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Investment and Recoveries Laws:

Study of Modern and Islamic Banking of Pakistan

Dr. Muhammad Aslam Rajper
Government Degree College, Thari Mirwah, Khairpur Mirs

Imtiaz Ahmed Memon
PhD Scholar, Shaheed Zulfiqar Ali Bhutto University of Law, Clifton, Karachi
imtiazahmed25@yahoo.com

Dr. Liaqat Ali Abro
Law Officer, Department of Law, govt. of Sindh

Abdul Aghaffar Korai
Associate Professor, Shaheed Zulfiqar Ali Bhutto University of Law, Clifton, Karachi

Abstract:

Since 1947, the people of Pakistan are in demanding to eliminate the Riba from the financial system/mechanism in Pakistan, the constitution of Pakistan is also incorporated this demand. Elimination of Riba in the main objective of the state policy mentioned in the constitution as mentioned in the in the Principles of Policy of the Constitution of Islamic Republic of Pakistan. Quaid-e-Azam, Muhammad Ali Jinnah, in his speech at the occasion of the inauguration of State Bank of Pakistan, had expressed the desire for evolving an Islamic system of banking. Article 38(f) of the Constitution of the Islamic Republic of Pakistan provides: "The State shall eliminate Riba as early as possible."

Conventional banking system surely the basic need of the every society, it provides several services and functions which also provide to growth of economy as well as increasing of investment projects. Islamic Banking system surely different from conventional banking system, the methods and products in the both systems are differ to each other's. In Islamic banking system fixed return on investment is not permitted and also fixed charge rate not permitted on loans to customers.

The main purpose of this research study is to determine and analyze the different products in conventional banking system, its importance in view of Islamic and Sharia Scholars and why all products of conventional banking are illegal as declared "Haram" in Islamic banking system. It is also need to be discussed what type of more changes require to be done in the current structure/mechanism suitable for Muslims. The study review and compare performance of conventional and Islamic banking in respect of investment and recoveries operating in Pakistan.

The aims of this study are to evaluate and compare the financial performance in respect of investment and recoveries of Islamic and conventional banks of Pakistan. By this research it will be focused on history and evolution of Modern and Islamic banking, Comparison, principles, challenges, growth, differences and similarities, criticism and recommendations.

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KEY WORDS: Investment, Recoveries, Riba, Comparative, Critical, Modern, Islamic banking, Laws, Conventional, financial system, growth, challenges.

Introduction

The increasing level of competition, globalization, continuous innovation and consolidation among various banks has increased the spectrum of services for the banking sectors. Since the introduction of Conventional and Islamic banking, the critical evaluation of these banks developed high level of interest among many people (Salem, 2008). Among these are the bank managers, investors, regulators, depositors who are concerned with the way banks are performing. In the modern era, the goals of profitability are very important for everyone (Rashid et al., 2017). The financial markets performances are evaluated based on how well the banks are performing and to what extent they signal to investor either to invest or withdraw from banks (Siraj and Pillai, 2012). The research further provides a comparative analysis of banking features, investment modes and recovery strategies.

In the mid of 20th century, the liberation from colonial powers of the Muslim world was almost completed and revival of Muslim ideologies began to take with increasing pace. The Muslim societies as well focused in looking the social systems with Islamic lenses and suggested for developments. During this era, the Muslim scholars and philosophers identified that the economic system had some weaknesses (Hanif, 2011). The notion of capitalism was examined in detail and some short-comings were discussed. There are four factors land, labor, capital and entrepreneur. The three resources somewhat earns the similar level of rewards except the entrepreneur that bears the most risk. Under the capitalist structure, the capital yields a fixed reward called ‘interest’. As a dealer of money, the reward for using it is interest. Thus, this forms the basis for conventional banks to regulate sources of revenue and cost of funds via interest. All conventional banks functions of the principle of capitalism and charge interest which is forbidden in Islam (Shaikh, 2013). The introduction of Islamic banking and its growth came into being in 1973 in the Conference of Foreign Ministers of Muslim countries. The decision to make Islamic banks was announced. In the recent few decades’ Islamic banking shows significant growth.

