CHAPTER I
THEORETICAL BACKGROUND OF ISLAMIC BANKING AND FINANCE

INTRODUCTION

Banking as a social institution has had its successes and failures. It has contributed enormously to the growth and development of modern industrial society. Large-scale production and capital formation would not have been possible without the financial assistance of the banks. Banks have performed an important role and have very successfully served the needs of society by channelising savings of people where they were needed. They have been in a position to offer the required funds through bank credit to businessmen for investment purposes. They have, in fact, played a dominant role in the distribution of the community's available financial resource among its various sectors, although it has not always been in the best interest of the community at large.

In the modern economic system, capital and enterprise based on interest occupy a key position. The whole banking system rests on interest. It is imperative that for the reconstruction of the economic system on Islamic pattern, an interestless banking system should be established and run successfully. There is a consensus of opinion among the Muslim economists on the point that even without interest, a banking system can be organized to discharge its all the usual functions performed by interest-based banking system. At present, Islamic banking (also known as participatory banking, banking without interest, or profit and loss sharing system) is considered as one of the latest developments in banking and financial organizations. Its presence is felt almost in every part of the globe. However, its major concentration is
roughly in four regions: South Asia especially the Subcontinent, Middle East including Egypt and Sudan, some Western Countries, and South-East Asia. Although short papers and brief studies are available that give some information about the existence and functioning of Islamic banking in various countries, need is felt to have comprehensive studies on different regions of its concentration. The present thesis is such an attempt. We intend to do an in-depth study of the fast growing movement of the Islamic banking and finance in the region of South-East Asia in general and Malaysia in particular, where it is playing a significant role in channelising idle savings into productive activities and financing development programmes.

Since the basic characteristic of an Islamic banking and financial system is the prohibition of payment and receipt of interest, it seems appropriate to first discuss the question of interest and its prohibition.

THE PERPLEXING QUESTION OF RIBĀ

A large number of questions, concerning the meaning and significance of ribā (the Qur'anic term for interest) have already been discussed by Islamic jurists and economists. This is not, however, due to any ambiguity in the Qur'an and Sunnah's (tradition of the Prophet Muhammad) verdict about it. That is clear and is reflected in the consensus prevailing among Muslims throughout history that ribā is undoubtedly prohibited. However, the question that continues to crop up, again and again is: what constitutes ribā? Over the entire Muslim history there has been an ijma' (consensus) among all schools of Islamic thought that ribā includes interest in all its various forms. However, after the foreign occupation of most Muslim countries and particularly because of the domination of the world financial market by the western interest-based system, there have been, off and on, scholars who have argued that conditions have changed and that there is need for a re-consideration. The gist of the argument is that interest given and taken by modern-day financial institutions is not the same nature as that in the Jāhiliyyah (pre-Islamic) period and hence a
change is called for in the interpretation of ribā. There is, therefore, effort to create a distinction between interest and ribā.

The arguments given in favour of legalizing interest, however, have not as yet been able to create a dent in the opinion of the Shari'āh (Islamic Law) scholars as well as a majority of modern Muslim economists, who uphold the historical consensus on ribā. There have been a number of international conferences of fuqahā’ (jurists) to discuss the question of ribā, including the Mu'tamar al-Fiqh al-Islami held in Paris in 1951 and in Cairo in 1965, and the OIC and Rabitah Fiqh Committee meetings held in 1985 and 1986 in Cairo and Makkah respectively. The unanimous verdict of all these is that the term ribā includes interest. These verdicts have received unreserved support from countless religious scholars giving them almost the character of ijma’. The Federal Shari'ah Court of Islamic Republic of Pakistan clearly reflected this consensus when it, in response to the appeal of the government, clarified:

- That the literal meaning of ribā is ‘increase’ and that it denotes taking anything in excess or giving less than the capital;
- That not only usury with excessive rate but any interest charged on loans or given on deposits by the banks falls within the definition of ribā;
- That it makes no difference whether a loan is taken for consumptive or for productive purposes (like trade, commerce, industry);
- That indexation of a loan or debt implies excess over and above the sum lent and thus becomes interest, which is prohibited.

ABOLITION OF INTEREST

Interest has always been considered unethical inhuman by all the world’s largest religions and by the ancient philosophers. For the followers of Islam, prohibition of interest is imposed through the revelation of the Holy Qur’ān and the traditions of the Prophet (s.a.w.). Furthermore, the traditionists
and jurists of Islam have elucidated socio-economic consequences of interest to mankind. Let us study them in some details.

**Religious Factors for Abolition of Interest**

*Qur‘ān*

The Holy Qur‘ān has condemned and forbidden interest transaction and warned the offenders of the doom of Fire. It has regarded interest transaction as a practice of unbelievers:

 Those who devour interest (al-ribā) will not stand except as stands one whom the Satan by his touch hath driven to madness.\(^{10}\) That is because they say: ‘Trade is like interest’; but Allah hath permitted trade and forbidden interest. Those who after receiving admonition from their Lord, desist, shall be pardoned for the past; their case is for Allah (to judge); but those who repeat (the offence) are companions of the Fire: They will abide therein. Allah will deprive interest of all blessing, but will give increases for deeds of charity: for He loveth not any ungrateful sinner. Those who believe, and do deeds of righteousness, and establish regular prayers, and give zakat (poor-due), will have their reward with their Lord: on them shall be no fear, nor shall they grieve. O ye who believe! fear Allah, and give up what remains of your demand for interest, if ye are indeed believer. If ye do it not, take notice of war\(^{11}\) from Allah and His messenger: but if ye repent ye shall have your capital sums: deal not unjustly, and ye shall not be dealt with unjustly. If the debtor is in difficulty, grant him time till it is easy for him to repay. But if ye remit it by way of charity, that is best for you if ye only know. And fear the Day when ye shall be brought back to Allah. Then shall every soul be paid what it earned, and none shall be dealt with unjustly.\(^{12}\)

In other places, the Qur‘ān reads:
O ye who believe! devour not interest doubled and multiplied; but fear Allah; that ye may (really) prosper. 13 And fear the fire, which is prepared for those who reject faith. And obey Allah and the Messenger; that ye may obtain mercy. 14

So give what is due to kindred, the needy, and the wayfarers, that is best for those who seek the Countenance 15 of Allah and it is they who will prosper. That which you give in interest for increase though the prosperity of (other) people will have no increase with Allah: but that which you give for charity, seeking the Countenance of Allah, (will increase): it is these who will get a recompense multiplied. 16

Traditions

The prohibition of interest has also been reported in numerous traditions (sayings, deeds or tacit approvals) of the Prophet Muhammad (s.a.w). Some of them, for instance, are given below:

1. From Ibn Masud: the Prophet, peace be upon him, cursed the receiver and the payer of interest and one who records it. 17

2. From Ibn Masud: the Prophet, peace be upon him, said: “Even when ribā is much it is bound to end up into paltriness.” 18

3. From Abu Hurayrah: the Prophet, peace be upon him, said: “There will certainly come a time for mankind when everyone will take ribā and if he does not its dust will reach him.” 19

4. In his sermon during Hajjat al Widā’ (the last Pilgrimage), the Holy Prophet, peace be upon him, in presence of about one hundred thousand reverend companions declared; “All kind of interest of Jāhiliyah is repealed.” 20
The above cited verses of the Holy Qur’ān and reports of the traditions of the Holy Prophet (s.a.w) represent the divine words of guidance and promising accountability of the only God, Allah, Almighty. Those verses and reports of the prohibition of interest vehemently imply the concept of common wealth and brotherhood. Wealth, as remarked by Almighty, does not, in fact, increase by interest earning, but through giving charity that wealth of a person assured by His blessings will increase manifold.  

Moral and Economic Reasons for the Prohibition of Interest

Besides clear-cut prohibition of interest from the primary sources of Islam, Qur’ān and Sunnah, many Muslim jurists, traditionists and economists have elucidated some of the rigorous consequences of interest and demanded its extinction from the community. Some moral and economic reasons for the prohibition of interest are discussed below.

1. Interest and Injustice

Islam prohibits fixed interest because it represents an income, which is exploitative and unjust. The lender is assured with the fixed return on lending whereas the borrower, alone, is forced to bear all risks and uncertainties surrounding his business. Islam has prohibited interest on capital and, thus, has foreclosed the door of accumulating wealth without work or without taking risk. The general principle in business is that whoever wants to yield a profit must be willing to assume risk as well. The operating principle is ‘no risk no gain’.  

