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**ISLAMIC BANKS IN THE GCC COUNTRIES
CURRENT PRACTICE**

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January 1996

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**PROJECT SUBMITTED TO THE UNIVERSITY OF BAHRAIN
COLLEGE OF BUSINESS ADMINISTRATION
IN PARTIAL FULFILLMENT OF THE REQUIREMENTS
FOR THE DEGREE OF
MASTER IN BUSINESS ADMINISTRATION**

ABSTRACT

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The purpose of this academic study is to demonstrate the practical implementation of the concept of Islamic banks in the GCC countries. Many theoretical studies on Islamic banks have been conducted, but few of which deal with the actual implementation of the concept of Islamic banks. It is hoped that this research will highlight the applied aspects of Islamic banks in the GCC countries.

The sample which was taken in the study included three banks: KFH, BIB, and QIB. The methodology used in this research is a case study, because it enables the researcher to gather the information in different ways, whether by way of interviewing, observations or documents reviewing. The research illustrated the applied aspects in the following spheres: deposits, financing, investment, social role and the difficulties and obstacles facing Islamic banks. Finally, the financial performance of these banks was analyzed by using the financial ratios in comparison with the conventional banks operating in the respective country of each bank.

The findings of this study show that there is a similarity among the three banks in some aspects and dissimilarity in others. These banks are similar in the methods used in calculating the return on deposit accounts and the profit sharing ratio in financing. Yet they are different from each other in financing, deposits, the sole role they play and the difficulties and obstacles each of them faces. The financial analysis of these banks achieved growth rates exceeding that of other traditional banks during the period of the study, from

1983 until 1992. They also made good profitability levels and competed favorably with the conventional banks despite their new experiment and the limited size of these banks.

ACKNOWLEDGMENTS

I would like to extend my special gratitude to Dr. Jassim Abdulla, the supervisor of this study, who has given it a major part of his time and for his valuable recommendations and advice which have had a positive effect on completing this study.

I would like also to extend my appreciation to Dr. Sa'ad Al Mutawai' and Dr. Batool Asiri, readers of this dissertation, for the time they spent and the efforts they put in this study and for their observations which greatly helped me in compiling this research. Dr. Sa'ad has acted as the supervisor of this research during the supervisor's absence abroad, thus giving the research some of his valuable time. His advice and remarks positively helped in completing this thesis.

Special thanks should also go to every one of those who assisted me or contributed towards completing this research, particularly managements of Islamic banks which were covered in the study, for giving me their time and providing me with all information and data which I asked for. This information and data also contributed positively in completing this research. I also thank officials at the Ministry of Education who provided me with the opportunity to conduct this study, encouraged me and provided me with all facilities.

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LIST OF ABBREVIATION

ABK:	Al-Ahli Bank of Kuwait
AVG.:	Average Rate of Growth
BB:	Burgan Bank
BBK:	Bank of Bahrain & Kuwait
BCCI:	Bank of Credit and Commerce International
BIB:	Bahrain Islamic Bank
BKME :	Bank of Kuwait and the Middle East
BMA:	Bahrain Monetary Agency
CB:	Commercial Bank (Kuwait)
CBQL:	Commercial Bank of Qatar Limited
DIB	Dubai Islamic Bank
DBL:	Doha Bank Limited
FIB:	Fisal Islamic Bank (Bahrain)
GB:	Gulf Bank (Kuwait)
IAIB:	International association of Islamic Banks
KFH	Kuwait Finance House
NBB:	National Bank of Bahrain
NBK:	National Bank of Kuwait
QIB	Qatar Islamic Bank
QIIB:	Qatar International Islamic Bank
QNB:	Qatar National Bank
IAIB	International Association of Islamic Banks
UAE	United Arab Emirates
USA	United States of America

GLOSSARY OF ARABIC TERMS

Allah:	God
Amanah:	Trust & Safe Deposit
Bai Al- Ajal :	Instalment Sale
Fiqh:	Jurisprudence
Ijarah:	Leasing
Istisna':	Bargain Sale
Koran:	The Revealed Book of Islam
Mudarabah:	Commenda
Mudareb:	Capital Owner in Mudarabah Contract
Murabaha:	Mark-up
Musawama:	Bargain Sale
Musharaka:	Partnership
Qard-e Hasan:	Interest Free-Credit
Rabb-al-mal:	Provider of Capital
Riba:	Interest or Usury
Sadaqat:	Alms
Shari'a:	Islamic Law
Souk:	Market
Umma:	Muslim Nation
Zakat:	Compulsory Poor Due

CHAPTER ONE

CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION

The idea of interest-free banks based on the Islamic concept of profit and loss sharing gradually evolved during the last thirty years (Ahmad, 1987), leading to a fairly comprehensive model of banking by the early seventies.

The emergence of Islamic banks applied to modern business is a new trend. Whereas Conventional banking is based on utility, Islamic banking is based on the strict application of Islamic law which advocates the prohibition of paying and taking interest in all economic transactions. In their mobilisation of funds, Islamic banks operate under a system based on profit and loss sharing in all financial transactions (El-Ashker, 1987).

A bank is conceived, in the first instance, as a financial intermediary mobilizing savings from the public on the basis of Mudarabah and advancing capital to entrepreneurs on the same basis. The bank also offers a number of familiar banking services on a fee or a commission basis. The bank's own share capital also goes into the business of offering banking services and advancing capital on a profit-sharing basis. Profits received by depositors in Mudarabah accounts are, therefore, a percentage of banking profits which mainly accrue to the

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bank as a percentage of the profits of enterprises it finances. Deposits are also accepted in current accounts with a promise to pay on demand. No profits are allocated to these depositors from whom a service charge may or may not be realized. The bank is obliged to grant very short-term interest-free loans to the extent of total deposits in its current accounts (see Chachi, 1989).

The area of Islamic banking at national and international level is new, dynamic and in the process of evolution (Chachi, 1989).

The emergence of Islamic banks is a recent phenomenon. Although enough theoretical research has been undertaken on Islamic banking, not much empirical research is available on existing Islamic banks (see Ahmad, 1987).

1.2 RESEARCH PROBLEM

The research problem was that there was little information on the actual operational aspects of Islamic banks and its competitive position. Therefor, there are two key issues of this research which are:

1. To establish how management implement the Islamic banking concepts i.e. are they implemented in much the same way as other or there any significant differences?
2. To show how Islamic banks compete with Occidental banks.

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1.3 RESEARCH HYPOTHESIS

The main hypothesis of this study can be stated as follows:

1. There are no significant differences in implementing the Islamic banking system between Islamic banks in GCC countries.
2. Comparison between Islamic banks in GCC countries and traditional banks shows that there are no significant differences in their performance.

1.4 IMPORTANCE OF THE RESEARCH

The practice of Islamic banking has become a fast growing and widespread phenomenon. The transformation from traditional or conventional form of banking to a banking system that corresponds with Islamic principles and codes has generated a great deal of interest on the part of the public, academicians, government officers, and bankers outside the countries involved. One reason for this great interest might be that the process of Islamization of banks and banking would affect local traditional banks.

According to Ahmad, (1987) "Although the literature on Islamic banking has been growing quite rapidly during the past 10-15 years or so, however, most of the writings on Islamic banking are generally theoretical in nature and there is very little information on the actual operational aspects of Islamic banks. The annual reports of various

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Islamic banks, newspapers, news magazines, and reports on Islamic banking, which are published from time to time, are the sole sources of such type of information. However, they are not analytical enough in their nature”.

About 20 percent of the world's population is Muslim (Wilson, 1990), many of whom are devout. They would prefer to be sure that their financial affairs are in line with the precepts of Islam and wish to earn legitimate profits. Here lies the opportunities for Islamic banks, both in mobilising and utilising funds. They are competing with conventional banks to attract deposits from Islamic-minded and interest-eschewing customers. It is important to analyse to what extent each of them succeed in competing with the conventional banks since Islamic banking is based on quite different concepts from those of conventional banks.