The concept of Islamic banking is based on Shariah which is the ultimate law of Islam. Its practical implementation is possible once the structure of economy comprises of Islamic financing institutions such as the development of Islamic banks in societies. It shares the risk among the capital provider and user of funds (entrepreneur). The profit rate is maximized based on the principles of Shariah.One important aspect of the Islamic banking system is Zakat which is inclusion not only for customers but for people governing this system (Shahid et al., 2010). The system of banking based on Islamic Shariah promotes equal contribution to parties involved in the case of loss or profit. The customers and clients are referred to as partners or contributors in any transaction that takes place. Among the Asian countries, in Pakistan the growth of Islamic banking is growing exponentially (Rashid & Jabeen, 2016). Five major banks are operational in the country and functioning as per the Shariah with each one of them having Shariah Board advisors to govern. The conventional banking system is the one that totally relies on the financial model where the banks borrow from the savers and lends money to other individuals. Profit is made based on the difference at the time of borrowing and lending of money. In addition to this, the conventional banks also earn from services provided such as letter of credits.

Research Background

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The banking industry exists from early days of human existence. There was exchange of goods among people on the basis of barter trade. With the passage of time the exchange of goods emerged on the basis of money, this was the time when money came into the mode of finance in the shape of coins and notes (Moin, 2008). Hence, the banking operations speeded up and people were more concerned with investing into banks for yielding higher returns. The conventional banking system is not new and it takes form of interest based banking. The depositors or investors yield higher returns by money in banks and earning interest on it. Whereas, the Islamic banking prohibits the interest based banking and promotes halal financing modes for investors and depositors (Deehani et al., 2015).

In the modern or commercial banking the system is purely functioning on the rate of interest. This is not permissible in Islamic Shariah. There are segment niches in the society that likes to be associated with religion is most of their matters (Chong & Liu, 2009). According to the Islamic laws and institutions, the element of interest is strictly not permitted. With the passage of time the banking sectors of the world became important means of functioning in the economies and societies. Interest in Arabic language is known as interest which is the basic functioning system of conventional bank (Paldi, 2014). It is the amount that is charged additionally on a loan for an extended time of credit. In the religion of Islam, for trading and transaction purpose, the element of interest had never been supported in Islam. But also in many other religions there are restrictions. According to the Bible, it was stated that usury to the person for the money use shall not be lent. Similarly in Quran is a displeasing act in the eyes of ALLAH.

The banking system came into existence when there were growing human needs in trade and production (Rammal and Zurbruegg, 2016). An increase in capital production resulted in more capital banking. The emergence of banks was visible in the ancient time in the Middle East. People used to exchange goods against the resources they had. Initially, in 3400 BC, the banks were related to religious beliefs and after Hammurabi's Banking Code, the banking was considered as commercial activity (Iqbal, 2001). The first conventional banking system was observed in Italy in 15th century. By 19th century due to various political and economic conditions, banking system was considered financial institution that provided services.

Research Problem

Risk results due to uncertainty in survival of a project or venture. When there is higher risk or insolvency the bank loans are difficult to be paid. Operations of lending are different in Islamic and conventional banks. This is because the nature and goals of these banks are different. Initially, the banking operations were visible only with interest based banking system (Asad et al., 2018).With passage of time worth of Islamic banks has increased for depositors, investors and researchers. It is crucial to identify how banking systems operate and manage the risks with regard to the lending of funds and recovering of liabilities (Howard, Martin and Wilson, 2011). The bankers reported several difficulties in both banking systems such as evaluate projects, customers, difficulties in repaying debts and using legal actions to recover funds. The gap lies to determine the investments in Islamic and conventional banks with recovering of debts according to the laws. In Pakistan, living cost is high and earning per capita is not justifiable. The issues faced by common citizen are with regard to banking systems, the interest rate, the repay time and procedures (Zahir and Hassan, 2001). The unequal distribution of wealth and income is also among the reason that people prefer to institutions to fulfill their needs and wants. Hence, the banking sector has been contacted most when people needed finance to meet their wants. However, due to the presence of Islamic banks and conventional banks the competition have grown intense. Some niche segments of the market have considered Islamic banking over conventional banking due to several reasons (Rehman,2016).With the help of this research the gaps shall be addressed and investment modes in Islamic and conventional banking will be discussed, followed by the legal method to recover loans and debts. The comparative study in the

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scenario of this research visibly depicts the differences in conventional and Islamic banking system. The laws governing each window of banking type largely depends how they are regulated and what are the basis of operations in each of the banking system.