Interest involves both oppression (zulm) and exploitation. In case of consumption loan, it perpetrates the basic concept of brotherhood whereas God has bestowed upon people, wealth and prosperity. Islam lays an obligation upon those who have surplus wealth to support and help needy and poor.  In case of investment loan, it is unjust. Because it reflects a guaranteed return of capital under all circumstances, while uncertainly and risk surround entrepreneurial efforts. Siddiqi argues that the borrowed capital, whose
repayment to the lender is guaranteed, takes no part in the enterprise in which it is invested and is, therefore, not entitled to any return even when the enterprise does make a profit. This capital does not expose itself to risks and uncertainties of the enterprise.\textsuperscript{24} Islam requires that the lender must participate in the risk of loss, if he so desires to share in the profit earned by the entrepreneur from the use of borrowed capital through his skill and hard work. As all business dealings have an inseparable risk factor, applicable to both labour and capital. Moreover, it is obvious that interest rate, either low or high, is unjust. High interest rates penalize entrepreneur as the cost of borrowed capital goes up. Low interest rates, on the other hand, exploit savers who deposit their money with interest-based institutions as the net interest rates further go down or even become negative due to rate of inflation.\textsuperscript{25} By abolishing interest and replacing it with Islamic system of financing,\textsuperscript{26} the risk and uncertainties would be definitely redistributed to all over the concerned parties in just and equitable manner, so that oppression, exploitation and injustice paralyzing in the institution of interest can be eliminated and cured completely.\textsuperscript{27}

2. \textit{Interest and Redistribution of Income}

Interest reinforces a tendency of wealth to accumulate in the hands of few thereby diminishes their concern for their fellows. Interest transfers wealth from the poor to the rich, increasing inequality in the distribution of income and wealth. It is a fact that banks and financial institution owned by few persons, with a view to maximize their private gains and lack concern for society, often channelise funds, procured from public, to business activities they have a stake. This contributes in a big way to growth of monopolies, and concentration of economic and political power, whereas the over all economic activity and weaker section of the economy go on suffer. The nationalization of banks by government can never remove this problem, unless the abolition of interest and establishment of Islamic banking and financial system attain successfully. In this way, the banks’ profits, earned by banks’ participant in business and by
entrepreneurs from banks' financing, can pass on to a much larger number of depositors and entrepreneurs and thus solve the problem of redistribution of income and wealth remarkably.  

3. **Interest as an Unproductive Banking Principle**

The 'conservative principle' of banking does not allow any conventional bank to participate in the losses of enterprise, rather it grants loans against collateral. As a result banks rely on security rather than productivity of capital, so long as they get interest paid or hold collateral as security. They need not show any genuine interest in the borrower's success or failure. On the other hand, the entrepreneur, who takes loan from the bank must pay back the principal plus predetermined rate of interest whether he gains or not. Under these conditions, interest has contributed to the following consequences.

3.1 **Duality of Interest**

Both parities of loan agreement, i.e. bank and client, carry heterogeneous objectives of economic pursue, i.e., interest and profit. And keeping collateral as security, bank has no interest to the outcome of entrepreneurial business of the client. This results in a duality of interest and is not conducive to economic development. A partnership business, on the other hand, will do as under business partnership the capitalist, bank or depositor, participate in the venture and share the actual outcome of business with the investor, the borrower. This attitude toward common objective plays an active role in economic process paving the way toward development. As pointed out by Hameedullah, “the institution of interest introduces an essential duality of interest between the capitalists and the entrepreneurs, which is a source of fluctuation in the system. By abolishing interest and bringing the capitalist and the entrepreneurs together on the basis of profit-sharing, Islam ends this duality and harmonizes the interests of the two classes."
3.2 Lack of Concern toward Social Priority and Productive Investment

The obligation of entrepreneur in the repayment of capital borrowed plus interest, enforces him to undertake high yield project irrespective of its socially priority and economically productivity. He then invests in short-term but high yield enterprise to cover up his obligation. Even the bank itself prefers to grant money into this channel as it is a great way to make money in short spun of time, so that the money is locked in gambling, hoarding and speculation, and other unproductive business fostering unproductive boom and economic fluctuation.31

It is pointed out that many socially useful and beneficial economic projects, with low profit yield, are often abandoned because of difficulty in paying high interest rate on borrowed capital. Interest also puts a check and brake on economic progress, especially in under-developed and developing countries, as most of new projects under planning commission are of highly socially priority and economically prerequisite for economic development and welfare of the mass. This is due to low profit yielding capacity and long gestation period of the projects. A. Mannan, Mawdudi and Qureshi pointed out that interest holds back investment in production. It prevents the flow of capital towards projects with low yield even though they are socially most useful.32

Mahmud Ahmad pointed out that the institution of interest provides bank with unproductive channels to employ their capital. This causes scarcity of capital available for productive enterprises, which raises the rate of interest. In the absence of interest people’s money will either be spent on consumption causing demand to rise or be invested in productive enterprise. Both ways, there will be greater production and larger employment.33

Mawdudi has argued that the institution of interest discourages long-term investment as capitalist has a strong desire for liquidity. This is detrimental to the real interest of society. Furthermore, long-term loans based on a fixed rate of interest introduce an element of rigidity in costs which investment on the basis of profit-sharing would not.34
The discouragement of long-term investments is not, however, confined to the interest cost. It is the uncertainty and risk surrounding the return to investment that increases with the period involved. These discouraging factors would be alleviated under the profit-sharing system as they are diffused to all over the concerned parties in the investment. Tracing the consequence of interest, Siddiqi notes that fixed interest charged curtails the freedom of the entrepreneur who wishes to go by social priorities. The society is therefore obliged to admit low yield high priority undertakings into the public sector.  

4. Interest and Non-Expansion of Entrepreneur Class

Interest hinders skilled and artisan people to enter into business enterprise due to deficiency of collateral and poverty. Many skillful poor and God-gifted entrepreneurs lose their opportunities to take part and play active role in economic process and hence become idler. Interest also creates another class of idlers who sit tight and receive their income from accumulated wealth. They do not contribute to the welfare of society through labor, nor participate in a stake of enterprise as providers of capital. Mawdudi pointed out that the removal of interest or premium on capital shifts the emphasis on to the entrepreneur whose activity becomes the only source of income besides labor. The hold of the rentier class on society is destroyed and dynamic entrepreneurs with hard work are given the upper hand.

Furthermore, the techniques of interest-based lending may make a banker disinterested to the optimum result of such lending. So the appraisal of a project for loan sanctioned does not get genuine important rather it becomes a paper work having less relation with practical situation. As a result, a client based on the appraisal cannot raise further finance in time of shortage from other banks, as they do not rely upon the project appraised by others. This process of appraisal and reappraisal of project may result in fund crisis. In fact, the interest-based banking encourages motivated appraisal of a project that contributes to non-growth of entrepreneurship.
Hameedullah regards the institution of interest as the villain of the piece; "just when the vital interests of the entrepreneur demand that they should have financial resource to cope with the situation, the interest of the lending class demands a payment of the loans and are against their renewal..."^38

5. Interest and Economic Destabilization

Stability of an economic system, desired by all economies, is a crucial element for growth and development. It implies sound economic system that brings about social and economic welfare to the people. Thus, economic instability is of the contrary. It follows that interest is an important destabilizing factor in the capitalist system and creates tremendous uncertainties resulting in difficulty in making a future plan. Lee lacocoa says that due to wide fluctuation in interest rate, "no one can plan for the future."^39

Since 1960, the economies of the free world have been facing the twin problem of inflation and unemployment. Earlier, it was believed that the two problems had an inverse relationship. That if one was to control inflation, one would get higher unemployment and vice versa. Many policies have been applied to tackle down the twin problems, but they have survived despite all attempts at its solution. Because none of the policies have struck at the root cause of the problems, the real culprit, that is interest. Interest as a mean of business fluctuation is elucidated below:

5.1 Interest and Inflation

Interest on capital causes the general price level of commodities to increase and, hence, inflation. It is obvious that interest on capital raises the cost of production. The producer, in an attempt to cover up his additional burden of the rise in cost, pushes the burden to final consumer in terms of higher prices for his commodity. Mawdudi has pointed out "a basic imbalance is caused between production and consumption by the phenomenon of interest. This happens in two ways. Firstly, interest on consumption loans transfers part
of the purchasing power from a group of people with high propensity to consume to a group with low propensity to consume. This latter group mostly reinvests its income from interest, which means that the decrease in consumption demand is accompanied by an increase in production. Secondly, interest on productive loans raises the cost of production, hence the prices of consumption goods. Once again the amount taxed away from the people, in the form of higher prices falls in the hand of a class with a lower than average propensity to consume. 40

Hence, interest on capital is exploitative. The poor and middle class people, who account for the majority of total population, suffer from additional cost of living. Abolition of interest, not merely, brings down the price to the extent the interest entered into the cost of production, but it leads to higher investment resulting in greater supply of goods and services and will further brings down the price level. Besides, Islam also encourages an economy wherein the production sector is preferably organized on a profit-sharing basis, so that labour has a stake in the well being of the industry. As a result the chances of wage-push inflation are reduced to a minimum. 41

5.2 Interest and Depression

The rate of interest, either low or high, causes disequilibria in an economic system. Low rate of interest encourages aggregate spending causing inflation, while high interest rate discourages aggregate spending and causes depression. Regarding high interest rate in U.S.A. during 1970-78, interest payments were 33% of return on capital, which was three times the share of 1960s, and six times that of 1950s. This affected the profitability of corporate sector in U.S.A. resulting in decline of the proportion of risk capital in total financing, comprising of equity plus debts. The resulting lower rates of capital formation result in the decline of productivity. This reduces the ability of an enterprise to offset the rising cost of borrowed capital and, therefore, reduces profitability of the enterprise. The consequential decline in profitability has a
further negative effect on capital formation. Therefore, it becomes a vicious
circle, which gives rise to a number of problems such as unemployment and
depression.\textsuperscript{42}

Interest on capital retards the level of investment leaving physical and
human resources unemployed. At the going rate of interest, there will always
remain some investment proposal, which will not be able to convince the
potential investors that they would be able to earn enough to pay the interest.
Therefore, some viable projects would be set aside. Thus, the solution of
involuntary unemployment lies in reducing the rate of interest to zero.\textsuperscript{43}

It is thus, interest that brings in crisis to an economy. As pointed out by
Mawdudi and Mahmud Ahmad that interest is seen as the root cause of the
instability characterizing the modern economic system. Interest creates liquidity
preference for speculative purposes resulting in keeping a large part of the
money supply in hoard waiting for the rate of interest to rise. It encourages
speculation, which is the cause of instability in the system.\textsuperscript{44}

