successfully applied by the Jordan Islamic Bank mainly to finance real estate projects and the construction of commercial buildings and housing projects. The projects are financed by the bank, fully or partially, on the basis that the bank obtains a proportion of the net profits as a partner and receives another payment toward the final payment of the principal advanced. When the original amount is fully repaid, the ownership is fully transferred to the partner and the bank has no claim whatsoever. The Jordan Islamic Bank has financed the construction of a commercial market in Irbid, a community college in Jerash and a hospital in Zerqa using this method of financing.[47]

Application of *Musharakah* in Domestic Trade

The Al Baraka Islamic Bank of Sudan is using the technique of *musharakah* to finance the sale and purchase of goods in the local (Sudanese) market. *Musharakah* financing of domestic trade operates in the following manner:

The bank enters into a partnership agreement with the client for the sale and purchase of local goods whose specifications are given by the client. The total cost of the goods is divided between the parties and both parties agree to contribute their shares of the cost of the goods. A special *musharakah* account is opened at the bank immediately after the signing of the contract, which specifies all the transactions pertaining to this account. It is the responsibility of the partners to arrange the purchase and sale of the goods in question.

Profits are distributed as follows: An agreed percentage of the net profits is given to the client with the remainder distributed among the partners of the *musharakah* agreement in the same proportion as their capital contribution. In the case of a loss, the partners bear the loss exactly in proportion to their capital contribution.[48]

Application of *Musharakah* to the Import of Goods

The Al Baraka Islamic Bank of Sudan also employs *musharakah* technique to finance the import of goods. The contract is essentially the same as the one discussed above in terms of the sale and purchase of domestic goods, but differs in some details.

The importer requests the bank to participate in the import and sale of certain goods. The total cost of importing the goods is declared and the capital contribution of each party is specified. The cost of the whole transaction is designated in the appropriate foreign currency. The importer pays a part of his contribution immediately after the contract has been signed and pays the rest after receiving the invoices. A special *musharakah* account is opened at the bank. The bank then opens a letter of credit in favour of the importer and pays the full amount to the exporter after receiving the shipment document. The cost of insurance is charged to the transaction account. The importer is responsible for the import, clearance and final sale of the goods in question. The net profits are distributed among the partners in the agreed proportion and any loss is shared in the same proportion as the actual capital contribution.[49]

Letters of Credit on *Musharakah* Basis

The Bank Islam Malaysia issues Letters of Credit (L/C) under the principle of *musharakah*. The method adopted is as follows: The customer is required to inform the bank of his letter of credit requirements and negotiate the terms of reference for *musharakah* financing. The customer places with the bank a deposit for his share of the cost of goods imported which the bank accepts under the principle of *Al Wadiah*. The bank then issues the L/C and pays the proceeds to the negotiating bank utilizing the customer's deposit as well as its own finances, and subsequently releases the documents to the customer. The customer takes possession of the goods and disposes of them in the manner stipulated in the agreement. Profits derived from this operation are shared as agreed.[50]

Application of *Musharakah* in Agriculture

Islamic banks in Sudan and particularly the Sudanese Islamic Bank have developed yet another application of *musharakah* which has tremendous potential for rural and agricultural development in Islamic countries. The Sudanese Islamic Bank has, on an experimental basis, been providing finance to farmers by means of a *musharakah* agreement. The method adopted for this kind of financing is as follows:

The Sudanese Islamic Bank and the farmer enter into a *musharakah* contract under which the bank provides the farmer with certain fixed assets, such as ploughs, tractors, irrigation pumps, sprayers etc. and some working capital, such as fuel, oil, seeds, pesticides and fertilizers. The farmer's equity is confined to the providing of land, labor and management. Since it is a partnership contract, there is no need of collateral or guarantees other than personal guarantees. Profits are shared between the farmer and the bank in such a way that the farmer is first paid 30 per cent of the net profit as compensation for his management, and then the remaining 70 per cent is shared between the bank and the farmer on a pro rata basis based on each partner's respective share in the equity.[51]

3.4 *Mudarabah*

Mudarabah is also known as *qirad* and *muqaradah*. It refers to a contract between two parties in which one party supplies capital to the other party for the carrying on of some trade on the condition that the resulting profits be distributed in a mutually agreed proportion while all loss is borne by the provider of the capital.

Although it has been widely suggested in the theoretical literature on Islamic banking that *mudarabah* can be a viable basis of financial intermediation in an interest-free framework, there are certain difficulties with its contemporary application. For example, the legal system operating in the country should provide legal safeguards to the provider of capital so that he can finance projects on the basis of *mudarabah*. For this and other reasons, the number of banks providing finance on the basis of *mudarabah* is not very large. Even among those banks which use *mudarabah* as a financing technique, the frequency of its use is not very high. In view of the dearth of relevant information, it is not easy to describe the manner in which different Islamic banks practise *mudarabah* and whether there are any differences in these practices. However, some available information is presented below:

In Iran, *mudarabah* is considered a short-term commercial partnership between a bank and an entrepreneur. All of the financial requirements of the project are provided by the bank and the managerial input is provided by the entrepreneur. Both parties of the *mudarabah* agreement share in the net profits of the project in an agreed proportion. Iranian banks are directed by the monetary authorities to give priority in their *mudarabah* activities to cooperatives.[52] Furthermore, commercial banks in Iran are not allowed to engage in the *mudarabah* financing of imports by the private sector.[53] Article 9 of the Law of Usury Free Banking provides for banks to expand their commercial activities through *mudarabah*, within the overall framework of the commercial policy of the government.[54]

3.5 *Ijarah* (Leasing)

Islamic law permits the leasing of certain assets whose benefit can be obtained by the lessee against the payment of some agreed rental. Like any other contract, a lease contract has to fulfill all of the conditions of a valid contract stipulated by the *shari'ah*. For example, the contract should be clear, should be by mutual agreement, the responsibilities and benefits of both parties should be clearly spelled out, the agreement should be for a known period and against a known price, etc. These conditions become more important in a lease contract because there is more room for uncertainty *(gharar)*. Hence, it is necessary that the benefits and costs of each party are clearly stated in the contract.