It is hoped that this study will contribute towards deepening our understanding of Islamic banking and will encourage other more extensive research works to be undertaken.

1.5 OBJECTIVE OF THE RESEARCH

The aim of this project is to identify current practices of Islamic banks and to analyse to what extent Islamic banks in GCC countries succeed in competing with conventional banks in there countries.

I was specifically interested in how the managements of Islamic banks go about achieving the successful implementation of the concept of

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Islamic banking, and how the financial performance of Islamic banks in the GCC countries compares with the financial performance of Conventional banks in each GCC country. The focus of this research is on deposit operations, financing operations, the basis of calculating the returns on the deposits accounts, the bases of calculating the profit-sharing ratio in finance, profitability, competition, and the difficulties and obstacles facing Islamic banks.

1.6 RESEARCH METHODOLOGY

The case study method was employed in this study because it has a wide range of research techniques that can be used in this research including interviews, document reviewing, direct observation. These case studies required 15 interviews with the banks concerned. The interviews were unstructured and they lasted between 60 and 90 minutes each.

A set of key financial ratios has been prepared to evaluate the performance of the above banks during the period of comparison.

1.7 OUTLINE OF THE RESEARCH

This study is organised as follows:

Chapter one is a general information on the research outline, importance and objectives. Chapter two provides an overview of the development of Islamic banking and to describe the methodology and

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general concepts of Islamic banking . Chapter three presents a summary of some available research projects and articles which are closely related to the actual operational aspects of Islamic banking.

Chapter four provides information on the research methodology, analytical techniques and sources of data.

Chapter five includes the research findings and analysis in terms of empirical study by using the case study methodology. This chapter is mainly designed to identify the current practices of KFH, BIB, and QIB in implementation of the concept of Islamic banks. It also compares the performance of each of these banks with that of local traditional banks in the respective country.

Chapter six includes the conclusion of the study.

1.8 RESEARCH LIMITATION

1. This study was limited to the three Islamic banks in the GCC countries and did not consider other Islamic banks in other nations.
2. The time period covered by this study (one year) is relatively short.

CHAPTER TWO

CHAPTER TWO

AN OVERVIEW OF ISLAMIC BANKING

2.1 INTRODUCTION

While prohibiting interest, Islam permits profit-sharing. The central requirement of an Islamic banking system is the replacement of interest with profit on real activities as a means of allocating financial resources.

The purpose of this chapter is to present an overview of the development of Islamic banking and to describe the methodology and the general concepts of Islamic banking.

2.2 DEVELOPMENT OF ISLAMIC BANKS

The first attempt to establishing an Islamic financial institution in the modern Islamic world began in Pakistan in the late 1950s with the establishment of a local Islamic bank in a rural area. The experiment was initiated by some pious landlords who deposited funds at no interest, of which credit facilities would be made available to small landowners for agricultural development. The borrowers did not pay interest on the credit advanced, but they were levied a small charge to cover the bank's operating expenses. The charge was far lower than the rate of interest. Although the experiment was encouraging, two main

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factors were responsible for its failure to survive. First, the deposits made were regarded by (landlord) depositors as once-and-for all deposits. With the increasing number of borrowers the gap between credit available and credit demanded was huge. Second, the bank staff did not have complete autonomy over the bank's operations; depositors showed considerable interest in the way their money was lent out. with the shortage of funds and the problems of recruiting bank staff the experiment collapsed. Outstanding loans were paid back to depositors through bilateral agreement, without financial intermediation, and they were mostly repaid by the early 1960s. (El-Ashker, 1987).

Wilson, (1983) pointed out that the second attempt began in Egypt in 1963 with the establishment of the Mit Ghamr Savings Bank in a rural area. The Mit Ghamr soon prospered, and within three years the 1000 founding depositors had been joined by a further 59000. No interest was paid on deposits but, in order to receive an interest free loan, a borrower had to have a certain minimum sum in a savings account for at least a year. Thus there was some financial motivation to deposit funds, as depositors and borrowers belonged to the same group, unlike in Pakistan. Loans were used for a variety of purposes, including house building and repairs, the purchase of simple machinery for handicrafts

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industries, such as hand looms for weaving textiles, or even simple sewing machines.

According to Chachi, (1989) the Mit Ghamr was so successful that it would have covered the whole of Egypt by now, if it has not been stopped for political reasons outside its control. It came to an end in February 1967 after only three and a half years during which problems of rural indebtedness were reduced in the areas where this bank and its branches were operating. Soon afterwards many Islamic social, developmental and commercial banks started doing business following the example of Mit-Ghamr Islamic Savings bank with some improvements. The first of such banks is the Nasser Social Bank established in 1971 in Egypt, not as profit oriented institutions but as a social bank to serve the previously "unbankable" low income group; followed by the Islamic International Development Bank (IDB), an intergovernmental institutions established in 1975 in Jeddah (Saudi Arabia), with the purpose to foster the economic and social development of its member countries, and by the Dubai Islamic Bank (DIB) in Dubai (UAE) in 1975, the first major project of Islamic commercial bank, the success of which led to the establishment of a series of such banks elsewhere.

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As pointed out by Khalaf, (1995) The industry now has more than 100 banks and finance houses. Interest is banned in the banking systems of Iran, Pakistan and Sudan.

According to Allen, (1995) the total assets of Islamic financial institutions, they proclaim, have gone from nothing to between \$80bn and \$120bn in 20 years.

2.3 UNDERLYING CONCEPT OF ISLAMIC BANKING

The Islamic banking system can only be operational under two fundamental principles: namely the prohibition of interest, and the introduction of profit and loss sharing schemes and other types of finance. Thus if interest is ruled out, it does not mean that Islamic banks are no more than non-profit organizations. On the contrary, according to the risk reward trade off, the yield in a profit-sharing arrangement is, naturally, a legally accepted return in the Islamic economy (Chachi, 1989).

As pointed out by Chachi, (1989) that " Among those who excluded banking interest on deposits from Riba and considered it as permissible,

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Shaltout, Yusuf Ali, Khallaf, Dawalibi, Sanhuri and El-Fanjari. They argued that interest from bank on deposits is not Riba because the bank did not go to the depositors to borrow from them but it is the depositors who went to the bank and deposited their savings with it. They further argued that the interest given to depositors is not predetermined by the latter, as the lenders do in the case of Riba, but by the bank and so it represents the profit share of depositors in the bank's profit and is just like Mudarabah profit. Others like Dawalibi, distinguished between interest on consumption loans and interest on production loans and argued that Riba is concerned only with the former because in the case there is an exploitation of the need of the poor who need to be helped rather than oppressed. As for the interest on productive loans, they saw no objection in charging a so called 'fair and moderate rate'. Some others, like Sanhuri argued that what Islam prohibits is excessive compound interest and not moderate simple interest. They allow interest because they think it is the only way necessary for mobilizing savings for development".

Khan, (1983) pointed out that " another difficult issue involves the distinction between real and nominal returns on bank savings accounts. It was explained how the inflation may be unfair in its effects on the

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depositor, where there is no interest allowed. Indexation has been put forward as a solution to this problem. Indexation has also been advocated in the West as a means to minimize the inequities of inflation and to reduce it by changing it by changing expectations. Minimizing the uncertainty attached to inflation reassures creditors, and the functioning of long term capital markets is improved. Indexation, however, has not found ready acceptance among Islamic scholars. their stand against it is mainly premised on the lack of approval by Islamic jurists of Indexation. This opposition may be due to the negative view of hoarding in Islam, which funds forwarded to saving accounts (rather than for investment) closely resembles”.