By removing interest, and replacing it with profit-sharing system in
financial sector, an economy can maintain its stability. Weitzman has rigorously
advocated the principle of profit-loss sharing (as opposed to predetermined
wage rate) as the cure for modern problem of stagflation.\textsuperscript{45}

5.3 \textit{Interests and Foreign Exchange Instability}

Fluctuation in the rate of interest causes capital movement between
countries. Low rate of interest causes capital outflow and vice versa.
Differentiated rates of interest of different countries, thus, play a vital role in the
instability in foreign exchange market. The financial markets of the world shift
about 200 billions dollars from one place to another place everyday. Around
90% of these movements are speculative and seek to earn from differences in
the rates of interest and exchange rates. These fund transfers lead to
fluctuations in the rates of exchange, which reinforces the tendency to shift
funds. Interest on capital is, therefore, a major factor in the instability of the international monetary system.\textsuperscript{46}

6 Interest and Public Debt

In present day, the tyranny of interest manifests itself in the form of huge public debt of the Third World Countries. With a view to pursue economic development, they have borrowed large amount from the rich nations or from international financial institutions, like IMF and the World Bank governed by the rich nations. The debt servicing, i.e., interest payment, of the borrowing Third World Countries outgrow the economic growth of these countries and hence becomes a great burden for them to pay interest alone, need not mention about the principal. This is obvious from the World Debt Crisis in 1970s that broke out in Latin American countries. More recently, it follows that the economic conditions of these countries are not favourable characterizing by financial sectors crises.\textsuperscript{47} This phenomenon is highly susceptible to second round of Global Debt Crisis contributed by recent economic crisis in several Asian countries on account of their heavy borrowing. It is not exaggeration to arbitrate that once one borrows on interest, he has let himself in a vicious circle of debt paying and borrowing. By removing interest and replacing it with Islamic financial system, e.g., \textit{qard hasan} (interest-free loan) and profit-loss sharing, the burden of public debt of the borrowing countries can be subsided.

Although Islam prohibits interest in, among other things, banking and finance, the potential productivity of financial capital, money, is not refused but recognized, provided that the provider of capital is willing to participate in potential losses with his borrower. It is the system by which both the provider or financier of capital and entrepreneur or borrower can join hand and work out in a just and equitable manner.
THE ALTERNATIVE

Banking and financial system in Islam are conducted on Islamic principles. The prohibition of interest indicates two basic banking and financial principles.

1. Non-Creditor-Debtor Relationship

The abolition of interest in Islam suggests that interest on capital is forbidden and that loan should be given on interest-free basis, which is termed as *qard hasan* (benevolent loan). It follows that the institution of interest under conventional banking and financial system implies creditor-debtor relationships between depositors and banks on the one hand and between banks and borrowers on the other. These relationships are based on interest, which is viewed as the price of credit reflecting the opportunity cost of money for borrower and as compensation for parting with liquidity of creditor. Since interest is forbidden in Islam, hence, Islamic banking and financial system cannot be based on creditor-debtor relationship.\(^{48}\)

2. Risk Appliance

Another principle is that a true Islamic banking and financial structure would be the one wherein, like other factors of production, capital is also required to bear risk. The Islamic principle is that: no risk no gain, and one who desire to earn on his saving and financing should also be willing to assume the risk of loss.

It is, therefore, based on these two principles that an Islamic banks or financial institution can be operated. In addition, while Islam prohibits interest, trade is permitted. This implies that while interest-based transaction is repudiated, trade-based transaction is encouraged and permissible. The risk factor and profit and loss sharing basis reflecting in the concept of trade-based transaction provides another method of banking and financial system that would be its central-piece, i.e., share-risked banking and financial system.
Thus, banking and financial system in Islamic framework assume a characteristic of share-risked or participatory nature.

**ISLAMIC BANK – A SIMPLE MODEL**

Islamic bank, as an alternative to interest-based conventional bank, assumes a characteristic of participatory nature. Several Muslim jurists and economists recommended that an interest-free bank can be distinctively organized and operated on the basis of *mudarabah* or profit and loss sharing.

Under *mudarabah* arrangement, the creditor, which might be the bank itself, does not earn a predetermined fixed rate of interest rather it does participate in the business risks and share in profit and loss with its client, expressed in term of profit ratio. Thus, under this banking system, the cost of capital is not zero as some people wrongfully assume it to be analogous to zero rate of interest. In this connection it is more apt to pronounce that Islamic banking implies zero rate of interest but not zero rate of return as it does not deal in money but deals with money.

Muslim scholars and economists have developed alternative models of a banking system within the framework of Islamic requirements. Based on *mudarabah* principle called the 'Two-Tier *Mudarabah*', the most widely accepted model integrates the asset and liability sides of the bank's balance sheet. It envisages depositors entering into a contract with a banking firm to share the profits accruing to the bank's business. The bank, on its asset side, enters into another contract with an agent-entrepreneur who is searching for investible funds and is agreeable to sharing the profit with the bank in accordance with a predetermined percentage stipulated in the contract. The bank’s earnings from all its general activities are pooled and are then shared with its depositors and shareholders according to the terms of its contract with them.
In the conventional banking system, a bank is entitled to earn a return of capital irrespective of the performance of the finance extended. This is analogous to Islamic banking framework, whereby the return on capital is linked to the actual outcome of the business. Islamic bank does not merely lend money, except interest-free loan. Rather it becomes a partner of customer’s business.

Islamic bank is not merely an alternative to interest-based conventional financial institution in traditional sense of the word, but it is also a social institution attributed itself with the principles of Shari'ah (Islamic law) as laid down by the Holy Qur'an and Sunnah (Tradition of the Prophet) as regards its objectives, principles, practices and operations. It is not merely refraining from indulging in interest transactions, but also from business activities declared illegitimate in Islam. Furthermore besides being under control of the central bank, it is subject to supervision of an Islamic Religious Broad of the country or Shari'ah supervisory board of the bank. In this way, operation of the bank are required to fulfill primary and secondary objectives of banking business, social welfare and justice needed by the community of the country.

The basic function of the bank besides maximizing profit is to bridge between savers and investors, i.e., saving and investment, in an economy. As most of the investors need a lump sum of money to carry out their investment projects whereas people’s savings are scattered around the country. It is the basic function of a bank to bridge this gap. Thus, bank helps in creating capital formation of an economy by attracting savings of people and channelizing them towards investment projects. This conception has let some people to doubt of how an Islamic bank can attract savings of the people without offering a pre-determined rate of interest and how would it be able to control a huge demand for credit given on interestless profit-loss sharing basis. In other words, without the rate of interest mechanism, there would be no instrument to equate the demand for and supply of money.
This seems to be a fallacious conception. According to Islamic jurisprudence, Islam discourages keeping funds idle, as the system of zakat (poor's due) at the rate of 2.5% per annum on certain assets would eat up non-invested savings of people. In addition, the pre-agreed rate of profit stipulated under the investment account and contract on the basis of profit-loss sharing will act the same way as does the pre-determined rate of interest under conventional banking system. Even though, the return on capital in such system is not guaranteed, it is likely to be much more than one can expect. 'The higher the risk, the higher would be a return on capital' seems to be more appropriate to quote here, as billions and billions of dollars are invested in the share of joint stock companies throughout the world where the investors ran a similar risk.  

On the other hand, one must perceive clearly that under interest-free banking system, it does not mean that credit will be available free of cost to entrepreneurs for their investing requirement. Instead, finance will be available on profit and loss sharing ratio as against fixed rate of interest. The rate of profit realized from operational results will, therefore, replaces interest rates in allocation of resources, and will act as a mechanism for equating the demand for and supply of money. The diversion of funds towards projects depends, among other thing, on the projected rate of profit, i.e., the greater the projected rate of profit, the greater the supply of funds to that project. If the actual profit is constantly lower than the projected profit, the entrepreneur is likely to face obstacle in securing funds for his project in future. Moreover, 'no man can cheat twice'. It may be a precaution to prevent any entrepreneur from manipulating wrong and fraud accounting information about 'the actual result of the enterprise. In this way the mechanism of profit-sharing is, therefore, likely to become more appropriate instrument in creating financial discipline, higher efficiency and more careful and realistic feasibility and evaluation of projects and of post-finance monitoring.
Another careful demonstration focuses on the rate of profit or profit and loss sharing ratio (PLS ratio), as alternative stabilizing device to rate of interest. Variation in the PLS ratio affects investment decisions and depositors' desire to hold money. In case of saving investment deposit, the higher the PLS ratio the higher would be desire of savers to invest money with the bank and vice versa. On the other case, the bank can have a control over the supply of money. The higher the stipulated percentage share of the bank in PLS ratio, the lower would be the supply of money for investment and vice versa. The PLS ratio, thus, will replace 'Bank Rate' in British type and 'Discount Rate' in U.S. type banking system, as a tool of controlling the supply of money in an economy. If the Central Bank wants to make credit dearer, the minimum percentage of bank's share in profit (PLS) may be fixed at a higher level. Similarly by reducing bank's share in profit the Central Bank may ease credit and make it more attractive for investors to invest.\(^5^4\)

In this way, profit and loss sharing ratio in Islamic banking system can be a suitable device for creating and allocating capital formation as well as for controlling the supply of money, as compared to interest-based banking system. Moreover, under interest-based banking system, it may happen that people save less rather than more even when interest rates are high and that the savings of some other people remain unchanged due to variation in interest rate and that many people save more by consuming less even due to an expected fall in the rates of interest. The same thing can also happen in relation to investment decision i.e., some people borrow more to invest even when the rate of interest is high and borrow less on the contrary. To put in the word of Samuelson, "the economic principles alone can not give a decisive prediction as the level of interest tends to cancel out consumption and saving decision."\(^5^5\)

**Establishment of Islamic bank**

Like joint stock companies, the bank would be established on the basis of partnership or Shirkah al-Inan, i.e., two or more persons would participate in
an enterprise providing capital, working jointly and sharing in profit and loss of the business proportionately. All partners, i.e., shareholders, need not have equal share nor are equally responsible for the management of the business. Accordingly, their share in profits may be unequal, but this must be clearly specified in the partnership contract. Their share in losses would, of course, be in accordance with their capital contribution.  