Leasing is emerging as a popular technique of financing among Islamic banks. Some of the important Islamic banks which use leasing as a financing technique include the Islamic Development Bank, the Bank Islam Malaysia and commercial banks in Pakistan.

Under this scheme of financing, the bank purchases a real asset (the bank may even purchase the asset as per the specifications provided by the prospective client) and leases it to the client. The period of lease, which may be from three months to five years or more, is determined by mutual agreement according to the nature of the asset. During the period of lease, the asset remains in the ownership of the bank but the physical possession of the asset and the right of use is transferred to the lessee. After the expiry of the leasing period these revert to the lessor. A lease payment schedule based on the amount and terms of financing is agreed upon by the bank and the lessee. The agreement may or may not include a grace period. According to the Islamic view, the maintenance of the asset during the leasing period is the responsibility of the owner of the asset, as the benefit (rental) is linked to this responsibility (maintenance).

It is possible that some Islamic banks may invite other investors to participate in the leasing operation. For example, some investors and an Islamic bank may participate in an income yielding real asset leasing project. All participants in this venture take their share of profit out of the rental income. The bank also has the right to repurchase a participation according to the agreed terms.

Leasing is one of the approved methods of interest free financing in Pakistan.[55] In fact, the utilization of PLS deposit funds into leasing operations was authorized by the State Bank of Pakistan as early as 1982, even before the beginning of the full scale Islamization of banking in Pakistan.[56] Furthermore, by means of a circular issued in 1984, the State Bank of Pakistan indicated areas where leasing could be used. It was envisaged that the main recipients of leasing based finance would be the agricultural sector where all kinds of equipment, such as tube wells, tractors, trailers, fishing boats, solar energy plants, other farm machinery and transport equipment, etc., could be leased.[57]

Lease Purchase Transactions

These transactions are called *Ijarah wa Iqtina‘* (Lease Purchase Arrangement). The basic idea behind these transactions is that an asset is given to the client on lease at an agreed rental. At the same time, the lessee is allowed to purchase the asset at an agreed price. The technique is practised at Islamic banks in various forms, some of which are described below:

The Al Baraka Investment Company uses the technique of *ijarah wa iqtina‘* to finance the purchase of large capital items such as property, industrial plants and heavy machinery. It involves direct leasing where investors in the scheme receive regular monthly payments which represent an agreed rental. At the expiry of the lease, the lessee purchases the equipment.[58]

The Bank Islam Malaysia also uses lease purchase contracts. The procedure adopted is the same as that described above except that the client and the bank enter into an agreement at the time of the lease that the client will purchase the equipment at an agreed price with the provision that the lease rentals previously paid shall constitute part of the price.[59]

The lease purchase arrangement is also used by Islamic banks in Iran, which purchase the needed machinery, equipment or immovable property and lease it to firms.[60] At the time of the contract, the firms guarantee to take possession of the leased assets if the terms of the contract are fulfilled. The terms of the lease cannot exceed the useful life of the asset which is determined by the Central Bank of Iran. Banks in Iran are not allowed to lease those assets whose useful life is less than two years.[61] Furthermore, Article 10 of the Law of Usury Free Banking of 1983 authorizes banks, in coordination with the Ministry of Housing and Urban Development, to undertake the construction of low priced residential units for sale on a lease purchase basis.[62]

Hire Purchase Schemes in Pakistan

What has been described above as a lease purchase arrangement *(ijarah wa iqtina‘)* is called hire and purchase in Pakistan. Although there may not be many significant conceptual differences between the scheme operative in Pakistan and the one described above, there are certain operational details which merit elaboration.

When a client requests to participate in this scheme, a "hire purchase" account is opened in his name. The value of the asset as well as the amount of profit over cost payable by the client to the bank are recorded as debits. The installment payable by the client has two distinct components: the agreed rental and a part of the amount of profit. The asset remains in the ownership of the bank unless all installments have been fully paid. The ownership title is transferred upon the receipt of full payment. The installments are so devised that the agreed price is fully amortized during the useful life of the asset.[63]

3.6 Direct investment

Direct investment is an important and productive financing technique for Islamic banks.[64] With direct investment, an Islamic bank functions more like an investment company than an institution of financial intermediation. In comparison to conventional banks, this gives Islamic banks more leverage to vigorously perform a socially useful role. The option of direct investment gives Islamic banks an opportunity to invest in priority projects in chosen sectors. In this way, banks can channel their funds in the direction they think most desirable.

There are several ways in which Islamic banks undertake direct investment. A number of Islamic banks have taken the initiative in establishing and managing subsidiary companies. Conceptually, these companies could be of any type and concerned with any trade. However, the general trend is toward the establishment of companies dealing with investment, insurance and reinsurance, trade, construction and real estate, etc.

Another method of undertaking direct investment is participation in the equity capital of other companies. In this connection, two distinct patterns are noticeable:

i)the companies are established by the Islamic banks themselves and the public subscription of shares is invited;

ii)banks participate in the equity capital of companies established by others.