Every research conducted is unique in some way. This means that a research should address a certain gap or a problem. The researcher must identify the gap and address it. This makes the research different from other research studies. Research conducted in past may not be very accurate as the lack of data has been a problem and getting the relevant information is often difficult. Also, most studies were carried out in the developed countries. In developing countries, the research scope on such a context is low and there is room for new explorations within the field of banking. This study takes into consideration the scope of banking in near future with addressing the gap.

Research Questions

The research questions are developed based on the objective the study will achieve. Research questions are likely to be addressed with a justification and conclusion mentions the overall essence of research by reaching a common ground. With the help of the following questions the direction is set for developing a proper finding that are to be presented in the next few chapter. The research questions are stated as follows;

- What are the differences between Islamic banking and Conventional banking operations?
- What are the investment and recovery modes of Islamic banking and Conventional banking?
- What are the challenges and opportunities associated with Islamic banking and conventional banking practices with regard to recoveries and investment in Pakistan?
- What are the improvement strategies for making the banking sector of Pakistan effective and efficient?

Research Significance and Rationale

The research is conducted with regard to the investment and recoveries in the light of Islamic and conventional banking. The study is important as it provides the comparative analysis on the banking laws of Pakistan which is quite useful for law students to understand how the banking system is based. The two banking modes continue to exist and provided new gateways to carry out research and make some interesting findings. For researchers, this study is useful as it compares the laws under which Islamic and Conventional banks are operating. Each law has been provided and is aligned by the constitution of the Pakistan. Further, the State bank of Pakistan regulates the working of each banking operation. This means bankers can gain more insights into understanding of Islamic and conventional banking by weighing the pros and cons. The research is a good study material for students; they can view in detail the asset and liability sides of each banking mode and take help for their personal understanding in real world and with regard to the studies they are pursuing in the field of banking.

The research significance is not limited to the domain of education but for the corporate world as well. Investors and depositors can take advantage is studying how different are the operations of Islamic banking are from the conventional banking system. When it comes to investment modes, multiple Shariah based invest modes are available which are free from interest and this is what interests the Muslims the most in Pakistan. As far the continuum of recoveries under banking sector is concerned the conventional banking charges premium on the return which often becomes a challenge for people. Whereas in Islamic banking, if the recovery is not made the investor is liable to pay the welfare amount which should be spent for needy people. With this point it can be said most NGOs and welfare organizations might be concerned with the way banking sector is performing especially the Islamic banking sector. This is because via this research,

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they can determine that all Islamic banks are somehow welfare oriented in the case if the customer fails to pays the dues. Under the agreement signed between bank and customer, the customer is obliged to pay certain payments with passage of time for welfare cause.

The outcome of both banking system largely affects the normal citizen living in Pakistan as people evaluate and aim for opting less stressful banking options. When conventional banking was the only option, people did not have any choice; in many cases they were worried of being getting defaulter and paying heavy fines or penalties. Apart from that there is a segment that sticks to Islamic beliefs more and prefer halal ways of doing business where interest based markup is not involved. Now with Islamic based banking they are promoting their businesses. For such people, the research is valuable as it compares the differences in modes of financing among the conventional banking and Islamic banking. This research is useful for Islamic scholars; they can further use it and add more substantial matter to provide more comprehensive understanding. Industrialists and investors can utilize this research report for making decision for their future course of plan. They can offer products and services to the niche segments of the society based on the modern laws of banking. It would be wise for the investors to provide the people of society with options to finance from banks. The facilities to be financed would not be limited to any specific banking type but both windows of banking that is conventional and Islamic can be offered to facilitate them as per their belief and needs.