Several agreements may be decided at the time of making contract such as what would be a term of financial period, areas of operation, pattern of distributing profit and loss, method of baking accounting, etc, provided that each agreement should be renewed at specified period decided by all shareholders. Major policy decisions of the bank would be made by a board of directors elected by shareholders. Day-to-day decisions shall rest with trained executives whose appointment and removal rest with the board of directors. The financial liability of a partner in the Islamic bank will not be limited to the extent of his share-capital. Supposing in case of loss, the assets of the bank are not sufficient to pay the liabilities, the deficiency will be paid by the shareholders from their private assets. However, liabilities arising out of the private enterprises of the shareholders shall not be honored by the bank.

In the interest-based system the shareholders of a bank are the sole beneficiaries of the profits of the bank. They also suffer in case the bank incurs a loss. This means that all income earned either by employment of funds or sale of services belongs to the shareholders. Similarly, all expenses in terms of interest payment on deposits or expenses on establishing and administering are incurred on account of the shareholder.

Under Islamic banking system, a distinction must be made between shareholders' profit and depositors' profit. Income earned from investment of funds other than PLS deposits, sales of services, the share out of depositors' profit paid to the bank for managing the investment of PLS deposits, and management fee received by the bank for managing the mudarabah business
shall belong to the bank’s shareholders. Whereas depositors’ profit comprises only of income generated through investment of their PLS deposits in terms of proportionate share with the bank on the basis of PLS or mudarabah contract. However, the losses must be incurred out of depositors’ account in case of mudarabah or PLS account, whereas under musharakah or partnership account, both depositors and shareholders must bear them in exactly proportionate to their capital contribution.58

Banking Operations.

The primary function of an Islamic bank, like conventional one, is to attract deposits from the public and direct them towards business investments, with an aim to generate income. But the difference lies on the methods of raising funds and financing investment. How Islamic bank performs these two functions can be studied below:

Banking Operation: Consumers’ Deposit.

Regarding deposit’s operation of Islamic bank, various countries have different system of collecting consumers’ deposit. However, the consumers’ deposit of Islamic banks in different countries can be broadly classified into three categories i.e., current, saving, and investment accounts.

1. Current Account

Islamic bank accepts deposits from its customers in the form of ‘current accounts’ as conventional bank does. Bank pays no interest to customers as stipulated by Islamic jurisprudence. These accounts constitute current or demand deposits in which the consumer may, any time, withdraw a part or whole of their balance they so desire. The bank guarantees the refund of such balance. The bank may (through customers’ permission) make use of these funds at its own risk, so long as these funds remain with the bank. Since bank bears all risk from the use of their funds, the customers are not entitled to any
share in profits generated by the bank. The bank provides its customers with cheque books and other usual services connected with current accounts.

2. Savings Account

Islamic bank also accepts deposits from its customers in the form of savings accounts. As contrast to interest-based system, bank pays no interest stipulated by Islamic jurisprudence. The customers may withdraw a part or whole of their balance at any time they so desire, and the bank guarantees the refund of such balance. The bank, through customers' permission, makes use of these funds at its own risk, so long as these funds remain with the bank. In contrast with current accounts, Islamic banks in Malaysia operate savings account on the principle of al-wadiah (Trust) requesting their customers' consent to make use of the funds at their own risk, but guaranteeing a full return and voluntarily sharing non-promised reward generated from the use of such funds at their absolute discretion from time to time. The Islamic banks in Sudan, under suggestion of Shari'ah Supervisory Board, mobilize savings deposit as a special type of investment deposit for short-term (three months) period. This would mean that savings deposit holders would be given a choice to convert part of their deposits into short-term investment deposit. Besides these, the Bank Markazi of Iran treats both current and savings deposits under a title of qard al-hasana, which accounts for bank reserves in their utilization. As far as Islamic finance is concerned, a financial technique under a category of qard hasan (benevolent loan) will be financed out of current and savings accounts.

Even if there is no guaranteed reward remunerated on these two accounts, customers, who look for safe custody and conveniences in the use of their funds, find it more convenient to deposit part of their saving in Islamic bank. This is obvious because of the fact that the inexcusable prohibition of interest in Islam attracts the true believers and humanitarian to come forward to Islamic banks. Besides, most of the banks also attract deposits by offering
incentive services connected to those accounts such as an exemption from or
discount in the payment of commission and fees, priority in the use of banking
facilities, and non-fixed prize and bonuses in cash or kind on non-regular basis
connected with savings account.\textsuperscript{62}

3. Investment Account

Islamic bank provides investment opportunities to its customers looking
for fortunes from their savings. The bank accepts deposits in the form of
investment accounts under the principle of \textit{mudarabah}. These accounts, also
called \textit{mudarabah} accounts or profit and loss sharing accounts, can be opened
either by individuals or business firms for specified periods such as three
months, six months, one year, and over. Interval withdrawals are not granted
from such accounts except under special circumstances subject to certain
obligations laid down by the bank. Under investment accounts, depositors do
not earn any interest but, instead, share in the actual profit in a pre-agreed
proportion expressed in terms of PLS ratio, e.g., 50:50, 60:40, 70:30, etc, with
the bank. However, the losses under such accounts are borne by the
depositors. In other words, the funds' owners share investment risk with the
bank and, thus, there is no fixed rate of return nor even a guarantee from the
bank for repayment of their principal amount in full.\textsuperscript{63} Investment accounts of
various Islamic banks can be classified into four categories.

3.1. General Investment Account

Under this category, deposits of different maturities are pooled together.
They are not tied to any specific investment projects but are channelised in
different investment operations. Profits are accounted and distributed at the end
of every term periods, i.e., each month or every three months. The attraction to
the savers will be that the profits and losses will be pooled and, in all likelihood,
the net result will be a profit. The general purposed investment account holders
will be able to earn a positive return.\textsuperscript{64}
3.2. Specific Investment Account

Under this category, either the account holders will authorize and specify to the bank to invest their funds in a particular project or enterprise or the bank may selectively accept deposits from its Government or corporate customers in the form of special investment account. In the latter case, the bank works as an agent of investors and share in the profit and loss, whereas in the former case the bank may either select to work as an agent or merely manage the funds against fees and the profit and loss will be entirely on account of the investors.65

3.3. Limited Period Investment Account

Under this category, the bank accepts investment deposit for a specified period determined by the mutual consent of the depositor and the bank. The contract may terminate at the end of the period, but profits are accounted and distributed at the end of the financial year.66

3.4. Unlimited Period Investment Account

Under this category, investment deposits are automatically renewable without specifying the period. They could be terminated by giving a specified notice to the bank. Usually the notice period is three months. No withdrawal or increases in the amount of deposit is permitted during the period. Profits are accounted and distributed at the end of the financial year.67

As far as the financial sources to the bank are concerned, Islamic banking experiences are quite diverse, as revealed by the 5 case studies68 comprising Bangladesh, Egypt, Malaysia, Pakistan, and Sudan. All these banks operate current, savings and investment accounts, although the mode of operation varies considerably between countries. In effect, money placed on current accounts amounts to no more than 'qard hasan' (benevolent loan from depositors to banks). In case of savings deposits, even if they are based on the principle of qard hasan, gift to depositors are distributed unexpectedly and
unperiodically at the absolute discretion of the Islamic banks on the minimum balance kept. Remarkable variations have been found in the investment deposits on the principle of mudarabah. For instance, the Islamic bank in Bangladesh offers 'Profit and Loss Sharing Special Notice Deposit Account' (PLS-SND A/C), 'Profit and Loss Sharing Deposit Account (PLS-D A/C) and 'Profit and Loss Sharing Term Deposit Account' (PLS-TD A/C). These PLS accounts can be said to rank from current type of deposit to term one with respect to their respective periods, conditions of withdrawal and shares in the profits. The Islamic bank in Malaysia accepts two kinds of investment deposits, i.e., 'general' and 'special'. The latter refers to 'institutional' or 'seasonal' deposit held for specific period, such as those of the pilgrimage fund.

The ratio in which profits and losses are shared between the Islamic banks and their depositors also tends to vary from place to place and time to time. The mode of payment also varies considerably. For instance, profits are provisionally declared on a monthly basis in Malaysia, on a quarterly basis in Egypt, half-yearly basis in Bangladesh and Pakistan and on an annual basis in Sudan.

One common feature of all these banks is that most of their deposits are of short-term nature. This presumable reflects the depositors' preferences to keep money in hands and to anticipate return from investment as fast as possible. Even in Malaysia, where investment deposits account for a much larger proportion of the total due to large number of investment opportunities, the bulk of them are accounted for a period of less than two years.

It is interesting to note that the secret of sound banking consists in the maintenance of adequate reserves, while at the same time making profit. A bank, in fact, deals with peoples' money, i.e., deposit, and this money can be withdrawn with or without notice. The bank must, therefore, maintain adequate reserves to meet this demand and in the meanwhile generate profit by utilizing
the rest. Thus, a wise banker must strike a proper balance between liquidity and profitability. Too much stringent caution will mean too little profit, whereas reckless utilizing and lending of money may erode depositors’ confidence towards the bank. This banking investment policy is applicable to both interest-based and interest-free banking system. But a close review manifests that under interest-free banking system a bank, firstly, does not have to pay interest on any deposits, and, secondly, the return of capital invested (principal) is not guaranteed by such bank. These two very conditions provide interest-free bank free from any severe pressure and condition that might weaken its establishment and chance of bankruptcy.