In both cases, Islamic banks attempt to make sure that the projects are of public benefit and comply with the Islamic *shari'ah*.

Yet another method of investment undertaken by Islamic banks is the adoption and promotion of a particular project by the banks themselves, for example the construction of a housing complex or shopping plaza, etc.[65]

Direct Investment by Banks in Iran

Under the Islamic banking system, Iranian banks have been allowed to undertake direct investment in any activity and in any sector of the economy. Article 8 of the Law of Usury Free Banking of 1983 authorizes Iranian banks to undertake direct investment "in productive and development projects or activities. Plans for such investments should be included in the State Annual Budget Bill to be approved by *Majlis* (The Islamic Consultative Assembly) and evaluation of the project should be indicative of no loss". The same article also states that "the banks are by no means entitled to invest in the production of luxury and nonessential consumer goods".[66]

Direct investment by Iranian banks is also subject to certain other conditions some of which are listed below:

i)Iranian banks are not allowed to invest directly in any project in conjunction with the private sector.

ii)The ratio of the initial capital of these ventures of the total funds needed must not be less than 40 per cent.

iii)The total fixed capital necessary for undertaking these projects must be provided for by long-term financial resources.[67]

3.7 *Qard Hasan* (Benevolent Loans)

Since interest on all kinds of loans is prohibited in Islam, a loan which is to be given in accordance with the Islamic principle has to be, by definition, a benevolent loan *(qard hasan)*, i.e. a loan without interest. It has to be granted on the grounds of compassion, i.e. to remove the financial distress caused by the absence of sufficient money in the face of dire need. Since banks are profit oriented organizations, it would seem that there is not much scope for the application of this technique. However, Islamic banks also play a socially useful role. Hence, they make provisions to provide *qard hasan* besides engaging in income generating activities.

There may be slight variations among different Islamic banks in the use of this technique. The Faisal Islamic Bank of Egypt provides interest-free benevolent loans to the holders of investment and current accounts, in accordance with the conditions laid down by its board of directors. The bank also grants benevolent loans to other individuals under conditions decreed by its board.[68] On the other hand, the Jordan Islamic Bank Law authorizes it to give "benevolent loans *(qard hasan)* for productive purposes in various fields to enable the beneficiaries to start independent lives or to raise their incomes and standard of living.[69]

Iranian banks are required to set aside a portion of their resources out of which interest-free loans can be given to (i) small producers, entrepreneurs and farmers who are not able to secure financing of investment or working capital from alternative sources, and (ii) needy customers. It should also be noted that Iranian banks are permitted to charge a minimum service fee to cover the cost of administering these funds.[70]

In Pakistan, *qard hasan* is included in the lending mode of financing.[71] Two important differences are to be noted: (i) No service charge is imposed on *qard hasan* loans and (ii) *Qard hasan* operations are concentrated in the head office of each bank and branch offices are not permitted to extend these loans which are granted on compassionate grounds. These loans are repayable if and when the borrower is able to pay.[72]

4. ISLAMIC FINANCING TECHNIQUES SPECIFICALLY USED IN PAKISTAN

There are 12 Islamic modes of financing which have been approved by the State Bank of Pakistan, the central bank of the country, to be used by commercial banks. These financing techniques can be classified into three categories:

(i) Trade Related Modes
(ii) Investment Related Modes
(iii) Loan Related Modes

The State Bank of Pakistan has identified six trade related modes, *viz.* purchase and resale of goods on mark-up, leasing, hire purchase, development charges, purchase of trade bills and buy-back arrangement. There are four techniques grouped together under investment related modes, *viz. musharakah,* equity participation, participation term certificates and *mudarabah* certificates and rent sharing. The lending mode includes only two techniques: loans with service charges and *qard hasan.* Many of these financing techniques of Islamic banks have been discussed above. However, those which have not been dealt with above and which are specific to Pakistan are described below:

4.1 Trade Related Modes

Trade related modes are those which are based on some kind of mark-up and applied mainly to the trade sector. In using these modes, the bank is concerned with buying and selling. Three modes of financing belonging to this group, *viz.* purchase and sale of goods on the basis of mark-up *(murabahah)*, leasing *(ijarah)* and hire purchase *(ijarah wa iqtina)* have been dealt with in previous sections of this study. The remaining financing techniques are discussed below.

Development Charges

Banks in Pakistan are authorized to provide finance to clients for the development of land or property on the basis that the bank will share in the increased value of the developed property.

The technique is practised in the following manner: The client approaches the bank with a request for finance for the development of a property. He submits details of the estimated development expenditures and the dates by which he will finally repay the amount. The bank studies the project and upon finding it sound, purchases the said property from the client. The sale price of the property is the amount of expenditure which is to be spent on the development of the project. At the same time, the client "buys back" the same property from the bank for a price which is payable at a later date. Thus, one transaction between the client and the bank is on cash basis while the buy-back transaction between the bank and the client is deferred. Usually banks do not finance more than the estimated amount of the development expenditure. The period and method of repayment is decided by mutual agreement. If the client pays back in time, or before the date of the final adjustment, some rebate is given to him for prompt payment.

Purchase of Trade Bills

Pakistani commercial banks are also allowed to purchase trade bills. In the case of an export bill expressed in a foreign currency and drawn under an irrevocable letter of credit, the exchange rate differential is the return to the bank. Domestic trade are handled on the basis of *murabahah*.