The research significance is extended to other domains as practitioners and researchers can contribute to existing body of knowledge and present new dimensions on interpretations. The overall purpose of the research is to convey the knowledge about the investment and recoveries in Islamic banking and conventional banking in the context of Pakistan. Hence, the significance of the research is well defined and people belonging to various fields can refer it and produce new dimensions within the related topic.

Concept of modern and Islamic banking and its impact on investment and recoveries

Banking institutions are a fundamental part of the financial system globally and the main objective stressed on with regards to the banking system, other than to facilitate transactions is the goal to maximize profits. According to a study of literature (Cerovic, Nikolaj & Maradin 2017) the banks came to exist through the exchange system where banking services were primarily offered by official religious entities; however, later on, it transformed into a commercial activity and since then, has worked for mostly corporate and commercial use. Bankers were considered as merchants, and the field was dominated by the demand for high production and growth (Ceroviz, Nikolaj & Maradin, 2017). This increase in demand led to a significant increase in the banking industry. Apart from the competitive market, globalization also plays a major role in characterizing the modern banking world (Ceroviz, Nikolaj & Maradin, 2017).

Islamic finance has now made a significant progress in the modern financial world and contributes to the world economy despite the fact that conventional banking has been in place for more than 5000 years as compared to Islamic banking (Cerovic, Nikolaj & Maradin, 2017).

(Alharbi 2015) defines Islamic banking as an institution where the financial parties abide by the Shariah laws, have legitimate contracts, and have a balance between the monetary and the social returns received. (Ali 2015) elaborates on the underlying ideology of the Islamic banking system and relates that it is subjected to the idea of risk sharing, and collective and social welfare. This is in opposition to the conventional banking system which is aimed at maximizing profits and based on the principles of time value of money.

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(Abedifar et al., 2015) highlights that while Islamic finance was made by the Muslim empire, it comprised of 1% of the global financial holdings of assets and grew at a much faster pace than the conventional banking system post the real estate crisis.

Following the rules of the divine law as laid under the Quran and the Sunnah, Islamic banks are prohibited from investing in or disbursing interest as noted in the Holy texts as Riba, and are not to contract with any parties that might have their other financial dealings laced with interest (Ali, 2015). (Abedifar et al., 2015) also emphasized on the adherence to Shariah (Islamic law) and the prohibition of Riba in business and financial deals under Islamic law and the same was confirmed by (Ahmed, Siddique & Mufti 2013) which stated that interest and usury are prohibited in Islam, such that both fall under the umbrella of Riba. Further elaborated by Ahmed, (Siddiqui & Mufti, 2013) about the main distinctions between conventional and Islamic banking in the contemporary world was the use of interest, uncertainty and speculation by the banks and the prohibition of it by the Islamic banks. Due to this, a large Shariah-abiding society has access to financial services that enable them to invest in a permissible manner and safe manner.

According to (Moisseron, Moschetto & Teulon 2015), the system for Islamic banking has always been a mirror for the Muslims and often deals with the challenges that they face, hence keeps changing with respect to the societies and modern-day problems. Some of the basis on which Riba is prohibited in the world of Islamic banking and finance is because it leads to many social evils which lead to economic downfall such as income disparity, unequal wealth distribution, and a large accumulation of wealth with the rich of the society which eventually leads to poverty (Ahmed, Siddiqui & Mufti, 2013). Furthermore, while the conventional banking system prioritizes return and profit maximization, Islamic banks give priority to fair business dealings and their customers, such that the institutions take on additional risk with their clients (Ahmed, Siddiqui & Mufti, 2013) and it is now an area which other countries are now willing to explore.

The formation of the Organization of Islamic Countries (OIC) and the Islamic Development Bank (IDB) marked a significant position of Islamic banking and finance in the world where it was ensured that the Islamic system was in place and the interest-free system could be employed providing catalysis for the Islamic financial world (Ahmed, Siddiqui & Mufti, 2013).