Banking Operation: Financing.

The most distinguished and unique feature of Islamic banks lies in the financial techniques employed by them. The prohibition of interest has put forward many discussions among Muslim scholars of how banks could function as a financial intermediary in the light of Islam jurisprudence. Obviously, Islamic banks cannot take part in any usurious transactions. They were compelled to seek out alternative modes of financing which would not involve interest.

The basic postulate that has guided all theoretical and practical work on Islamic banking is that while interest is forbidden in Islam, trade and profit is permissible. Consequently Muslim scholars have developed a radically oriented different model of financing which does not make use of interest but base on Islamic teachings related to trade, contracts, and transactions.

There are several Islamic alternatives to interest-based financing. First and foremost, there are participatory or share-risked or primary modes such as musharakah (partnership) and mudarabah (profit and loss sharing). Second, there are sale-based modes such as bai’ salam, bai’ muajjil, murabahah, and istsina’. Third, there are lease-based modes. It is suggested that, if financing is meant for a commercial purpose, it can be based on the concept of share-risked financing for which mudarabah and musharakah have been designed
since the very inception of Islamic commercial law. There are, however, some sectors where financing of the basis of shared-risk financing is not feasible for one reason or another. For such sectors, the contemporary scholars have suggested some other instruments, which can be used for the purpose of financing, e.g., *murabahah, ijarah, salam* or *istikna*. Nevertheless, there are some differences in details, which mainly follow from the observance or different recognized schools of Islamic Law. But the major categories and types of financing transaction, which shall be characterized here, are accepted by all Islamic banks and financial institutions. Following financial techniques employed can be grouped as under.

1. Share-risked Financing

The share-risked or participatory financing has put away the advancing of capital on interest and brought forth the participating of capital and labour with a view to share in profit and loss in an enterprise. It includes *mudarabah* and *musharakah* that are orientedly central feature of Islamic financial system based on the principle of sharing profit and loss. Participatory modes have many desirable economic and Shari‘ah advantages and are the ‘first-best’ Islamic alternative to interest-based financing. The scope of participatory modes, however, as is now widely appreciated, is limited to financing ventures that generate explicit income or output that can then be ‘shared’ among the investor and the other parties to the ventures.

1.1. *Mudarabah*

*Mudarabah* or profit and loss sharing is the most oriented model of financing in Islam, ever to be allowed and postulated as a dominant mode of financing under the scheme of Islamic banking and finance.

It is a contractual mode of financing that comprises of two persons or groups of parties in which one merely provides capital (called *rabb al mal* or provider of capital) while another (called *mudarib* or agent) utilizes it with a view
to share in profit generated. The profit is shared among them in pre-agreed ratio, whereas loss, if any unless caused by the negligence or violation of the terms of contract, is borne by the provider of capital.

The jurists pointed out that this is because of the fact that loss means destruction of a part of the capital and hence, as it occurs, is a liability of the owner of capital alone. In this connection, the effort and labour of the mudarib have gone in vain and his work has not brought any fruits to him. This is the loss of mudarib.

Under mudarabah, the provider of capital has no right to interfere in the business undertaken by the mudarib, but can stipulate certain conditions related to the business for the best utilization of his funds, at the time of making the contract. The liability of the capital provider should be limited to his amount of capital. The period of the contract depends, effectively, on the life and nature of the business enterprise or on whatever term may be so desired by both the parties. The contract of mudarabah can be terminated at any time by either of the two parties keeping in views of the fact that it should not bring any hardship or severe setback to anyone.

Division of profit should be done upon pre-agreed ratio of the net profit accrued. No party can claim any exact amount of profit he should earn, because it is obviously tantamount to interest and the reward to each party varies accordingly with the actual outcome from the business.

The legitimacy of mudarabah as a mode of finance derived from the authentic sources that mudarabah (or muqaradah) and musharakah were prevalent in Madinah at the time of the Prophet Muhammad (s.a.w.) and he did not disapprove of it. There are also reports that mudarabah was widely practised in Makkah, and on some occasions, the Prophet himself obtained funds on the basis of mudarabah to conduct his trade activity. Mudarabah financing can be used to finance trade, commerce, manufacturing in small and medium enterprises, etc, for short-term period in particular.
1.2. Musharakah

*Musharakah* or partnership is another form of share-risked financing. It is defined as a form of partnership where two or more persons combine with their capital and labour together to share the profits, enjoying similar rights and liabilities. Under *musharakah* financing, all partners or shareholders pool their capital to undertake business. They are entitled to participate in management but are not necessarily required to do so. Profit is distributed among the partners in pre-agreed ratios, but need not be proportionate to their capital contribution. Whereas loss is borne by each partner exactly in proportion to the respective capital contribution. This is because of the real world situation may be that under *musharakah* contract all partner providing capital may not be proportionately active in entrepreneurship and management. The profits need not be shared in accordance with capital contribution. They may be shared in any proportion agreed to by the partners depending on their contribution to the success and profitability of the business.

There are two modern types of *musharakah*, viz, permanent and diminishing. In the former case, it is a contract between bank and entrepreneur in which the period of termination is not specified. It can continue so long as both parties involved wish it to go on. In the latter case, bank and its client participate in a joint commercial enterprise and enjoy profit earned on pre-agreed ratio. However, mutual agreement is also made that a certain proportion of the entrepreneur's share in profits is kept in a screw account (as part of a repayment of the principal financed by the bank). As soon as the value of this account becomes equivalent to the value of the financier's ownership in the joint enterprise, the payment of this ownership is made and the entrepreneur becomes the sole owner. Islamic bank found this mode of financing quite suitable to finance commercial building, transport sectors and so on.

There is also a possibility of combination of the two modes of financing in which the clients who enters into a contract with the bank on *mudarabah*
basis may wish to invest some of his own money in the said contract with bank consent. In such case, mudarabah and musharakah modes are combined and the calculations of profit and loss would be more complicated than ordinary single mode, but can be proportionately agreeable.\(^{62}\) Musharakah financing is used by the bank to finance trade, import and export, agricultural\(^{63}\) and industrial sectors and issue a letter of credit in foreign trade.\(^{64}\)

2. Lease-related Financing

Leasing (or ijarah in Arabic) is one of the approved methods of earning livelihood according to Islamic Law. In terms of properties, it means to transfer the usufruct of a particular property to another person in exchange for a rent claimed.\(^{65}\) Leasing is very much analogous to sale, because in both cases something is transferred to another person for a valuable consideration. The difference is that in case of sale, the sole right of ownership is transferred to purchaser, whereas in case of lease only the right to use it that being transferred to lessee for a certain period while the title of ownership remains with the owner, the lessor.\(^{66}\)

Originally, like mudarabah, leasing is not a mode of financing. It is rather a normal business transaction.\(^{67}\) Even bank and financial institution in Western counties have adopted it as a mode of financing in lieu of long-term lending on the basis of interest for some specific reasons.\(^{68}\) That makes leasing very similar to interest. However, on the basis of leasing transaction, Islamic bank may employ it for financing purpose in the following modes.

2.1. Leasing (Ijarah)

Under leasing scheme of financing, bank can purchase to acquire possession of real assets such as machines, buildings, vehicles, and consumer durable goods, and leases them to customers against a specified amount for a certain period. The lease rentals, terms and conditions should be agreed and
clearly spelled out in the contract so as to avoid any element of associated uncertainty (*gharat*) and dispute between both the parties.

The bank may first purchase the asset required by a customer and subsequently lease it to him for a certain amount and period determined by mutual agreement according to nature and useful life of the asset. During the period of lease, the title of ownership, including procurement and associated expenditure in terms of taxes, insurance and unforeseen damage (unless caused by misuse, negligence, and normal tear and wear by lessee) rest on the responsibility of the bank. Termination of contract must be done with mutual consent. Absolutely after the expiry of the lease contract the asset be reverted back to the bank.

Leasing is found to be a popular technique of financing. Islamic banks and leasing companies in Pakistan, Bank Islam Malaysia and Islamic Development Bank, etc., use leasing as a technique of financing.

2.2. Hire-Purchase.

The hire-purchase technique is another form of lease contract by which the lessee can purchase the leased asset at the end of the lease period on an agreed price. Of course, the price may constitute part or all of the rental paid. This mode of financing is similar in most respect to a ‘Finance’ or ‘Full-Payout’ lease of the conventional financial system in which the ownership remains with the banks until it is transferred to lessees against payment of a specified nominal amount. This seems to be consistent with rule of leasing and then purchase in Islam. It is suggested that under the scheme, the parties concerned should have two separate documental contracts. The first contract constitutes normal lease agreement, while the second constitutes unilateral promise to sell the leased asset to the lessee at the end of the lease period by the bank. The unilateral promise by the bank implies that the bank is bound to fulfill the promise, but the promisee is not and may exercise his option (whether to purchase or not). This arrangement is called *ijarah wa iqtina*.

This financial
scheme is widely used by Islamic banks and financial institutions. In Malaysia, this mode of financing is called *al-ijara thumma al-bai'* (leasing and then sale).

2.3. Rent-Sharing.

It is another scheme of lease-related financing. This financing is employed by House Building Finance Corporation as well as commercial banks, particularly in Pakistan, based on the concept that they provide part of finances required for construction and purchase of property and receive a share in the rental income of such property with client.