Buy-Back of Movable/Immovable Property

With this financing technique, a movable or immovable asset is sold to the bank for an agreed price and is bought back by the client for another price. One sale (from the client to the bank) is on a cash basis while the other sale (from the bank to the client) is on a deferred basis. The client may pay the bank in lump sum on the agreed date or establish a schedule of installment payments. The bank pays the client in cash immediately, while the client may refuse to buy back the property.

The buy-back arrangement is being used in Pakistan on a large scale and in various ways. In order to clarify the exact nature of buy-back arrangements, two examples are given below. These are (i) short- and long-term financing provided by commercial banks (other than agricultural inputs) and (ii) the financing of a house/flat or its construction on a buy-back basis. These examples are based on the contract forms used by the United Bank Limited of Pakistan.

A)Short- and Long-Term Financing through Buy-Back

The customer (an individual entrepreneur, a partnership firm, a public or private limited company) agrees to sell to the bank for a specified sum of money raw materials, finished goods, spare parts, machinery, etc. which the client may own. The customer also agrees to buy the same goods from the bank on the basis of mark-up. The price paid by the bank to the client is called the sale price and is a given percentage of the value of those stocks which are sold to the bank. The customer immediately repurchases the same goods from the bank at a price which is referred to as the purchase price.

The purchase price normally includes the original sale price plus the amount of the mark-up agreed upon by the client and the bank. The purchase price is payable by the client to the bank on a certain date in the future, or in equal installments. The contract stipulates the period or number of installments by means of which the client is to pay the purchase price in full. In case the client pays the installments of the purchase price on or before time, the bank pays the client a prompt payment bonus.

In most cases, for the security of the payment of the purchase price, the same goods are pledged to the bank. In cases where pledging may not be possible, for example, in the case of certain raw materials, the bank may require some other security. While agreeing to the conditions required by the bank and stipulated in the contract, the client also undertakes not to borrow any money or make use of any other financial or mark-up facility from any other bank or financial institution against the same goods.

B)Financing for the Purchase of a House/Flat or Its Construction on a Mark-up Basis.

Another example of the way in which buy-back arrangements are used in Pakistan is the provision of financing for the purchase/construction of a house/flat. The client first negotiates the purchase of a property (a house/flat or a piece of land) and then approaches the bank to obtain the necessary finance. The customer then agrees to sell this property to the bank for a specified sum (sale price) and further agrees to purchase it back at a purchase price which includes the sale price and the amount of mark-up payable to the bank. The payment of the purchase price is deferred and a schedule of installment payments is agreed upon. There is also a provision for a prompt payment bonus if the installments are paid on time.

The contract is modified somewhat in the case of construction of a house on a piece of land. The client should be in possession of the land on which the said house is to be constructed. The costs of construction, fixtures, building materials, etc., are worked out in detail and scrutinized by the bank. The bank agrees to buy from the customer within a specified period and for a specified sum all the building materials, fixtures and fittings, etc. required for the construction. This is referred to as the bank's investment which is a specific percentage of the prospective value of the said property after its completion. The client agrees to repurchase the building material from the bank on a deferred payment basis in installments. The construction of the property is completed under the direct supervision of the customer who is responsible for the implementation of the project in accordance with the approved plan.

The buy back arrangements discussed above are widely used in almost all sectors of the economy involving banking finance. However, there are serious reservations among scholars regarding the validity of buy-back arrangements. If not implemented carefully, such arrangements may be a mere subterfuge to circumvent the prohibition of *riba*. For example, there is no real transfer of ownership of goods when these contracts are put into effect. Buying and selling at the same time is merely another method of lending on interest. Furthermore, in certain cases, as in the case of financing the purchase and/or construction of a house/flat, it may violate another Islamic norm, i. e. selling something which one does not possess. For these and other reasons, the Workshop on Investment Strategy in Islamic Banking held in Amman during 23-25 Shawwal 1407H (19-21 June 1987) recommended the "avoidance of the sales where a commodity is bought from the client to resell it to him at a deferred higher price".[73] Thus, these contracts need to be carefully reviewed from the point of view of the *shari'ah* in order to determine whether or not they conform to all of the requirements of permissible contracts.

4.2 Investment Related Modes

The financial techniques included in this group are based on the principle of profit sharing and include both *mudarabah* and *musharakah*. Of the four techniques approved by the State Bank of Pakistan, *musharakah* was dealt with in an earlier section. The other three techniques are described below:

Equity Participation

Banks in Pakistan can participate in the equity of companies by purchasing shares. By acquiring such equity, banks can influence their debt equity ratio. In fact, by expanding the equity base of companies, the need for debt finance may be reduced.

Purchase of Participation Term Certificates and Mudarabah Certificates

Commercial banks in Pakistan can diversify their portfolio structure by investing in Participation Term Certificates and *mudarabah* Certificates. A participation term certificate is a transferable financial instrument. These certificates are issued for a specified period and are secured by a legal mortgage on the fixed assets of a company.

A *mudarabah* certificate is a certificate of definite denomination issued to the subscriber of *mudarabah* acknowledging the receipt of the money subscribed by him. Companies in Pakistan, if they are registered as *Mudarabah* Companies, are allowed to float their own *mudarabah* under the *Mudarabah* (Flotation and Control) Ordinance of 1980. Commercial banks are allowed to invest in the purchase of *mudarabah* certificates in the same way as they invest in the shares of a limited company. A commercial bank can also register itself as a *Mudarabah* Company and issue *mudarabah* certificates.