According to Chachi, (1989) “there seems to be a general consensus among contemporary Muslim scholars that all forms of predetermined interest on loans and deposits considered Riba and therefore prohibited. The Koranic prohibition of interest is in Koran 2:261-283, prohibits it categorically with the most sever condemnation by declaring war against those who take it, and clearly defines it as any gain over and above the principal lent, be it small or large. A distinction is made between interest from loan which is prohibited and sale which is permitted and a contrast is , once again, made between acts of Infaq

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(charity) and acts of Riba suggesting that it is the former rather than the latter which causes prosperity. As for the majority of Muslim scholars, the main reason why Islam abolishes interest is that it is injustice and exploitation. In the case of consumption loans, they violate the basic function for which Allah has created wealth that the needy should be supported by those who have surplus wealth. In the case of productive loans, predetermined and guaranteed return to capital is unjust in view of the uncertainty surrounding the business. The second reason is that it transfers wealth from the poor to the rich, increasing thus inequality by making the rich richer and the poor poorer. This is against social interest and contrary to the will of Allah who ordains justice and benevolence and forbids injustice and oppression. A third reason why interest is abolished is that it creates an idle class of people who neither work nor participate in bearing the risk of losses that might occur to the borrowers. If, instead of lending their surpluses, they have themselves invested them directly, they would not be certain of getting profits, they even might suffer losses, so why should they get predetermined returns on their lent capital?"

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2.4 BANKING OPERATIONS AND THE BASIS OF CALCULATING THE RETURN ON DEPOSIT ACCOUNTS AND PROFIT-SHARING RATIO FOR FINANCING

One area which should receive more attention from economists engaged in theoretical and empirical research on Islamic banking is the profit-sharing ratio. This is because it is this ratio which has to replace interest rate in a Riba-free economy and undertake the function of allocation of scarce investible resources.

Islamic banks offer their customers the choice of a number of different deposits accounts which are either interest-free or profit and loss-sharing based, depending on the purpose and commitment of the depositor and depending also on the security or risk involved in each of these types of deposits. Concerning the allocation of finance, Islamic banks may use a number of different methods of finance.

In this section, the sources and uses of funds of Islamic banks are discussed. We will focus on the determination of profit-sharing ratios.

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2.4.1. Deposit operations

Deposit taking is the major source of funds in Islamic banks as with conventional banks. Islamic banks currently offer, the following types of deposit accounts:

1. Current deposits:

These accounts are payable on demand, and the Islamic bank does not pay any return on these deposits and may charge fees, if necessary, for running and maintaining these accounts. Banks request the permission of customers to use their money so long as it remains held with the banks at their own risk. If any profits are generated from the use of money in the current accounts, they belong completely to the bank. Customers have the right to withdraw part or the whole of their amount at any time without notice and the bank guarantees to honor all demands.

2. Saving Deposits:

Depositors entrust their money to the bank and authorize it to invest their money. It can be pointed here that any return on funds is Islamically justified only if it participates in the risk. If the savings of

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depositors are guaranteed these amounts are refunded in full, if and when they want them, because they are not participating in the risk.

3. Investment Deposits

Investment deposits operated by Islamic banks are the counterpart of fixed deposits in conventional banks. Most Islamic banks accept funds for a specific period ranging from one month to 5 years. Generally speaking, depositors do not have the right to withdraw money held in this type of account.

Investment deposits are operated on the basis of Mudarabah. In this case, the bank acts as the "entrepreneur" (Mudareb) and the customer as the "provider of capital" (Rabb-al-mal). Both parties agree on the proportion in which profits are to be shared. So the bank acts as the agent manager, while account holders acts as the fund supplier.

2.4.2. The Basis of Calculating the Return on Deposits Accounts

The saving deposits are not Islamically entitled to any return. If the bank pays a portion of its profits generated from using saving deposits, this will be absolutely at the discretion of the bank and it must be treated as

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a gift. By contrast, some banks call this account a saving account with the authorization to invest it. Depositors are allowed to withdraw their savings, but profits are shared between the bank and depositor. The return could be calculated on the minimum monthly saving balance or on the average saving balance at a sharing rate lower, of course, than the sharing rate of investment deposits.

El-Ashker (1987) outlines the basis of calculating the return on deposit accounts as follow:

“The agent manager returns to the fund supplier (the investor) his capital and a previously agreed on share in the profit, while the agent keeps the remainder profit for himself as a reward for his labor and effort. In case there is no profit, the agent returns the capital to the investor, having forfeited his time and effort. If a loss is incurred, it is deducted from the capital, and the remaining capital is returned to the investor, and again the agent manager forfeits his time and effort”.

As pointed out by El-Ashker (1987), the allocation of profit between the agent manager and the capital supplier can be expressed as follows:

First: the agent manager participates by labor only:

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$$RG = E + M$$

$$RC = GP - (E + M)$$

where:

RG = the agent's share of profit for expenses and management

E = a portion of profit to cover expenses

M = a portion of profit for management

RC = the capital supplier's share of profit for capital

GP = gross profit

The expenses are calculated arbitrarily, using guidelines from the practice of merchants, which might vary from one trade to another. If accounting records are kept properly, the expenses can be calculated more accurately. In such cases the gross profit in the above equations is substituted by net profit taken from accounting records. Actual investment expenses are deducted from investment revenues and the actual net profit is used in the above calculations”.

As pointed out by El-Ashker (1987), Faisal Islamic bank of Egypt has emphasized the principles of the above relationship of distributing investment profits. The bank uses the following basis in the calculation of investment returns:

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1. Accounting records are kept in such a way as to distinguish between banking services activities, investment activities and commercial operations.
2. The bank, in its capacity as a Mudareb (agent manager), is entitled to a portion of the net profit of investment and commercial operations.
3. The net profit of investment and commercial operations is apportioned between investment accounts and the bank, according to the ratio between the value and duration of the investment account on the one hand and the financing contributed by the bank from its own resources.

Eligibility for profits differ from one bank to another. In Faisal Islamic Bank of Egypt, and Faisal Islamic Bank of Bahrain, profits are paid on a monthly basis, whereas in the Faisal Islamic Bank of Sudan and Islamic Bank of Dubai, profits are paid on quarterly and yearly basis respectively. In the Islamic Bank of Pakistan, profits are calculated on the points products methods.(see Chachi, 1989)

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Kabbara (1987), pointed out that the method of profit distribution as currently applied in the Islamic banks, with the exception of Pakistan, is not in favor of small or short-term savers. The banks argue that the calculation of profits for short-term deposits (e.g. less than a month) is tedious and costly. This allegation is not convincing and does not secure equitable treatment among savers who have the right to profits whatever their balances may be.

2.4.3. Financial Operations and the Basis of Calculating the Profit-sharing Ratio in Finance

Under the conventional banking system, personal or corporate loans are performed through a simple financing mechanism. The banks, acting as financial intermediaries, accept deposits from the surplus units and lend them to the deficit units. The profit of the bank is mainly attributed to the difference between the loan rate and the deposit rate.

Islamic banks differ greatly from commercial banks in their use of funds. They provide financing on the basis of the financial transactions permitted by the Shari'a. These financial practices include: Murabaha, Musharakah, Mudarabah, Deferred Sale, Ijarah, Lease Purchasing,

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Financing and social services. These financial operations are explained below (Ahmad, 1988):

1. Murabaha:

According to Bokhari, (1995) "Murabaha is a sale of goods at a specified profit margin. The term is used for describing a sale agreement where the seller buys the goods for the buyer and sells them on at a fixed price that includes a mark-up. The payment has to be settled within an agreed period either in installments or as a lump sum".