It is interesting to note that most of the leasing business in Pakistan was handled by leasing companies or by registered *Mudarabas*. It was reported that these companies provided finance for purchasing and leasing of defined assets. The asset was identified, procured, and transported by client at his own risk. It was, of course, registered in the name of financier held as collateral. During life of the asset, the client bores the costs and risks of depreciation, disaster, obsolescence, idle capacity and decline in values. While entering into the contract, the client had no any option to accept the equipment or to return it before the lease term. In this way the companies did not assume any 'business risk', which the lessor would have assumed. They merely got back their money along with a fixed predetermined increment. This, no doubt, creates a degeneration of a great potential interest-free financing.

Another potential problem attached to lease-related financing arises out on the part of the client on account of delay in payment. Many suggestions had been made in this regard. But, however, the most agreeable one recommends imposition of a 'charitable penalty'. Under such concept, right in the contract, if any lessee fails to pay rent on its due date, he will pay a certain amount to charity for social use and would not constitute part of income to lessor. This arrangement, though does not compensate the lessor for his opportunity cost of the period of default, yet it may serve as a strong incitement in prompt payment.

Unlike interest, sale is permitted and even encouraged in Islam. Islamic banks and financial institutions can employ certain kinds of sale as their modes of financing subject to certain rules of sale transactions. For instance, one cannot sell what he does not possess. This constitutes an intriguing element of argument for various kinds of sales. As pointed out earlier, certain kind of projects cannot be financed out of participatory and lease-related financing so that various kinds of sale transaction have come to a rescue and constitute mode of financing. Islamic banks and financial institutions can strictly use the following modes of sale-related financing for their relevant projects.

3.1. Murabahah (Mark-up Sale).

Murabahah or mark-up sale is one of the most popular sale-related financing adopted by Islamic banks. It is a contract in which a client, wishing to purchase equipments or goods, requests the bank to purchase the items and sell them to him after they become in the possession of the bank at cost plus a reasonable declared profit.

Under murabahah the client, at his convenience and reliance upon bank's compatibility in procuring best suited quality equipments or products approaches the bank to finance the specified products. The bank then undertakes to access all related information of the required commodities and specifies their cost and profit margin or cost-plus to resell to the client, including time and place of delivery and payment. If these conditions are so agreed, the contract of murabahah would be signed. The bank will first purchase the required commodities and then sell them to its client on mark-up basis. The payment may be at spot or on a subsequent date agreed upon by both the parties. Therefore, murabahah does not necessarily imply the concept of deferred payment as generally apprehended by some people or banks. Murabahah in its original Islamic connotation is simply a sale. The only feature distinguishing it from other kinds of sale is that the bank, i.e., seller, deliberately
declares how much cost of the commodity at the time of procurement and how much profit margin associated with its final price.\textsuperscript{102}

There are certain conditions for a \textit{murabahah} contract to be valid. Firstly, there should be two separate transactions in procuring and selling of the commodity by which three parties must be involved, i.e., seller, bank, and client. Bank purchases the required commodity from seller in one transaction and the bank sells it to the proposed client in another. Secondly, the first condition implies that the required commodity must be in possession of the bank before its sale to the client. Thirdly, both cost and profit margin (mark-up) of the commodity must be determined and mutually agreed upon by both the parties. Fourthly, time and place of delivery and payment must be determined. Finally, there must be no mark-up on mark-up in case of late payment. Mark-up on mark-up is viewed as interest.\textsuperscript{103}

3.2. \textit{Bai’ Muajjal} (Deferred Sale).

\textit{Bai’ muajjal} or deferred sale is another mode of sale-related financing adopted and employed by Islamic banks and financial institutions. It refers to a sale transaction in which the seller allows the buyer to pay the price of a commodity at a future date in lump sum or installments.\textsuperscript{104} Under this mode of financing, a customer approaches the bank to acquire a specified asset but to defer the payment. The bank then undertakes to determine all conditions including period, term and manner of repayment with its customer. The bank purchases the asset concerned and subsequently sells it to the customer on deferred payment either in lump sum or installment basis so agreed upon. It is given that deferred price may be more than cash price on spot sale, provided that once the price is fixed at the time of making the contract it can not be decreased nor increased any further.\textsuperscript{105} This technique is widely used by Islamic bank. In Malaysia, the technique is called ‘\textit{al-bai’ bithaman ajir}’.\textsuperscript{106}

It is significant to note that both modes of financing i.e., \textit{murabahah} and \textit{bai’ muajjal}, are closely analogous to one another, operating on profit motive.
The permissibility of higher price in deferred sale implies that ‘time-value’ is apparently acceptable in Islam for permissible economic activities such as sale.\textsuperscript{107} Even on spot sale, the price of commodity may be high depending on mutual consent of the parties involved. Since \textit{murabahah} is operated on the basis of declared profit while \textit{bai' muajjal} on the basis of deferred payment in which the actual profit might not be disclosed. Hence, most Islamic banks have combined them to create an ideal mode of financing popularly known as \textit{murabahah} (on deferred payment basis). This mode becomes very popular and is widely used to finance for purchasing of consumes durable goods, working capital equipments, etc., on short-term basis. \textit{Murabahah} contract is also used to facilitate international trade.\textsuperscript{108}

It is worthwhile here to note that one of twelve permissible modes of financing namely purchase of moveable or immoveable property by the banks from their clients with buy-back agreement or otherwise was introduced by State Bank of Pakistan. This mode is proposed to finance real estate and consumer durable goods. The bank buys property from the customer and the customer has a right to buy-back later. No mark-up was mentioned in the buy-back agreement. It happened that banks in Pakistan re-introduced interest by combining this buy-back agreement with mark-up sale and form another practical mode of financing in which the bank;\textsuperscript{109}

- buys some items (such as raw material and consumer durable goods) from the finance demanding customer (and not from a supplier for later re-sale to the customer);
- who immediately (and not at a later date) buys back these items at a price, which is higher than the price the bank had paid, i.e., at a price with a mark-up for the bank, on deferred payment basis.

All this happens in one sitting and filling in different types of documents. One can see that the above-mentioned practice of mark-up with buy-back agreement\textsuperscript{110} with only two parties involved (bank & customer) is a ruse to lend
money on interest. The bank just lends money to the client and gets a pre-determined return. It is a mere stratagem to avoid the name of interest and yet retain its substance. ¹¹¹ This susceptible element to subterfuge of murabahah and its economically akin to interest have led the jurist of Islam to degrade and deprive it of the central-piece of Islamic modes of financing. ¹¹²

3.3. *Bai’ Salam* (Forward Sale)

*Bai’ salam* or forward sale is another kind of sale-related mode of financing adopted and employed by Islamic banks and financial institutions. Under this mode, buyer, i.e., bank, agrees to purchase a commodity from producer in advance and pays the agreed price immediately, but the commodity will be delivered on an agreed future date. All details of the commodity regarding its nature, quality, price, place and time of delivery are contractually specified. ¹¹³

The permissibility of *salam* sale derived from the compromise bestowed by the Prophet of Islam to relieve associated hardship in certain kind of trade, particularly related to agriculture. After the prohibition of interest small farmers who need subsistence for themselves and families could not take loan on interest. Therefore, it was allowed for them to sell their produces in advance. ¹¹⁴ Similarly, the traders of Arabia used to export goods to other places and import some other goods to their homeland. They needed more money to carry on their businesses. It was, therefore, allowed for them to sell goods in advance.

*Salam* sale is proved to be beneficial to buyer also as the price transacted under *salam* sale is normally lower than that transacted in spot sale. The difference between the two prices will constitute part of a profit to buyer. But the administrative practice of *salam* sale is proved to be cumbersome especially when there are large numbers of proposed farmers, shortages of storage, problems of specified required quality of produce and late delivery. Banks may find it difficult to undertake these dealings. However, the contemporary economists suggest that this method can be effectively and
conveniently done at the national level. Nationalized banks and other financial agencies being fully-owned by government can act as its agents for making payment of purchase price while the commodity can be taken delivery of at the harvesting time by the concerned departments in the manner normally followed by them in procurement season.\

Another potentiality for banks and financial institutions using salam sale as mode of financing is to enter into a 'parallel salam contract'. Under this contract the bank after purchasing a commodity from the first party may sell it through another salam contract with the third party for later time or date of delivery. The price of commodity of the second (parallel) transaction should, of course, be higher than the first one as to constitute part of profit to the bank. This parallel salam contract can be undertaken by banks provided that both contracts must be independent from one another in term of right and obligation. This condition, of course, implies two separate independent contracts and three groups of participant involved. The bank may thus, after signing the first contract, obtain another salam contract from the third party.

It is interesting to note that in bai' salam and bai' muajjal either goods or the money price are being deferred. Bai' salam has no practical advantage over bai' muajjal. On the other hand, bai' salam is more cumbersome. These techniques are allowed to facilitate genuine transaction of trade between parties genuinely engaged in trade. A caution must be added about their indiscriminate use. It will be repugnant to Shari'ah if these techniques are used for conducting transactions, which are normally considered 'speculative', or for facilitating 'make-believe' transaction in which commodities are only 'deemed to have been purchased or sold'.