Rent Sharing

Rent sharing is another mode of financing used in Pakistan. In addition to commercial banks, this mode is being used by the House Building Finance Corporation which is a specialized national financial institution in the housing sector. Banks provide finance for the building of houses, housing complexes, flats, apartment buildings, etc., and receive a share of the rental income of the property.

4.3 Loan Related Modes

The last group of financial techniques is referred to as loan based modes of finance. It includes *qard hasan* and loans with service charges. As the practice of *qard hasan* in Pakistan has already been discussed, the financial technique of loans on service charges is described below:

Loans on Service Charge

Banks in Pakistan are authorized to provide loans on the basis of service charges which are considered to be permissible under *shari'ah* provided they are not related to the amount of the loan and are related to actual administrative expenses. In Pakistan, the maximum service charge on loans for a given period is computed using the following formula:

Service Charge: $$\frac{E}{A} x 100\ 1$$

where

E: Administrative expenses during the year

A: Average assets during the year

5. ISLAMIC FINANCING TECHNIQUES SPECIFICALLY USED IN IRAN

The Islamic Republic of Iran has taken the necessary steps to restructure its banking sector in conformity with the Islamic *shari'ah*. Hence, the Iranian Parliament passed the Law for Usury Free Banking in 1983. The following 10 modes of finance have been adopted in Iran: *Musharakah, Mudarabah,* Direct Investment, *Salaf* Transactions, Investment Sale, Lease Purchase, *Jo'alah, Muzara'ah, Musaqat,* and *Qard Hasan*. Those modes which are specific to Iran and have not been discussed before are described below:

5.1 *Salaf* Transactions

These are transactions which are usually known as *bay' salam* (forward sale). In order to provide working capital to business enterprises, Iranian banks are empowered to purchase future output by paying the price in advance. The specification and characteristics of the output must be determined as accurately as possible at the time of the contract. Similarly, the price agreed upon should not exceed the market price of the goods at the time. Banks are not allowed to sell the products, thus acquired, unless they are in physical possession of the goods. The duration of this transaction is usually a production cycle or a year, whichever is shorter.

5.2 Installment Sale

The Central Bank of Iran describes this technique in the following way:

Installment sale or credit sale is the surrender of existing property to someone else at an identifiable value in such a way that all or part of the mentioned value is received in equal or unequal installments at a fixed date or dates. In order to provide the necessary facilities to secure working capital to producing units, Iranian banks are permitted by the Central Bank of Iran to acquire raw materials, spare parts, working tools and other preliminary requirements of such units, solely upon a written request and the undertaking of the applicants to purchase, use and arrange the installment sale of the mentioned items. Similarly, for the purpose of providing the facilities necessary for the expansion of housing activities, Iranian commercial banks are empowered to construct low-cost housing and sell it to applicants under the above mentioned conditions.[74]

There are certain other conditions which are imposed on this type of contract by the Central Bank of Iran. For example, the raw material acquired under this scheme should not exceed more than what is required for one production cycle and the price should be repaid within one year. The price to be paid by the client to the bank is to be determined on a cost plus basis. The repayment period for machines, tools and other implements cannot exceed their useful life. The Central Bank of Iran is empowered to determine the useful life of various kinds of assets for this purpose.[75]

5.3 *Jo'alah*

Jo'alah means a transaction based on a commission. Under the Usury Free Banking Law of 1983, Iranian banks are authorized to provide various kinds of services and charge a commission for these services. The nature of the services and the prices to be charged must be exactly determined at the time of the contract. This contract can also operate in reverse, i. e. banks can engage any other agency in a *jo'alah* contract, acquire some services that they need and pay for these services.[76]

5.4 *Muzara'ah*

Under this contract, Iranian banks are allowed to hand over to farmers land which they own or which is otherwise in their possession. The plot of land has to be completely specified and must be given for a specific period. The bank and the farmer share the output in an agreed proportion.

5.5 *Musaqat*

Under this contract, banks provide farmers with orchards, gardens or trees which they own or which are otherwise in their possession. This is done for the purpose of gathering the harvest of the orchard or garden and dividing it in a specified ratio. The harvest may be fruits, leaves, flowers, etc., of the plants and trees in the orchard or garden.

6. CONCLUSION

In this paper, an attempt has been made to survey the Islamic financing techniques used by Islamic financial institutions in different countries. The similarities and dissimilarities of these financing techniques in various institutions and countries have been noted. It may be observed that Islamic banking is far more interesting and complex than conventional banking as far as financing techniques are concerned. Even in the case of deposit mobilization, Islamic banking has been able to offer various kinds of financial products. However, it is in the area of assets rather than liabilities that the practices of Islamic banks are more diverse and complex than those of conventional banks.

Although this paper has not attempted a comparative study of the frequency of use of different financing techniques, it is generally believed that *murabahah* is the most widely used technique and that the majority of the financing provided by Islamic banks goes to short-term trade and the financing of real estate. However, it should be kept in mind that the dynamics of contemporary Islamic banking change at a fast rate under market pressure. Hence, it may be that the composition of the basket of financing techniques used by Islamic banks is also undergoing a significant change.

There is no doubt that *murabahah* was the most popular financing technique in the early stages of development of Islamic banks. This was so for several reasons. First, *murabahah* is simple to apply. In terms of the simplicity of application, the *murabahah* financing technique may be best placed to compete with conventional interest-based borrowing. All other Islamic financing techniques require more elaborate arrangements for their application. Secondly, it was possible to get higher returns on depositors' money using this technique, and in their initial stages of establishment and development, Islamic banks required higher returns in order to build confidence in themselves.