The contract normally caters for short-term financing requirement of clients through legitimate trading practices. Under this contract, an Islamic bank purchases goods, raw materials, equipment, machinery or any other items of economic significance from a third party at the request of a client and sells such goods to the client on spot or deferred payment basis at its own price. The difference between the purchase cost of the Islamic bank and the sale price to the client is the profit available to the Islamic bank from this transaction. After the Islamic bank and the client enter into such contract, the bank issues a letter of credit or any other relevant document ordering the purchase of the goods in question from the manufacturer or supplier for onward delivery to the client.

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The sale price, which is agreed upon in advance, is calculated as follows:

Purchase price (including cost of transportation)	****
Add: mark up	____ **
Sale price	****

According to El-Ashker (1987), calculation takes various factors into account, such as:

1. The profitability of the commodity; the higher the profitability the higher the mark-up.
2. The necessity of goods to the average consumer; mark-ups on alimentary goods (e.g. foodstuffs) are lower than those on other goods.
3. The amount of work involved; imported goods have higher mark-ups than locally purchased goods.

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4. The degree of risk involved; risk from buying goods abroad is higher than risk from buying locally.

El-Ashker (1987), pointed out that the average annual mark up rate for Faisal Islamic Bank of Egypt is between 10 and 15 percent, which is still lower than the 15 percent or more annual rate of interest in conventional banks on Egypt.

Pervez (1993) pointed out that since Murabaha entails fixed pre-determined rate of return to the Islamic bank, arguments have been raised as to its similarity with conventional interest. As will be observed from the following characteristics of Murabaha contract, an Islamic bank deals in goods and not in documents, and bears several risks until the contract consummation. Because it is tantamount to trading, the contract is an legitimate Islamic banking operation. The Murabaha contract has the following implications:

- a. The customer has the right to reject the goods should they not conform to the required quality.

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- b. The Islamic bank is not permitted to assign the benefits of and resources under manufacturer's warranty to the client if this should entail extra costs to the client. The Islamic bank is responsible for providing services under such warranty to the client and may, therefore, have to act as an intermediary between the client and may, therefore, have to act as an intermediary between the client and the manufacturer and/or supplier.
- c. The Islamic bank is obliged to provide the break-down of its cost and profit and all other expenses involved as are charged to the client under the sale price.
- d. Under the Murabaha contract, client only promises to purchase the goods and is not under legal binding to necessarily take their delivery upon arrival of goods at the port of destination. Although Islam requires that promises be invariably fulfilled, the client may have reasonable and justifiable excuse for refusal.
- e. The Islamic bank always obtains title to the goods before passing these on to the client.

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f. In countries where imports are subject to duties and taxes, the Islamic bank's profit is treated as a part of the purchase price and is, therefore, subject to such levies and taxes as are charged on imported items, which increases cost of import to the Client. This is because financing by Islamic bank is treated as trading and not generally recognized as 'debt'. Due to this problem, trade financing by Islamic banks with such countries, where import taxes and duties on imported are charged, has not developed satisfactorily.

Kabbara (1987) pointed out that the purchase price should be declared to the client especially when the bank succeeds in obtaining a discount or rebate. Since the mark-up is calculated on the net purchase price, any discount or rebate obtained has to be acknowledged and accounted for to the benefit of the client. This procedure is a strict adherence to Murabaha rules.

According to El-Ashker (1987), although the method, is in conformity with Shari'a, it is received with great caution by Islamic bodies. It is feared that the method might open the back door for dealing on a

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fixed interest basis; the mark-up which is determined by the bank might be a mere replacement for interest. The report of the Council of Islamic Ideology of Pakistan has restricted the use of this method to 'only inescapable cases', and has suggested that the mark-up should be observed by the State Bank of Pakistan in order to specify, review from time to time and vary the sub-sectors item for which banks may provide finance under this method as well as the profit margin applied. Moreover, Islamic banks, which apply this method in financing commercial and industrial enterprises, have the following argument:

1. Murabaha is not a risk-free operation, it involves a twofold risk:
(a) risk during the purchase transaction which incorporates physical losses, unacceptable quality, delivery delay, etc., which lie entirely with the bank, and (b) risk during the collection of debt, which might arise as a result of payment failure partly or entirely.
2. Banks undertake all proceedings prior to purchase, including inquiring, studying the market and choosing the best purchase offer. The client benefits from these services which he would

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have to undertake himself if he relied on fixed-interest finance.

3. The client is not in the same position as the bank in obtaining discounts from suppliers, either quantity discounts or payment discount. This makes the sale price offered by the bank to the client lower than the price the client would pay if he depended on Western style banking finance.
4. the mark-up is variable-based and takes into account various factors which are not considered in the interest finance.
5. The client benefits from the speed at which these transactions take place. Goods suppliers, particularly exporters, would be pleased to deal with Islamic banks in these transactions because they get paid quicker and without risk and it saves them from having to arrange trade credit themselves on behalf of their Islamic clients with their ordinary banks.
6. There is a great demand for these operations by clients, which suggests that the method is still cheaper than the fixed interest finance.

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2. Musharaka Financing

Musharaka (participation) is a form of joint venture between the bank and the client, a partner, where both participate in the capital and the client manage the business. The liability of both the bank and the client is limited to the amount of capital put into the business.

According to El-Ashker (1987), the basis of profit distribution between the bank and the partner is as follows:

1. The profit is defined as net profit after deducting all expenses, except any remuneration to the partner.
2. A portion of profit is given to the partner for his labor and effort.
3. The remaining profit is distributed between the bank and the partner in proportion to the capital.
4. In case of losses, these are distributed in proportion to capital.

The portion of profit is not an overall fixed percentage, but rather it varies from one Musharaka to another depending upon the amount of work involved and the level of expertise required from the partner.

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3. Mudarabah:

Mudarabah is very similar to Musharaka except that in Mudarabah the partner does not participate in capital in the joint venture. The bank provides all the capital and the partner provides his work and expertise. The profit from Mudarabah is distributed according to proportions determined in advance, while the loss is borne entirely by the bank. Ahmed (1987) pointed out that the rationale is that the capital provider is exposing his capital to business risk and that makes him entitled to a share in profit. Both parties have an equal position in the determination of ratio in which profits shall be shared between them. In case of loss, if the provider of capital suffers a reduction of his principal amount, the provider of labor is deprived of any reward of his labor, time and efforts.

The Islamic bank allows all costs of production including management expenses of the client himself and his labor as deductible expenditure. In addition, the client is permitted a fixed percentage of profit as fee for his labor, time and efforts. It is normally 15-30% of the profit (see Perves, 1993) depending on the

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extent and quality of technology, management efforts and expertise involved.

Pervez (1993) pointed out that Mudarabah remains to be a high risk financing mode. Although client has sufficient incentives to make the unit a success, he has no capital committed to the enterprise. Islamic bank, therefore, puts in extraordinary efforts to carefully scrutinize feasibility and projections provided by the clients using the most sophisticated credit risk evaluation, analysis techniques and criteria for its decision-making process. Following credit approvals, the Islamic bank takes necessary steps to guard, as far as possible, against completion and operational risks and such common causes of project failures, changes in regulatory risk factors, raw material shortages and ineffective marketing while it requires the enterprise to be managed to the highest standards to ensure that the projections are achieved. After the project's completion, the Islamic bank maintains strict check on operational risks such as the quality, quantity, availability and price of raw materials, changes in the regulatory and environmental conditions, productivity and effective output at desirable cost levels, adequacy of infrastructure and continued availability of qualified and skilled labor and managerial

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personnel. If required, Islamic banks may put a member on the client's board of directors to keep abreast of the developments taking place within the enterprise.