3.4. **Istisna’**

Another mode of sale-related financing belongs to the category of istisna’. It is defined as a contract to purchase by order now, for a definite price, something that may be manufactured or constructed later according to agreed
Specifications.\textsuperscript{119} It means to order a manufacturer or constructor to manufacture or construct a specific object for a definite price.\textsuperscript{120} As the object in question is deferred on delivery, it is quite fair that the money paid is also deferred. But both parties, seller and buyer, can agree upon the maximum period of delivery as well as on the pattern of payment which may be on installment basis, provided that once the manufacturing or constructing process starts working the contract can not be cancelled.\textsuperscript{121}

Islamic bank, permitted by Shari'ah, may use the technique of \textit{istisna’} as a mode of financing by entering into a parallel \textit{istisna’} contract or by subcontracting with the third party.\textsuperscript{122} Thus the bank may undertake a construction of a facility for a deferred price and subcontract the actual construction to a specialized firm. In this case bank can calculate its cost and fix the price of \textit{istisna’} with its client in a manner, which may give it a reasonable profit. \textit{Istisna’} as a mode of financing can be best employed by Islamic banking and financial institution to finance house building in private sector as well as infrastructural projects in public sector.\textsuperscript{123}

4. Loan-Related Financing

Other, last but not least, types of mode of financing based on loan-related financing. Under Islamic banking and financial system, loan sanctioned does not carry any rate of interest as stipulated by Islamic jurisprudence based on Qur’ān and Sunnah. Since all Islamic banks and financial institutions receive interest-free deposits from the public, they are, hence, entitled to sanction interest-free loan to public needy as well. Under loan-related finance, two modes of financing are quite interesting.

4.1. \textit{Qard Hasan} (Benevolent loan)

\textit{Qard hasan} or benevolent loan is defined as “a loan with the stipulation to return the principal sum in the future without any increase.”\textsuperscript{124} Its literal sense is derived from the verses of the Holy Qur’ān, among them, reads; "If you loan
to Allah, a beautiful loan\textsuperscript{125}, He will double it to your (credit), and He will grant you forgiveness: for Allah is all thankful, most forbearing\textsuperscript{126}.

Socially, banks provide interest-free loan on the basis of \textit{qard hasan} to needy sections of the society either for consumption such as marriage, education, health care, etc, or for productive purposes to small producer, farmers, village artisans, etc. It often happens that certain entrepreneur may need short-term loan to work out final stage of production or kind, and this process cannot be financed out of PLS modes of financing. Only interest-free loan will be more preferable in this case. The general objective of interest-free loan is to help people start their independent lives or to raise their income and standard of living.

This type of financing, however, as a matter of policy, does not constitute any significant source of income to the bank but, in long-run, it proves to be quite impressive. Interest-free loan on the basis of \textit{qard hasan} reflects bank's prestige and goodwill in the society. The general public will look upon this service of the bank as social amenity and will greatly appreciate it. This public goodwill is of a decisive importance for establishment and successful operation of the bank. Furthermore, the more the profitability of business, the better the standard of living of people and the more the banking business will prosper. Therefore, from the viewpoint of modern economic and financial theory, interest-free loans will not be entirely non-productive. They are not only profitable in long-run but are also considered as a measure of social service to the community as a whole.\textsuperscript{127}

4.2. \textbf{Loan with Service Charge.}

Interest-free loan as a mode of financing of Islamic banks will necessarily involve considerable expenditures. These expenditures may not be met by any mean. Since the funds being lent in this case do not belong to the banks and have to be returned to their depositors without any decrease, someone, hence, has to pay for the costs of bank's management in the form of
service charge. However, it would be contrary to the Islamic spirit if these fees constitute any source of income for the bank.\textsuperscript{128}

The Council of the Islamic Fiqh Academy established by the Organization of Islamic Conference in its third session held in Amman from 8\textsuperscript{th} to 13\textsuperscript{th} Safar 1407 A.H. (11\textsuperscript{th}–16\textsuperscript{th} October 1986), in response to a query from the Islamic Development Bank, has resolved that it is permitted to charge a fee for loan related service offered by the bank. However, this fee should be within actual expenses and any fee in addition to the actual service-related expenses is forbidden because it is considered to be usurious.\textsuperscript{129}

This mode of financing can be used to finance exports, agricultural inputs to small farmers or to salaried class for consumption purpose that do not qualify for qard hasan on compassionate grounds or cannot be financed out of any other modes of financing. In the opinion of N.A. Zaidi, financing mode of lending with service charge can be employed to finance priority sectors of the economy where either participation in profit and loss is not possible or the possibility of potential loss is imminent.\textsuperscript{130}

Summing up here with the underlying fact that financing operations of Islamic banks and financial institutions engulf all those aforementioned categories. A comparative evaluation of experiences shows that murabahah, as a sale–related mode of financing, appears to be the most popular among them.\textsuperscript{131} Yet, the majority of Muslim scholars and jurists seemed to regard participatory (mudarabah and musharakah) and qard hasan as the only three ideal modes of financing.\textsuperscript{132} Nevertheless, in relation to broad range of business and banking contracts, the significance of other techniques including murabahah, bai' salam, istisna' and leasing could not be denied, only if these techniques be conducted in accordance with the Shari'ah rules and regulations underlining for each of them. If this is the case, not only their conformity with Islamic Shari'ah will be obvious, the attribution of these techniques as window
dressing to interest-based financing system argued by some Western scholar would also cease to emerge in future.

Banking Operation: Other Services.

Commonly Islamic banks also provide other usual banking services under various rules of Shari'ah. Such services are, of course, rendered even today by the conventional banks, for fees, commission, or fixed charge provided that they should be free from interest involved. Such services are, for instance, remittance and transfers, sale and purchase of foreign currency, sale of travelers' cheques, investment/portfolio management, trustee and nominee company services, and so on.

Given the long history of contemporary banking business, Islamic bank and financial institution have emerged as a viable and feasible alternative to traditional commercial banking, which is mostly based on the concept of ribā, which is strictly forbidden in Islam. Important developments have taken place both in the theory and practice of Islamic banking during this period. Hundreds of financial institutions are working around the globe putting the principles of Islamic banking and finance into practice. Islamic banking is no more a mere wishful dream but, instead, has converted it into an existing reality.

Impressed by the success of various Islamic banks and financial institutions, they are, however, considered to be relatively new institutions. They are very young and they still have a long way to go. Yet, these institutions are a living vindication of the Islamic theory of banking and finance.

NOTES & REFERENCES


10. An apt simile: whereas legitimate trade or industry increase the prosperity and stability of men and nations, a dependence on interest would merely encourage a race of idlers, cruel blood-suckers, and worthless fellows who do not know their own good and therefore akin to madness [commentary of the verse 2:275, in the Presidency of Islamic Researches, IFTA, Call and Guidance (ed), *The Holy Qur'ān: English Translation of the meanings and commentary*, Madinah, King Fahd Holy Qur'ān Printing Complex, 1410 A.H., no. 325, p. 126].

11. This is not war for opinions, but an ultimatum of war for the liberation of debtors unjustly dealt with and oppressed [the commentary of Qur'ān 2:279, The Presidency of Islamic Researches..., op.cit., no. 328, p. 128].

13. Real prosperity consists, not in greed, but in giving - the giving of ourselves and our substance in the cause of Allah and Allah's truth and in the service of Allah's creatures. [The commentary of Qur'ān 3:130, The Presidency of Islamic Researches...op.cit., no. 451, p. 180].


15. Seeking the 'Face' or 'Countenance' of Allah, i.e., out of our pure love for the true vision of Allah's ownself (in next world). [The commentary of Qur'ān 30:38, The Presidency of Islamic Researches...op.cit., no. 3550, p. 1189].


20. Ibid.


23. The Qur'ān 70: 24-25 says: 'And those in whose wealth is a recognized right; for the (needy) who asks and him who is deprived (for some reason from asking). It is commented that true charity consists in finding out those in real need, whether they ask or not. Most frequently those who ask are idle men who insolently wish to live upon others. But all cases of those who ask should be duly investigated, in case a little timely
help may set the erring on the way. But the man with wealth or talent or opportunity has the further responsibility of searching out those in need of his assistance, in order to show that he holds all gifts in trust for the service of his fellow-creatures. [The commentary of Qur'an, The Presidency of Islamic Researches...,op.cit., no. 5691, pp. 1817-18].


26. Such as mudarabah and musharakah. See more about these types of finance in next section on banking operation: financing.


28. Ibid, p. 70.

29. The difference between interest and profit is obvious. Both can be regarded as return on capital. But in the former case, the guarantee of return is positive, whereas in the latter case, there is no guarantee of return, instead it might turn out either positive or negative. This is because interest is a reward from loan whereas profit is from trade and other business activities.


34. Mawdudi, Sayyid Abul A'la, op.cit., pp. 105-106.


36. Mawdudi, Sayyid Abul A'la, op.cit.


38. Hameedullah, M., op.cit., p. 221.


43. Khan, Muhammad Akram, *An Introduction to Islamic Economics*, op.cit.


49. Ibid, p. 11.


57. Siddiqi, M.N., *Shirkat aur Mudārabat ke Shara'i Usul*, ibid, pp. 120-121. The main purpose of unlimited liability of shareholders is to protect the interest of the depositors. But practical experience shows that in case of bankruptcy of the bank, it is rarely possible to recover enough money from the shareholders to meet the liabilities of the bank to its depositors. This has led to other measures being taken to ensure depositors' interest. These measures relate to constant supervision and regulation of banking business by the central bank. Depending on central bank supervision and control, banks may be allowed to be set up on a limited liability basis as corporations and joint-stock companies. It is not possible here to go into the juristic issues involved, but the expansion of banking business does require that banks be established on a limited liability basis and that the central bank enforce necessary measures to safeguard depositors' interests. [Siddiqi, M.N., *Banking Without Interest*, ibid, p. 18].