However, some available evidence suggests that the significance of *murabahah* is declining in the overall financing operations of Islamic banks, which are now experimenting with other modes of financing. The Jordan Islamic Bank has been successfully using *musharakah* as a financing technique in the manufacturing sector and the Sudanese Islamic Bank is doing the same in the agricultural sector. Islamic banks have also been experimenting with leasing and its various forms as a viable financing technique. Nevertheless, much deeper, more detailed and thorough studies are required to corroborate these impressions and to highlight these trends more effectively.

Financing techniques such as the buy-back arrangement and some applications of deferred sale need to be carefully reviewed from the point of view of the *shari'ah.* One has to first determine what exactly is being practiced and how. This can be done by reviewing the contract forms used by the banks for various transactions. Once the practice is established beyond any reasonable doubt, it may be submitted to the ***shari'ah*** scholars for review.

A review of the contract forms used by various Islamic banks and the determination of the exact nature of these practices would also lead to the standardization of these practices as the banks themselves would know what other banks are doing and would be able to eliminate illegal and inefficient practices. Ultimately, simple, easy to use and standardized financing techniques have to evolve through experience and experiment over a period of time. However, imaginative and innovative research can accelerate this process.

Research studies could also be undertaken on the various economic aspects of these financing techniques. For example, the relative profitability of these financing techniques is an issue which has not yet been dealt with. Is *murabahah* more popular among Islamic banks because it is more profitable? How does the rate of return on other techniques compare to *murabahah*? These and other questions on efficiency and stability, finance mobilization, promotion of economic justice, etc. need to be addressed in future empirical research on Islamic banking.

NOTES AND REFERENCES

1.For a detailed account of the evolution of these and similar views in a Muslim country, see: Rahandjo, M. Dawan (1988), "The Question of Islamic Banking in Southeast Asia" in Ariff, Mohammed (1988) ed., *Islamic Banking in Southeast Asia*, Singapore: Institute of South East Asian Studies, pp. 137-163.

2.Siddiqi, Mohammad Nejatullah (1973), *Banking Without Interest*, Lahore: Islamic Publications. Also "Islamic Approaches to Money, Banking and Monetary Policy" in Siddiqi, Mohammad Nejatullah (1983), *Issues in Islamic Banking: Selected Papers*, Leicester, U.K: The Islamic Foundation.

3.Siddiqi, Mohammad Nejatullah (1981), *Rationale of Islamic Banking*, Jeddah: Centre for Research in Islamic Economics, King Abdul Aziz University. Also reprinted in Siddiqi, Mohammad Nejatullah (1983), *op. cit.*, pp. 67-96.

4.For a good collection of research papers dealing with theoretical aspects of Islamic banking, see: Khan, Mohsin S. and Mirakhor, Abbas (1987), *Theoretical Studies in Islamic Banking and Finance*, Houston, Texas: The Institute for Research and Islamic Studies. For an excellent review of this book see Khan, M. Ali (1992) "Book Review on Theoretical Studies in Islamic Banking and Finance" *Journal of King Abdul Aziz University: Islamic Economics*, Vol. 4.

5.However, contemporary practices of Islamic banking have been studied in Ahmad, Ausaf (1987), *Development and Problems of Islamic Banks*, Jeddah: Islamic Research and Training Institute; Siddiqi, Mohammad Nejatullah (1988), "Islamic Banking: Theory and Practices" in Ariff, Mohammed (1988), *op.cit*; Nienhaus, V. (1988), "The Performance of Islamic Banks - Trends and Cases". Paper presented at the conference on Islamic Law and Finance, School of Oriental and African Studies, University of London; Ahmad, Ziauddin (1989), "Islamic Banking at the Cross Roads", *Journal of Islamic Economics*, Vol. 2 No. 1; Ahmad, Ziauddin (forthcoming) *Islamic Banking: State of the Art*. IDB Prize Lecture Series, Jeddah: Islamic Research and Training Institute.

On experiments of Islamic banking in Pakistan and Iran, see Iqbal, Zafar and Mirakhor, Abbas (1986), *Islamic Banking*, Washington, D.C: IMF Occasional Papers.

6.Iran nationalized all privately owned banks on June 8, 1979. See Amin, S.H. (1986), *Islamic Banking and Finance: The Experience of Iran*, Tehran: Vahid Publications. p. 41. Five major banks in Pakistan which constitute a significant portion of the banking sector in terms of deposit mobilization as well as assets owned by the banks were nationalized even before the process of Islamization began.

7.Principal subsidiaries of the DMI Trust are: Islamic Investment Company of the Gulf (Sharjah); Islamic Investment Company of the Gulf (Bahrain); Faisal Islamic Bank, Bahrain; Faisal Islamic Bank, Niger; Faisal Islamic Bank, Senegal; Faisal Islamic Bank and Trust, Bahamas; Islamic Investment Company, Niger; Islamic Insurance Company, Bahrain; Islamic Insurance Company, Luxembourg; Islamic Insurance and Reinsurance Company, Bahamas; DMI, Geneva; *Shari'ah* Investment Services, Geneva, and DMI Investment Services, Jersey. In addition to the above, the DMI also has interests in different Faisal Islamic Banks in many countries such as the Faisal Islamic Banks in Sudan and Egypt and the Faisal Finance Institution in Turkey.

8.*Dalil D_r-al-M_l-al Isl_m_* (Arabic) p. 7.