In a study organized by (Shabbir & Rehman 2015) it was observed that Islamic banks ranked higher than conventional banks in terms of providing a quality of service to their customers; however, there was a lack of professional bankers with the Islamic banking system such that if their recruitment process was better with improved training workshops, employees would have better information regarding the services offered, and would be helpful towards tailoring products according to their clients' and public's need etc. '

In case of Pakistan, while the country is an Islamic Republic, there is a mix of conventional banking and Islamic banking in the country and the customers are free to choose. While most customers tend to lean towards Islamic banks towards investments and other such opportunities, banks that are not exclusively Islamic do engage in activities with conventional banks and commercial businesses that partake in activities related to conventional banking (Shabbir & Rehman, 2015). (Shabbir & Rehman 2015) further notes that the lack of incentives for the Islamic banks and their customers, and an increased level of concentration makes it difficult for people to invest in the Islamic banking system. Another difference highlighted by (Shabbir & Rehman 2015) amounted due to the fact that conventional banking systems are less complex than their Islamic counterparts as they are only concerned with monetary gains and profit generation, whereas Islamic banks have to be careful with their Shariah compliance with every act.

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Background of Banking Companies Ordinance in Pakistan

The Banking Companies ordinance was initially issued in the year of 1962 and promulgated by the president of Pakistan at the time, under the argument to consolidate all laws relating to banking companies and to amend them with recent progressions such that the ordinance is applicable to all banking companies and they abide by the rules laid down (Banking Companies Ordinance, 1962).

The ordinance was further amended in the future. Foremost in the year of 2000, where the country was under martial law after a declaration of the state of emergency, and the national assembly and the senate was dissolved, the short title along with major sections including section 13 concerning reserves, minimum capital requirements, and currency exchanges (Banking Companies (amendment) Ordinance, 2000, 2017).

Later in the coming year of 2009, an amendment bill was passed which concerned percentages of shareholding in banking companies, where if any percentage of shareholding was found to be disadvantageous to a bank, the shareholding must be transferred (Amendments in Banking Companies Ordinance 1962, 2010). However, it is widely unclear as to which amount of percentage would be considered as disadvantageous and may differ with different situations (Amendments in Banking Companies Ordinance 1962, 2010).

Recently, in 2018, the senate passed the bill to amend the Banking Companies Ordinance further, such that the title is changed to Banking Companies (Amendment) Act, 2018; and section 27B is omitted concerning trade unions (Rabbani, 2018). While the Banking Companies Ordinance was issued for the regulation of banking companies, section 27B was in violation of rules and conduct that Pakistan was obligated to abide by, such as article 17 of the 1973 constitution, ILO provisions, and IRO 2009 (Rabbani, 2018). This was done post a report was published that suggested the omission of the section, which restricted trade union activities, which are currently regulated by the IRO (Rabbani, 2018).

Investments of conventional banking

Because the conventional banking system has pre-existed for a long time, conventional banks offer a wide range of services and investment opportunities for their investors such that they have developed financial products for the general use of public. This generates an increased circulation of funds in the economy (Climent, 2018). However, because the primary goal for conventional banks are to maximize profit (Cerovic, Nikolaj & Maradin, 2017) they often neglect the ethical or the social aspect of their financial and investment activities.

Furthermore, according to (Climent 2018) the investment criteria for conventional banks differ vastly from the Islamic banking systems i.e. it is dependent upon the Return on Assets (ROA), Return on Equity (ROE), and risk diversification. On the basis of the aforementioned criteria, a conventional bank identifies and then decides to invest in the product.

(Hanif 2014) attempted to draw a comparison between the investments of the conventional and the Islamic banking systems. Conventional banks offer other businesses opportunities by providing them overdraft facilities, long term, short term, and medium-term loans and other credit facilities, while demanding a fixed rate of return and the businesses are engaged in production that benefits the economy (Hanif, 2014). Other than this, conventional banks offer leasing activities where the ownership of the asset is not transferred, and the lease amounts are pre-determined (Hanif, 2014).