62. Cf. Ibid.


72. For more details, see Saleh, Nabil A., *Unlawful Gain and Legitimate Profit in Islamic Law - Ribā, Gharar and Islamic Banking*, op.cit., pp. 107-143.


74. Under mudarabah, restricted and unrestricted mudarabah are classified. If the provider of capital specifies a particular business for the mudarib (agent-entrepreneur) to invest the money in that particular business only, it is called restricted mudarabah (al-mudarabah al-muqayyadah). In case of unrestricted mudarabah (al-mudarabah al-mutlaqah), mudarib is given a full authorization to invest money in any business he deems fit [Usmani, Muhammad Taqi, An Introduction to Islamic Finance, op.cit., p. 49].

75. The term of the contract is automatically terminated due to death and insane. [Ibid, p. 43].

76. Ibid, p. 53.


79. Al-Khaff, 'Ali, Al-Shirkāt fīl-Fiqh al-Islāmi, Egypt, Dar al-Nashr li'l-Jāmi'āt al-Misriyah, n.d., p. 55, as quoted by Siddiqi, M.N., ibid, p. 19. As far as the liability of loss is concerned, there is unanimous decision of the four famous schools of Sunni jurisprudence that loss will always be distributed in proportion to capital contribution. Whereas for the distribution of profit, the jurists of the Mālikī and Shāfī'ī schools hold the view that profit under musharakah must reflect the proportion of invested capital, while the jurists of Hanbali and Hanafi schools support that for the distribution of profit, the partners in business can settle any proportions by mutual agreement. [See more about these points in Siddiqi, M.N., ibid, pp. 19-37].

81. This mode of financing was first proposed by Sami Hassan Hamoud in his research thesis on Islamic banking (in Arabic) at Al-Azhar University, Cairo, Egypt in 1974. This proposal was subsequently discussed and approved as a permissible mode of financing by the First International Conference on Islamic Banking, held in Dubai, during 23rd-25th Jamad al-Thani 1399 A.H. (1979) [Abdallah, Ahmad Ali, "Methods of Financing Housing According to Shari'ah in the proceedings of IRTI Seminar on Housing Financing from Islamic Perspective, Khartoum, October 27-29, 1991]. See more details and aspects about diminishing *musharakah* in Bendjilali, Boualem and Khan, Tariqullah, *Economics of Diminishing Musharakah*, Jeddah, IRTI/IDB, First edition, 1995, pp. 103.


83. Partnership in agriculture takes two forms, viz., *muzara'a* (share-cropping) and *musaqat* (tree-sharing). In the former form, it is a contract whereby the landlord puts his agricultural land at farmer's disposal to farm and the farmer undertakes to give the owner an amount of agricultural produce already agreed upon. In the latter form, it is a contract when one person strikes a deal with another calling the latter to trim and water his fruit trees or kinds for an amount of fruits or proceeds from sale as agreed upon [Al-Harran, Saad Abdul Sattar, *Musharakah Financing: Concepts, Principles and Methodology*, op.cit., pp. 17-18; also in Ahmad, Ausaf, *Contemporary Practices of Islamic Financing Techniques*, Jeddah, IRTI/IDB, First edition, 1993, p. 58].

84. *Musharakah*, apart from *mudarabah*, can be used to finance import and export through the issuing of letter of credit. If the letter of credit has
been opened without any margin, the form of *mudarabah* can be adopted. If with some margin, *musharakah* or both will be relevant. After imported (and exported) goods are cleared and sold, in case *musharakah* mode is being employed, their sale proceeds will be shared by importer (exporter) and the bank according to pre-agreed ratio. [Usmani, Muhammad Taqi, *An Introduction to Islamic Finance*, op.cit., p. 61].

85. Ibid, p. 158.

86. Ibid.

87. Leasing is allowed by Shari'ah subject to certain rules. For more details about rules of leasing, see Usmani, Muhammad Taqi, ibid, pp. 159-163; Saleh, Nabil A., *Unlawful Gain and Legitimate Profit in Islamic Law*..., op.cit., pp. 120-122; etc.

88. The most particular reason is tax concessions for leasing. Instead of giving a simple interest-bearing loan, some financial institutions started leasing some equipment to their customers, while fixing the rent of these equipments, they calculated the total cost they have incurred in the purchased of these assets and add the stipulated interest they could have claimed on such an amount during the lease period. The aggregate amount so calculated is divided on the total months of the lease period and monthly rent is fixed on that basis. [Usmani, Muhammad Taqi, ibid., p. 159].


91. Hire-purchase (ijarah wa iqtina) was unknown to traditional Muslim scholars, yet there is nothing unlawful or suspicious in the combination of two well-established concepts, i.e., lease and option (to purchase), provided that ribā is avoided and is not what the contracting parties eventually aim at. [Saleh, Nabil Ali., Unlawful Gain and Legitimate Profit in Islamic Law..., op.cit., p. 122].

92. Usmani, Muhammad Taqi, An Introduction to Islamic Finance, op.cit., pp. 174-176. However, according to Qur’ān 5: 1 and 17:34, the fulfillment of promise is obligatory and made mandatory by the majority of jurists. As far as this question is concerned, the unilateral promise of the bank to sell in hire-purchase is some how similar to that of diminishing musharakah which can be cautiously be inferred from the OIC Islamic Fiqh Academy Resolution No. 2 (Jeddah, 1989), that the sale provision of the contract can be made binding only on the financier. This implies that the purchase is not binding on the entrepreneur. This is because it is unjust to make the entrepreneur binding to purchase something in the future (which he does not express his interest by approaching the bank like in the case of murabahah). Although the entrepreneur will enjoy priority rights of purchasing the leased assets on the promise to sale by the financier (bank), some other parties may always show their interest in purchasing the assets and the entrepreneur himself may not be ready for the purchase. [Cf. Bendjilali, Boualem, and Khan, Tariqullah, Economics of Diminishing Musharakah, op.cit., pp. 17-19].


94. This scheme of financing is more or less similar to musharakah mode of financing in housing in which bank provides finance to customer on musharakah basis in order to have a share in the rent of the asset.


98. For more details about rules and conditions of a valid sale contract, see for example Sabiq, Syed, *Fiqh al-Sunnah*, (Arabic) Jeddah, Al-Qiblah Company for Islamic Culture, n.d., Vol. 3, pp. 223-250; Usmani, Muhammad Taqi, ibid., pp. 97-101; etc.


100. It should be noted that spot sale, i.e., prompt exchange of goods and money, is a legitimate business transaction, derived from Qur’an 2: 275, of the bank. However, it does not constitute any part of bank's finance to its client.

101. Saleh, Nabil, A., *Unlawful Gain and Legitimate Profit in Islamic Law*, op.cit., p. 117. The legality of *murabahah* is not questioned by any of the schools of law. [Ibid]. There has been a record of *murabahah* transaction in early Muslim society, see Malik, *Muwatta*, Egypt, Al-Halabi, n.d., Part I, p. 159.


103. Iqbal, Zubair and Mirakhor, Abbas, *Islamic Banking*, op.cit., p. 17. It is believed that mark-up cannot be charged in transaction of loan, as it is similar to interest. Since the amount of payment on *murabahah* transaction that the client owes to the bank is nothing but a debt, mark-
up on debt, hence, becomes interest on loan. On the other hand, a rebate on earlier payment is not permissible unless it does not constitute part of the conditions in the contract and it is given by the bank voluntarily. [Cf. Usmani, Muhammad Taqi, ibid, pp. 140-143].


108. At this connection, the letter of credit under the principle of *murabahah* is employed. Under the scheme, customer informs Islamic bank of his letter of credit requirements and requests the bank to purchase/import the goods indicating thereby that he would be willing to purchase the goods from the bank upon their arrival on the principle of *murabahah*. The bank establishes the letter of credit and pays the proceeds to the negotiating banks utilizing its own funds. The bank sells the goods to the customer at a sale price comprising their cost and a profit margin under the principle of *murabahah* for settlement by cash on a deferred term [Bank Islam Malaysia Berhad, *Organisation and Operations*, op.cit., pp. 17-18].

110. This mode of financing (mark-up cum buy-back agreement) had been declared un-Islamic by the Federal Shari'ah Court of Pakistan in November 1991 decision [Khan, Muhammad Akram, *Islamic Banking in Pakistan*, op.cit., p. 11].


121. The contract of istisna’ creates a moral obligation on the manufacturer to manufacture the goods, but before he start the work, any one of the
parties may cancel the contract after giving a notice to the other. However, after the manufacturer has started the work, the contract cannot be cancelled unilaterally [Ibn Abidin, *Radd al-Muhtar*, n.p., n.d., Vol. 5, p. 223].


123. For more details about how istisna’ financing can be best suited for financing infrastructural project in public sector, see Zarqa, Muhammad Anas, ibid, pp. 67-74.


125. Our charity or love or spending in the cause of Allah is called metaphorically ‘a beautiful loan (to Allah)’, which not only increase our credit account manifold, but obtain for us the forgiveness of our sins, and the capacity for increased service in future. ‘A beautiful loan’ is excellent in many ways: (1) it shows a beautiful spirit of self-denial; (2) in other loans there may be a doubt as to the safety of your capital or any return thereon; here you give to the Lord of All, in whose hands are the keys of want or plenty; giving you may have manifold blessings, and withholding, you may even lose what you have. If we remember that our goal is Allah, can we turn away from His cause? [Commentaries of the Holy Qur’ān, The Presidency of Islamic Researches..., op.cit. no. 5500, p. 1762 & no. 276, p. 108].


129. As referred to by Ahmad, Ausaf, “Contemporary Experiences of Islamic Bank: A survey” in Khan, M Fahim (ed.), op.cit., p. 94.