9.The Al-Baraka Group of Companies consist of the following: Al-Baraka Investment and Development Company, Saudi Arabia; Saudi Tunisian Finance House, Tunis; Al-Baraka International Limited, England; Al-Baraka Turkish Finance House, Turkey; Al-Baraka Islamic Investment Bank, Bahrain; Al-Baraka Bank, Sudan; Al-Baraka Thai International Company, Thailand; Al-Baraka Islamic Bank of Mauritania; Al-Baraka Bank, Bangladesh; Al-Baraka Bancorp, Texas, and Al-Baraka Bancorp, California. The sister institutions of the Al-Baraka Group are: The Jordan Islamic Bank for Finance and Investment, Jordan; Islamic Finance House (Universal holding), Luxembourg, and the Islamic Bank International, Denmark.

10.*The Jordan Islamic Bank for Finance and Investment Law*, Second edition (not dated), Amman: The Jordan Islamic Bank, p. 4.

11.State Bank of Iran (1984) *Annual Report*, Tehran: State Bank of Iran.

12.Bank Islam Malaysia Berhad, *Organization and Operations* (not dated) pp. 11-12 (Mimeograph).

13.Bahrain Islamic Bank, *Goals and Functions* (Arabic).

14.Dubai Islamic Bank, *A General Introduction to the Objectives and Investment* (not dated), Dubai: Dubai Islamic Bank, p. 6.

15.State Bank of Iran. *op. cit*.

16.Jordan Islamic Bank, *Annual Report* (1981) p. 25.

17.*Jordan Islamic Bank Law*, p. 4.

18. *Ibid*. p. 10.

19.See section 13(b) of the *Jordan Islamic Bank Law*, p.10.

20.See section (18) *Jordan Islamic bank Law*, p. 12.

21.Ahmad, Ausaf (1987), *Development and Problems of Islamic Banks*, Jeddah: Islamic Research and Training Institute, p. 10.

22. *Ibid*. p. 18.

23.*Jordan Islamic Bank Law*, p. 4.

24.*Iran Year Book* (1988) Bonn: Moini Biontino Verlagsgesellschaft GmbH., p. 253.

25.*Ibid*. p. 254.

26.State Bank of Iran, *Annual Report* (1984), Tehran: State Bank of Iran, p. 70.

27."The Law of Usury Free Banking - 1983" in *Iran Year Book*, 1988 p. 275.

28.Zaidi, Nawazish Ali (1987), Eliminating Interest From Banks in Pakistan, Karachi: The Royal Book Company, p. 78.

29.*Ibid*. p. 86.

30.Zaidi, Nawazish Ali "Profit Rate Policy and Depositors" Paper presented at the Islamic Banking Education Workshop held in Islamabad. Quoted in Zaidi, Nawazish Ali (1987) *Eliminating Interest From Banks in Pakistan,* Karachi: The Royal Book Company. Zaidi has provided the following figures:

Distribution of Domestic Deposits in all Scheduled Banks in Pakistan as on March 31, 1986 (in Rs. million)

Deposits	Amount	Percent
Current	27,139	17.2
Interest Based Deposits	27,890	17.7
PLS Deposits	1002,646	65.1
Total	1057,675	100.0

31.The weighting scheme uses the weights for saving deposits as one. The weights for other kind of deposits are: notice deposits up to 29 days: 0.65; notice deposits up to 30 days or more: 0.75; Term deposits less than six month: 1.15; less than one year: 1.30; less than 2 years: 1.36; less than 3 year: 1.54; less than 4 year: 1.66; less than 5 years: 1.78 and over five year: 1.84. The weighting scheme assigns ascendingly increasing weights to term deposits of longer maturities. Zaidi (1987) recalculated the weights for each of these categories of deposits on the basis of interest rates prevailing just before Islamization in 1985 and found that the weights presently used are consistently lower than those reflected in interest rates (Zaidi, 1987, p.3). However, the available information is not sufficient to determine how the State Bank of Pakistan arrived at these weights in the first place (Zaidi, 1987, p. 68).

32.Islamic jurisprudence imposes a number of conditions on the validity of sale and purchase contracts. These conditions mainly pertain to the parties of the contract as well as to the goods which are being bought and sold. For example, it is required that buyers and sellers must be adult and sane. The goods must be pure, useful and in the ownership and possession of the seller. The price, the quantity sold, the quality of the good, its time and place of delivery all must be well specified and there should not be any ambiguity or vagueness of any kind with respect to any condition of sale/purchase. These and other conditions of a valid sale contract can be found in any standard book of Islamic jurisprudence. For example Syed Sabiq (not dated) *Fiqh-al-Sunnah* (Arabic), Vol. 3 Jeddah: *Al-Qiblah* Company for Islamic Culture, pp. 223-250.

Murabaha financing, originally being a contract of sale, must fulfill all the conditions of a valid sale.

33. Research Department of the Islamic Economics Center (1988), *Bay-`al-Murabaha* (Arabic), Cairo: Islamic International Bank for Investment and Development.

34. Under Secretariat of the Treasury and Foreign Trade, Government of Republic of Turkey, "Communique on Special Finance House" Article 1(a) Published in the official gazette of Republic of Turkey on 25-2-1984 No. 18323, reprinted by Al-Barakah Turkish Finance House (not dated), *Regulations and Communiques Related to Special Finance Houses*, p. 9.