According to Kabbara (1987), the application of Mudarabah in financing current Islamic banking operations is very limited owing to the restrictions on Mudarabah transactions. These restrictions inhibit its wider application to cover many sectors in the economy. The argument for this is based on the terms and conditions applied in Mudarabah contracts. These are:

- a. The majority of jurists limit Mudarabah to trading activities, principally buying and selling;
- b. The entrepreneur has no right to commingle the Mudarabah funds with his own funds. However, the Mudareb can share in the equity of the Mudarabah venture.
- c. Before liquidation and distribution of profits, the Mudareb possesses an uncontested right not only to his share in the profits but also to any gains or appreciation in the value of output or assets of the joint venture that might occur during the

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life of the Mudarabah contract. Furthermore the determination of the partner's rights requires detailed calculation which is time consuming, especially if such an exercise has to be done several times a year. However, this is not, in itself, an obstacle, particularly when computerization is possible.

- d. The Mudarabah accounts must be recorded properly and audited independently, a rather dubious task especially for small businesses when the cost involved may be significant.

Kabbara (1987) suggests a broader definition of Mudarabah so that it may be applied in various economic activities by further research and thorough analysis. New instruments or alternative financing modes can be created to conform to Islamic principles. Islamic banking and finance is a new concept in many respects and it will not be impaired if new approaches are adopted, provided always that it serves the needs of modern societies, and concurrently it is in compliance with Shari'a.

4. Deferred Sale:

Islamic banks finance trade on the basis of deferred sale (Al-Bai-Al-Ajal). The bank agrees to sell a certain commodity on a fixed price

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for a limited period and delivers the commodity to the client and has control of the commodity. The price charged by the bank includes the cost of commodity to the bank and the bank's profit margin. After the expiry of fixed period the client should pay the agreed price. However, the bank may allow the client to pay by installments in any mutually agreed manner.

5. Ijarah:

Under this mode, Islamic banks acquire certain assets such as machines, buildings, or equipment and allow customers to use them for a certain period, at an agreed price. This is known as "leasing". The terms of lease are decided by mutual consent.

6. Lease-Purchase Financing

The bank acquires an asset and leases it to the client. The client undertakes to deposit agreed capital installments over a definite time period, into a saving account with the bank. With an authorization to invest, the profits accrued may also be credited to the saving account. The contract is terminated when the full price is paid and ownership is transferred.

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7. Social Services of Islamic Banks:

Social services are considered an integral part of Islamic banking operations. These services may be classified into three main areas: benevolent loans (Qard-e Hasan), overdrafts, collection and distribution of the Zakat fund, Sadaqat (donations), and finally the preservation of Islamic culture and heritage.

8. Guarantees, Transfers and Collections:

These services include performance bonds, letter of guarantee, letters of credit, traveler's cheques, money transfers, foreign exchange transactions, safe deposits, etc. An Islamic bank may collect a service fee corresponding to the exact expenses incurred by the bank on the services rendered.

CHAPTER THREE

CHAPTER THREE

LITERATURE REVIEW

3.1 INTRODUCTION

Although the literature on Islamic banking has been growing quite rapidly during the past 10-15 years or so, however, most of the works and writings on Islamic banking are generally theoretical in nature and there is very little which provides information on actual operational aspects of Islamic banks. This chapter presents a summary of some available research projects and articles which are closely related to the actual operational aspects of Islamic banking.

3.2 RESEARCH IN THE ACTUAL OPERATIONAL ASPECTS OF ISLAMIC BANKING

I have chosen to describe in this section two studies related to the actual operation aspects of Islamic banking as follow:

1. Ahmad (1986) “Development and Problems of Islamic Banks:

The purpose of this study is to study the business operations of Islamic Banks and bring out their performance. The data collected by basically by a mail-questionnaire technique. The sample included 8

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Islamic banks from 6 countries (Jordan Islamic bank, Faisal Islamic Bank of Egypt, Islamic Bank of Western Sudan, Tadamon Islamic Bank, Qatar Islamic Bank, Islamic Bank International-Denmark, Islamic Bank-Bangladesh, Sudanese Islamic Bank). Out of which 3 Islamic banks were from Sudan alone. Major findings are described below:

The number of accounts in these Islamic banks increased rapidly. The rate of increase was quite in the initial years and slowed down in later years. Eight different types of deposit accounts were found to be handled by various Islamic banks these are current account, saving account with authorization to invest, saving accounts without authorization to invest, investment account with fixed period, investment account with unlimited period, specified investment account, charitable investment account, and profit and loss sharing short notice deposit account.

The structure of deposits has also undergone significant changes in Islamic banks. The relative significance of current accounts has declined and that of investment accounts has increased. The distribution of total finance amongst the financing techniques show

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that Murabaha, Musharakah, and direct investment seen to be more popular among the studied Islamic banks. The finance provided under Mudarabah is very low.

The sectoral distribution of finance suggest that most of the finance goes to the trade sector. Agriculture and small scale industry is very little finance of Islamic banks.

This study has been concerned also with the main problems of Islamic banks. Special mention has been made to expansion and regional diversification. diversification of investment, excess liquidity, exchange of deposit, deposit mobilization by Islamic banks, penalty clause for delay of payment.

2. Chachi (1989), "Islamic Banking":

This Ph.D. dissertation in University of Wales aims to show that interest is not a necessary component of banking, as was widely held before, and that Islam, by prohibiting interest and permitting profit and profit sharing as alternatives, is not an obstacle to, but a promoter of, economic growth and development with social justice.

This study also attempts to distill and refine the theoretical bases of

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Islamic Banking. It critically surveys and discusses the different theories that have been advanced to justify interest and profits and compares the functions and institutions of the Islamic financial and banking systems with their interest-based counterparts. It also discusses the likely impact of the profit and loss sharing (PLS) system, and empirically analyses the performance of some of the oldest Islamic Banks vis-a-vis the performance of the interest-based banks of the same countries. The conclusions that may be drawn from this study are:

1. Islamic banking is only a tiny part of the Islamic Economic system which is itself a tiny part of the comprehensive Islamic way of life stipulated by the sources of Islam namely the Koran, the Sunnah and the Ijthad of Muslim scholars. This is different from all the other ways of life or economic systems such as capitalism or communism.
2. Although a great number of theories were advanced in order to justify interest on loans and profits from sales, none of them is free from flaws and criticisms and none has explained exactly why interest or profits should be paid. It is argued in this thesis that no

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theory can succeed in justifying interest which is an unnatural predetermined return on loans (the exchange of present money or of a commodity against a future greater money or commodity of the same kind). It is also argued that although the advanced theories of profits did not also escape criticisms, an attempt is made in this thesis to explain profits with what is called: the 'Theory of Sale Residual' (TSR). This attempt has tried to explain why Allah has prohibited interest and permitted sale. Besides, it is contended that it is quite possible to run a developed economy without recourse to interest but no economy can go beyond the subsistence economy if profits from sale is not allowed. Profit is thus, justified on the basis of sale (the exchange of goods and services against money) since without sale there would be no profit no matter how much risk, uncertainty, advantages, superintendent, etc., are involved and since sale is the incentive that encourages investment, employment, production and consequently progress and development.

3. The empirical analyses undertaken showed that Islamic banking is more appropriate and more relevant to the economic growth, and development of the Muslim World. Despite the fact that they

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are operating in hostile and non Islamic environments, the existing Islamic Banks have managed to mobilize substantial amounts of deposits and contributed greatly to the finance of many economic sectors and projects of the countries they are working in.

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3.3 Articles in the Actual Operational Aspects of Islamic Banking

I have chosen to describe in this section five newest articles related to the actual operation aspects of Islamic banking as follow:

1. Khalaf, (1995) "Consensus still sought on important issues"

In her article she pointed out that in three decades Islamic banking has grown into industry with between \$50bn and \$80bn in deposits. The industry now has more than 100 banks and finance houses.

In practice, however, Islamic banks were soon faced with the sober realization that depositors, however religious they may be, had little taste for risk-taking and were not likely to stick with an institution that invested their funds in money-losing projects. As a result, instead of investing in long-term development projects, Islamic banks have been forced to mirror conventional banking's fixed rate products which provide a pre-determined rate of return in a short-term. At the same time the market pressures are now forcing Islamic banks to reconsider their focus on short-term projects. Two reasons lie behind the shift. The first is that as the market expanded and newcomers to the industry multiplied, conventional banks began offering Islamic banking products, which widened depositors' choice and made them

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demand higher returns. The second is the drop in interest rates (although Islamic banks do not deal in interest, the mark-ups charged are directly linked to market interest rates) has lowered returns for the Islamic bank and the western arranger of commodity trade deals.

The trend towards long-term projects, however, has forced Islamic banks to face up to several problems. The first is the dearth of Islamically-correct products. Another problem facing the industry is that while going long-term on investments, deposits remain for the most part very short-term. This creates a potential mismatch of assets and liabilities, compounded by the fact that the long-term products are not securities and there is no inter-bank market to help fund daily liquidity.

2. Khalaf (1995) “Islamic Banking - International Expansion”

In her article she pointed out that, a few years ago, foreign bankers involved in Islamic banking treated it like a secret, avoiding any public discussion of their role in the market. Today, the same western bankers are eager to talk, and, in particular, to tell how different they are from the competitor next door. The involvement of foreign banks in the industry date back to the early 1980s, when funds began to accumulate in Islamic banking institutions in the Gulf.

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Because depositors left their funds in short-term current accounts, the Islamic banks had to invest this liquidity in short-term instruments while at the same time circumventing interest. Since they lacked contacts and experience, they turned to western institutions to find homes for their money. The western banks were quick to accommodate this demand. Since the Islamic banks paid little or nothing at all to depositors in the early days, they were a cheap source of funds for western institutions. The western bank acted as intermediary, mostly in commodity trading deals. In return for a fee, the western bank would arrange for a trader to buy goods on the Islamic bank's behalf and resell it at a mark-up.

Islamic funds, however have gradually become more expensive, causing western banks to re-adapt their role. As the Islamic depositor became more sophisticated, he demanded a higher return on his funds, thereby squeezing the Islamic bank's margins. At the same time, more and more foreign banks went chasing after Islamic funds, although the numbers remain relatively small. About 10 percent of Islamic funds are estimated to be channeled through western banks. This has led western banks to encourage Islamic banks to enter into longer-term deals with wider margins.

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There are now three types of Islamic banking products in which western banks are involved:

- One-off transactions where western banks originate deals and Islamic institutions take the risk;
- Deals where Islamic banks appoint western banks to undertake commodity transactions on their behalf and where the western bank guarantees the principal and profit to the Islamic bank;
- Islamic fund management, where western banks raise the funds and act as fund managers.

with increased competition, western institutions involved in Islamic banking are now trying to distinguish themselves through various marketing gimmicks, the tailoring of new and more sophisticated products for the Islamic banker, and the provision of a liquidity mechanism that allow Islamic banks to get back their funds within a reasonable time frame. Citibank, for instance has sought to show its commitment to the industry by planning to open a fully-fledged Islamic bank in Bahrain and thus attract deposits directly.

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3. Whittington, (1995), "Islamic Banking Regulation"

In her article she pointed out that Islamic banks can pose presentational difficulty to regulatory authorities in the Moslem world, especially in the Middle East and Gulf. Taken to its extreme, if one bank is recognized as an Islamic institution then all others, by implication, can be considered unIslamic. An example of this difficulty with semantics can be seen in Saudi Arabia where the ruling family's legitimacy is based on its Islamic credentials but the economy and banking system is managed along western practices. Despite the fact that the two largest Islamic banking groups, Dar al Mal al Islami and Dallah al Baraka, are owned by prominent Saudis, they cannot obtain a license to work in the Kingdom. Conventional banks are forced to report interest income as "special commission income" and the only commercial bank which actually operates along Islamic principles in the Kingdom, Al Rajhi Banking and Investment Corporation, conspicuously leaves out the word Islamic from its name to avoid embarrassing its competitors. With the notable exceptions of Iran, Pakistan and Sudan, where the whole banking system tries to operate along Islamic lines, most monetary authorities have shown little interest in helping develop an indigenous Islamic

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banking network with its own set of regulations-although few are as uptight as Saudi Arabia is. This poses a dilemma for Islamic bankers who argue that the special nature of their operations contradicts the rules governing the operations of interest-based banks.

Despite the large amounts of Islamic financing which goes on in the Gulf, only Bahrain appears to be taking into account the special needs of Islamic bankers. It already has the highest concentration of Islamic financial institutions, albeit mainly off-shore, and the most recent additions is a wholly-owned Islamic bank being set up by Citibank. The Bahrain Monetary Authority has Shari'a Advisers to help with the auditing of the banks and a new regulatory system is being worked out to take into account the characteristics of Mudaraba, Musharaka and Murabaha.

4. Allen, (1995) "Islamic Banking In the Gulf"

In his article he pointed out that the total assets of Islamic financial institutions, they proclaim have gone from nothing to between \$80bn and \$120bn in 20 years. The total assets of Islamic banks in the GCC countries were 30bn. Demand for Islamic asset-backed financing from GCC member banks is growing, particularly in the

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other Moslem countries in the Middle East and Asia which are Gulf banks' natural markets. Al-Rajhi is by far the largest Gulf Islamic bank in terms of assets, although it does not have a large international presence. KFH is second-largest in terms of assets. It is majority owned by the Kuwait government. Most of KFH's operating income comes from traditional Murabaha trade financing, Istisna and Ijarah. Like KFH, Dubai Islamic Bank is the offspring of the trading acumen of the city state that is its home. It is majority-owned by the prominent Lootah family.

5. Cooke, (1995) "Islamic Banking In Malaysia"

In his article he pointed out that to some in the Moslem world, Malaysia is at the forefront of Islamic banking. It has had an Islamic banking system in operation for more than 20 years. It offers a variety of Islamic financial instruments. Islamic institutions are actively involved in Malaysia's stock market, the biggest in south-east Asia. In 1983 parliament passed the Islamic Banking Act to form Bank Islam Malaysia (BIM), primarily to offer Moslems with reservations about conventional banking the opportunity to participate in the growth of the country's financial system. Today BIM, majority government owned, has more than 70 branches throughout Malaysia. This year its pre-tax profit rose 40 per cent to

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US\$23M. BIM's deposits and assets now stand at about US\$1.12bn and US\$1.27bn respectively.

BIM has been a world pioneer in introducing a comprehensive range of Islamic financial instruments: In 1983 Malaysia became the first country to issue government bonds on an Islamic basis. In 1985 BIM set up Syarikat Takaful Malaysia, the world's first Islamic insurance company. The Issuance of Islamic corporate bonds started in 1990 while the introduction of Islamic Acceptance Bills and the launch of an Islamic export credit refinancing facility followed soon after.

In 1993 Malaysia took a further pioneering step when it introduced its dual banking system, with conventional banks being allowed to offer service based on Islamic principles. Today, more than 30 commercial banks, merchant banks, finance companies and co-operative banks in Malaysia offer Islamic banking services. Some are domestic banks majority-owned and managed by non-Moslems. Others, like Standard Chartered are foreign institutions.

CHAPTER FOUR

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RESEARCH METHODOLOGY

4.1 INTRODUCTION

The aim of this chapter is to explain the methodology used in conducting the research.