35. However, it is argued in certain quarters that physical possession of goods is not required and acquisition of legal title to goods in question may serve the purpose. For example, the Council of Islamic Ideology in Pakistan in its report on the elimination of interest is on record as having said..." (it) would be sufficient for this purpose if the supplier from whom the bank has purchased the item sets it aside for the bank and hands it over to any person authorized by the bank in this behalf including the person who has purchased the item in question". See "Elimination of Interest from the Economy: Report of the Council of Islamic Ideology (Pakistan)" in Ahmed, Ziauddin. et. al. (eds., 1983) *Money and Banking in Islam*, Islamabad: Institute of Policy Studies, p. 118.

36. Islamic banks also open letter of credit when cost of transaction is fully covered by the client. The method of operation is as follows: The customer requests the bank to open a letter of credit to import goods from abroad. He deposits the cost of goods in full along with the commission of the bank by debiting his account. The bank makes all the necessary arrangement with its correspondent bank abroad to pay the exporter under advice the cost of goods against the receipt of the shipping documents. This is a straightforward on the spot transaction. In this case, the bank is functioning only as a commission agent and is not providing any credit.

37. Ahmad, Ausaf *op.cit*, pp. 45-47.

38. Shahadah, Musa Abdul Aziz, "Experiences of Jordan Islamic Bank", paper presented to the workshop on Investment Strategy in Islamic Banking jointly organized by the Islamic Research and Training Institute and the Royal Academy for Islamic Civilization Research, Amman, during 18-21 June 1987. Also reprinted in *Investment Strategy in Islamic Banking: Applications, Issues and Problems*, Amman: The Royal Academy for Islamic Civilization Research.

39. Shahadah, Musa Abdul Aziz, *op.cit*. p. 12.

40.Man, Zakariya, "Islamic Banking: The Malaysian Experience" in Ariff, Mohammed *op. cit*. p. 77.

41.Council of Islamic Ideology, "Report on Elimination of Interest From the Economy" in Ahmad, Ziauddin *et. al* (eds.) *op. cit*.

42. Ahmad, Ausaf *op. cit*. p. 20.

43. Sabiq, Syed, *op. cit*. p. 37.

44.These and other juridical details about *Musharakah*, *Mudarabah* and other contracts can be seen in: Sabiq, Syed, *op. cit*. pp. 327-332.

45.Sabiq, Syed *op. cit*. p. 330.

46. *Jordan Islamic Bank Law*, p. 5.

47. Shahadah, Musa Abdul Aziz *op. cit*. p. 11.

48. Al-Baraka Islamic Bank Sudan Brochure.

49. *Ibid*.

50. Man, Zakariya; *op. cit*. p. 76.

51.Ahmad, Ausaf, "Comparative Experiences of Islamic Banks: A Survey", paper presented at the seminar on `Financial Institutions in Accordance with the Islamic Laws' jointly organized by the Ministry of Finance, Government of Indonesia and the Islamic Development Bank in Jakarta, Indonesia, during September 17-19, 1990, p. 26.

52.*Iran Year Book* (1988), *op.cit.,* p. 256.

53.See Article 9 "The Law of Usury Free Banking 1983" in Iran Year Book (1988).

54. *Ibid*.

55. Zaidi (1988, p. 19). *op. cit.*

56.State Bank of Pakistan, Board of Directors' circular No. 37 dated November 2, 1982, quoted by Zaidi (1987, p. 89).

57.State Bank of Pakistan, Board of Directors' circular No. 13 dated June 2, 1984, quoted by Zaidi (1987, p. 92).

58.Al-Baraka Investment Company Brochure.

59.Man, Zakariya *op. cit*. p. 76.

60. Iranian banks have been empowered to undertake lease-purchase operations by article 12 of the "Law for the Usury Free Banking 1983" which states: "In order to create necessary facilities for the expansion of services, agriculture, industrial and mining activities, the banks may purchase movable and immovable property at the request of the client and his undertaking to hire-purchase the same for his own use, and place them at the disposal of the client in accordance with the hire purchase arrangement". See *Iran Year Book* (1988, p. 277).

61. Iran Year Book (1988, p. 257).

62. *Ibid*.

63. Khan, Abdul Jabbar (1985), "Some Thoughts on Non-Interest Banking in Pakistan - Concepts, Practices, Possibilities" (Mimeograph) pp. 13-14. Also see Zaidi (1987, pp. 25-26), *op. cit.*

64. See section 7-c(3) of the "Jordan Islamic bank for Finance and Investment Law No. 13 of 1978" in official gazette No. 2273, 24 Rabi Thani 1398H (1-4-1978).

65. Shahadah, Musa Abdul Aziz *op.cit*. p. 12.

66. "The Law of Usury Free Banking, 1983" in Iran Year Book (1988, p. 276).

67. *Ibid*. p. 225.

68. Faisal Islamic Bank of Egypt Brochure.

69. Article 7-b(1), "The Jordan Islamic Bank for Finance and Investment Law" No. 13 of 1978 in official gazette No. 2273, 24 Rabi Thani 1398H (1-4-1978).

70. *Iran Year Book* (1988, p. 257).

71. The other component of the lending mode of financing is loan with service charges which has been discussed in section 3.3.

72. Khan, Abdul Jabbar *op. cit*. p. 11.

73. Recommendations of the workshop on Investment Strategy in Islamic banking: Applications, Issues and Problems: jointly organized by the Islamic Research and Training Institute and the Royal Academy of Islamic Civilization Research held in Amman (Jordan) during 19-21 June 1987.

74. Central Bank of Iran, *Economic Report* 1984, p. 72.

75. *Iran Year Book* (1988, p. 256).

76. Central Bank of Iran, *op. cit*. p. 72.