4.2 RESEARCH SAMPLE

The scope of the research covers the following Islamic banks in the GCC countries:

1. Kuwait Finance House (KFH)
2. Bahrain Islamic Bank (BIB)
3. Qatar Islamic Bank (QIB)

State of Kuwait, State of Bahrain, and state of Qatar were chosen as a sample for this study for several reasons:

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1. They are Islamic countries and their constitutions declare that the Islamic Shari'a (law) is the main source of legislation.
2. They have relatively similar income level.
3. They follow a liberal economic policy.
4. No comprehensive analysis of an Islamic bank has been conducted to study the implications of abolition of interest with reference to a particular Islamic country.
5. The chosen countries are located in the same region in order to avoid political factors that may affect the performance of those banks.
6. Islamic banks in Gulf countries are the most successful Islamic commercial banks. KFH is the most successful of all Islamic banks in terms of local market penetration, with 14 branches, accounting for almost one-fifth of all bank deposits in Kuwait. KFH now ranks fourth in the market after the Commercial bank of Kuwait, The Gulf bank, and Al Ahli bank (see Wilson, 1990). The BIB has been almost as successful, in an admittedly much

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smaller retail market. It operates with three branches and accounts for around 16 percent of total deposits. QIB is more profitable than Dubai Islamic Bank (DIB) and BIB the oldest Islamic banks in the GCC countries (see Zuwied, 1993).

4.3 RESEARCH HYPOTHESIS

The main hypothesis of this study can be stated as follows:

1. There are no differences in implementing the Islamic banking system between Islamic banks in the GCC countries.
2. " Comparison between Islamic banks in the GCC countries and traditional banks shows that there are no differences in their performance". This main hypothesis has sub-hypotheses. These are:
 - 1.No differences in their growth.
 - 2.No differences in their activity
 - 3.No differences in their profitability.

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4.4 DATA GATHERING METHODS

The case study method was employed because it has a wide range of research techniques that can be used in this research including interviews, document reviewing, direct observation. These case studies required 15 interviews with the banks concerned. The interviews were unstructured and they lasted between 60 and 90 minutes each. The case study methodology was chosen to find answers to WHY and HOW questions in this research. The interviews took place at the offices of officials of these banks during the business hours of the banks. However, in general respondents spoke fairly freely and often offered written confirmation of their views, in the form of company documents.

A set of key financial ratios has been prepared to evaluate the performance of the above banks during the period of comparison. As in the case with financial ratios generally, using ratios helps achieve two main objectives : avoiding misleading conclusions in the comparison which might result from comparing absolute amounts, and treating the problem of different sizes in the comparison. The purpose of using financial ratios in this project is to evaluate the growth, activity and

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profitability of three Islamic banks (KFH, BIB, and QIB) compared with that of the non-Islamic banks in corresponding country.

For convenience of analysis, the ratios have been divided into three groups to examine various aspects of financial performance. Comments on the ratios will be directed to each group at a time. Group 1: examine the growth of each Islamic bank in total assets, total deposits, and total finance comparing with the other traditional banks in the same country. Group 2 : The ratios examine the overall activity of the bank. The first ratio - Total Deposits/Total Assets- examine how effective the bank is in attracting relatively high deposits in relation to their total assets. The second ratio -Total Finance/Total Assets examine how effective the banks are in providing finance in relation to their finance capacity. Group 3: The ratios examine the overall performance of the banks. The first ratio - Net Profit/Total Assets which is the rate of return on capital employed, reflects the overall earnings capacity of the bank in relation to its total assets. The second ratios - Net Profit/Total Equity reveals how rewarding the bank is to its owners.

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The necessary financial data were collected from the published annual reports of these banks and through the publications of the Institute of Banking Studies in Kuwait.

4.5 ADVANTAGES AND DISADVANTAGES OF THE CASE STUDY AS A RESEARCH METHODOLOGY

According to Yin, (1989), the case study's unique strength is its ability to deal with a full variety of evidence- documents, artifacts, interviews, and observation. Moreover, in some situations, such as participant-observation, informal manipulation can occur. The case study allows an investigation to retain the holistic and meaningful characteristics of real-life events- such as individual life cycles, organisational and managerial processes, neighbourhood change, international relations, and maturation of industries.

As pointed out by Yin, (1989), Although the case study is a distinctive form of empirical inquiry, many research investigators nevertheless have disdain for the strategy. The case study viewed as a less desirable form of inquiry than either experiments or surveys. This is because:

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1. Lack of rigor of case study research due to the biases of both the supplier and the recipient of the information. Not only are there problems in capturing data from witnesses, but there is also the problem of reading data subjectively after it has been written. Remenyi, (1990) pointed out that bias is everywhere, but it may be minimised, and clearly it is the primary function of the researcher to minimise the bias level in which he/she is working.
2. The case studies provide very little basis for scientific generalisation. It is difficult to generalise from a single case. Yin, (1989) argue that case studies, like experiments, are generalisable to theoretical propositions and not to populations or universes. In this sense, the case study, like the experiment, does not represent a "sample" and the investigator's goal is to expand and generalise theories (analytical generalisation) and not to enumerate frequencies.
3. They take too long and result in massive, unreadable documents. This complaint may be appropriate, given the way case studies have been done in the past, but this is not necessarily the way case studies must be done in the future.

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4.6 CASE STUDIES AS A RESEARCH METHODOLOGY

4.6.1. Definition of a Case Study as a Research Methodology

Yin (1989) states that " a case study from a research strategy point of view may be defined as an empirical inquiry that investigates a contemporary phenomenon and the context is not clearly evident, and in which multiple sources of evidence are used. It is particularly valuable in answering who, why and how questions in management research.

The case study can focus on the description of the process, or sequence of events in which the behaviour occurs, the study of individual or group in its total social setting, and comparison of cases leading to formulation or the confirmation of hypotheses.

However, it is important to bear in mind that the case study methodology is not designed to measure the frequency of occurrence of events, but rather to support or reject theoretical propositions.

4.6.2. Case Study Evidence

The case study methodology implies comprehensive and intensive study of the subject. Thus, thoroughness is one of the first prerequisites.

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Facts must be ascertained from the enterprise or enterprises being studied and then carefully interpreted. These may be obtained from documents, archival records, interviews, observations of the investigator, participant-observer interactions, as well as physical artefacts. However, information must be very carefully weighted, tested and sifted to eliminate fictitious and false statements, as well, where possible, personal rationalisations.

Case studies can rarely be perfectly objective due to the biases of both the supplier and the recipient of the information. Bias is everywhere, but it may be minimised by the process of triangulation. This involves a number of distinct activities. Firstly multiple sources of evidence should be sought to support all important assertions. Secondly through obtaining corroborative evidence from several different individuals in the firm. Finally, on the issue of bias, it is naive to assert that any form of research, or perhaps human activity generally, is without bias. Even in the pure sciences the researchers bias is reflected in the subject researched, the experiments chosen, as well as the way the experiment is conducted. As the form of the case study is primarily narrative, accurate description is essential. All relative facts must be included, and circumstances having no bearing on the situation should be omitted.

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There should be a logical sequence as well as continuity and cohesion through the narrative. Although simple language must be used where possible, terminology which has become accepted in the field being studied may be incorporated (see Remenyi, 1990)

4.6.3. The Formality of the Case Study Research Methodology

Yin (1989) states that, the case study methodology is often mistakenly thought to be rather informal. This is because it is confused with case writing from a teaching-learning point of view. In fact, the case study research strategy methodology requires a distinctly formal approach. Before the research can proceed a protocol must be drawn up. The protocol is a formal and detailed master plan for the research. It is a document in which full details of the case study research design, as well as details of the questions to be asked, field procedures for the researcher, details of all types of evidence required, as well as the structure of the final research must be specified. A protocol is a major tactic in increasing the reliability of the case study procedure and should have the following sections.

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1. An overview of the case study project: This include the objectives, key issues of the research as well as the interview schedule used to collect data during the case study unstructured interviews.
2. Field procedure reminders etc.: Field procedures need to emphases issues such as:
 - Defining who should be interviewed
 - How to access to the right people
 - Having adequate resources available including time, paper, tape recorders etc.
 - Developing a procedure for discussing the research with other researchers.
 - Making a schedule of the required data collection activities providing for contingencies
3. Case study questions: At the centre of the protocol is a set of questions reflecting the actual inquiry. There are two characteristics which distinguish such a set of questions from those used in a survey. Firstly, the protocol questions are actually set for the investigator and not for the respondent. The questions are in reality reminders or prompts to the investigator concerning the information

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which has to be collected. Secondly each question should be accompanied by a list of probable sources of evidence which cover interviewees comments, documents, artefacts and observations.

4. Guide to what is required for the case study report: The guide to the case study report forces the investigator to think about the audience for which the case study is intended early on in the case study process. The investigator should be concerned throughout the study with the design of the final report. An outline of the case study report should be included in the case study protocol. This protocol should also indicate to what extent documentary evidence will be used in the final report. Case studies often produce large amounts of documentation. These papers may be used to produce an annotated bibliography. These annotations might be helpful to readers in suggesting what is available for further research.

4.7 THE PROJECT PROTOCOL

The following is a list of the main reminders that has been developed for this research

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4.7.1. Objectives of the Research

The main objective of the case study research is to obtain evidence as to how the managemnts of Islamic banks go about achieving the successful implementation of the concepts of Islamic banking, and how the financial performance of Islamic banks in the GCC countries compares with the financial performance of Occidental banks in each GCC country through the use of annual reports, documents, and a series of unstructured interviews which will allow informants the opportunity of supplying information on a wide range of issues related to the banking activities.

It is intended to allow the informants as much freedom in the interview as possible as it is critical to ensure that the interviewer does not prejudice in any way the evidence which the informants will offer. Nonetheless, a list of possible discussion topics which the interviewer may use as an interview schedule has been developed. These topics are available to prompt the interviewer if the discussion requires some prompting or guidance.

4.7.2. Key Issues of the Research

There are two key issues of this research which are:

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1. To establish how management implement the Islamic banking concepts i.e. are they implemented in much the same way as other or there any significant differences?
2. To show how Islamic banks compete with Occidental banks.

4.7.3. Interview Schedule

The following is the interview schedule used to collect data during the case study unstructured interviews:

1. Has a generic corporate strategy been formulated and implemented?
What is the mission? Objectives? Key success factors?
2. What type of deposits are operated? How are they implemented?
What is the basis of calculating the return on deposits accounts?
3. What type of financial operations are operated ? How are they implemented? How are the profit-sharing ratios for each of them determined? How is the portfolio diversified? What is the structure of finance provided by the bank?

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4. Why is Mudarabah finance not used? Why is Murabaha finance used as the main source of financial operations?
5. What are the advantages offered by Islamic banks for their clients over the Occidental banks.
6. What is the social role played by Islamic banks?
7. How does each bank compete with Occidental banks in the same country?
8. What are the main difficulties and obstacles facing Islamic banks?

4.7.4 Field Procedures

The following is the field procedure reminder list for this study:

1. At the outset, five informants should be found in each case study.
This triangulation is for purposes of data validation.

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2. At least one informant per bank should be a senior manager. i.e. an individual who is either a member of, or reports directly to, the board of directors.
3. Access to informants should be obtained wherever possible by introduction through a trusted intermediary.
4. Initial contact with the respondent bank should be at the highest level possible.
5. A friendly gatekeeper or guide should be found as soon as possible.
6. Interviews should be tape recorded
7. Documentary evidence should be sought to support verbal information supplied.
8. An attempt should be made to secure multiple interviews per site so as to reduce travelling time.

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9. Attempt to interview informants in their office rather than in interview rooms.

4.7.5 Case Study Report Guidelines

The following are the major headings which were established as the key focal points of the case study reports. These were established early on the research process so that they could be used as a supplementary aided memory for the researcher in conducting unstructured interviews with informants:

1. Introduction and general background of the bank.
2. The mission
3. The objective
4. The corporate strategy
5. Bank operations
6. Bank performance
7. Bank difficulties and obstacles
8. Conclusions

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4.8. CONCLUSIONS

In conducting this research a considerable amount of time and attention has been devoted to the issue of methodology because the author sees this as the cornerstone on which the credibility of the research stands.

The case study method was primarily used because it allowed the practice of Islamic banks to be examined in a holistic manner in a real life situation. Furthermore, the case study research strategy accommodates the belief in multiple methods of data gathering and data analysis.

CHAPTER

FIVE

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SUMMARIES OF THE CASE STUDIES

5.1 INTRODUCTION

This chapter describes how the case study research was conducted. It also provides the summaries and analysis of the three banks participating in the case study research.

5.2 WORK CONDUCTED IN COLLECTING THE CASE STUDY EVIDENCE

In conducting the three in-depth case studies, the researcher visited each firm at least four times. These visits were to collect evidence by means of structured and semi-structured interviews or discussions. The researcher met with an average of five executives from each bank. Several executives were interviewed on multiple occasions. The average length of the interviews was 60 minutes. The number of interviews conducted in KFH, BIB, and QIB was 6, 5, and 6 respectively.

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Although individuals were prepared to speak freely about their experiences, wherever possible documentary evidence was sought to support the information supplied by these executives. Most of the interviews were recorded using a tape recorder. The tapes were subsequently transcribed, edited and combined with various diagrams etc. into the documents in Appendices A, B, and C. The three banks did not review these case studies due to the limited time assigned to the research which is not enough to obtain permission. The researcher also felt that it would be unnecessarily difficult and cause delay if a written permission from these banks was obtained.

5.3 THE UNSTRUCTURED INTERVIEW SCHEDULE

The interviews or discussions were given only a minimal amount of direction by the researcher. The reason for this was to allow informants to select for themselves the issues which they thought were most important for the success of Islamic banks. As most of the interviews did not direct from the point, the interviews schedule was not always followed. However, the questions in the interview schedule were:

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1. Has a generic corporate strategy been formulated and Implemented?

What is the mission? Objectives? Key success factors?

2. What type of deposits are operated? How are they implemented?

What is the basis of calculating the return on deposit accounts?

3. What type of financial operations are operated ? How are they implemented? How is the profit-sharing ratios for each of them determined? How is the portfolio diversified? What is the structure of finance provided by the bank?

4. Why is Mudarabah finance not used? Why is Murabaha finance used as the main source of financial operations?

5. What are the advantages offered by Islamic banks for their clients over the Occidental banks.

6. What is the social role played by Islamic banks?

7. How does each bank compete with Occidental banks in the same country?

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8. What are the main difficulties and obstacles facing Islamic banks?

5.4 SUMMARIES OF THE CASE STUDIES

Details of the case studies are supplied in Appendix A, B, and C. And thus only a summaries of the situations are reported in this chapter as follow:

5.4.1 CASE STUDY 1: KUWAIT FINANCE HOUSE

KFH is a public shareholder company incorporated in Kuwait on 3rd Rabei Al-Akher 1397 Hijri (corresponding to 23rd March 1977 A.D). It began its operations on 31st August 1978. The KFH's initial authorized capital was KD 10m which was increased several times to become KD 42.4m in 1994 (KFH's annual reports for 1994).

Currently the Kuwait Finance House (KFH) is the first and only Islamic bank operating in the state of Kuwait. and is the largest Islamic commercial bank. It accounts for almost one-fifth of total bank deposits in Kuwait, the highest market share of any Islamic commercial bank on the national market.