For agricultural and housing loans, conventional banks simply invest in these loans and mortgages with a predetermined interest rate. Agricultural loans are often returned when the farmers have sold their crop,

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while for housing loans, till the mortgages are paid off (Hanif, 2014). Other investments as reported by (Hanif 2014) include government securities, long term loans, bonds or debt instruments of leasing companies, shares, and other calls. Additionally, conventional banks also obtain an interest on the mandatory reserves they keep and further investments in interbank deposits (Hanif, 2014).

Investments of Islamic banking

Alharbi (2015) defines Islamic banking as an institution where the monetary returns and the social returns for investments balance out, and hence, investments of Islamic banks include instruments and products that would lean towards the socially and morally responsible activity, where prohibition of interest, uncertainty, and speculation would be present (Ahmed, Siddiqui, & Mufti, 2013). As (Najaf & Najaf 2016) state, the core purpose of Islamic banking lies in the values of equity, morality, and diversity.

In an Islamic banking system, a bank is not the sole owner of any rewards that are obtained from an investment but is shared with the depositor as well (Hanif, 2014). Furthermore, Islamic banking, unlike conventional banking, does not primarily depend on money but is centrally based on assets. The reasoning for illiquid assets being the foundation for Islamic banking is presented by (Iqbal & Quibtia 2017) given that it would help in the creation of real assets and inventory, which is then circulated for the economy. Furthermore, lending is done only when the business that is being considered is contributing to the welfare of the society through production rather than operating on a conflicting basis (Iqbal & Quibitia, 2017).

Hence, and Islamic bank can issue interest free loans namely (Qarz e Hasna) but not any other type unless it is an asset itself (Hanif, 2014). Islamic banks also lease assets known as an Ijarah in Islamic terminology; the rentals are agreed beforehand, however, the risk is managed by the Islamic bank alone, and not the lessee. The rental payments for the Ijarah are due only when the asset is delivered to the lessee, however, the banks cannot ask for additional payments in case of faulty equipment, or if any major maintenance is being done on the asset (Hanif, 2014). (Hanif 2014) further adds that in case of destruction of the asset, the bank cannot ask for further rentals either.

Agricultural loans in Islamic banking follow a principle similar to the one noted in conventional banking with the exception that interest is prohibited (Hanif, 2014). Housing loans work through the process of diminishing musharakah, where the bank and the borrower jointly purchase property which each a share in it; the bank rents its share to the borrower and later, the borrower pays their rentals as well as a purchasing price for the remaining share of the property (Hanif, 2014). By the end of the payments, the property's ownership is wholly transferred to the borrower. Similar are the services that are offered by Bank Islamic by the name of MUSKUN home financing (Najaf & Najaf, 2016).

Most of the investments relating to Islamic banking are short term and highly liquid instruments in the market (Hanif, 2014). This is because other medium to long term instruments, call options, government securities and bonds carry interest, which as factually mentioned consistently is prohibited in Islamic banking and finance. Reserves in the central bank, and interbank transactions also carry interest and are also therefore prohibited in Islamic banking investments, which often leaves the equity market for the segment. However, according to (Hanif 2014) the equity market also has conditions attached to it such that without the fulfillment of those conditions, an Islamic bank cannot invest in those securities. The conditions require the business to be invested in, to partake only in operations and trade that are permissible in Islam (i.e. the business is halal) and for the financial transactions of the particular business to be free of Riba i.e. interest (Hanif, 2014).

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The study (Hanif, 2014) presented that in Pakistan, there are a very few number of companies who meet the conditions required for Islamic banking investments due to the large influence of the conventional banking system.

In the context of Islamic banking, the investors must comply with certain guidelines to gain profit and falah. Muslims have the belief that attaining falah is not limited to this world but can get the virtues of it even in hereafter (Al-Mubarak and Osmani, 2010). There are multiple investment arrangements under Islamic Banking where the element of riba or interest is completely forbidden. Investors chooses principal Islamic asset management

Mudarabah (profit and loss sharing):

Mudarabah is when one partner is providing his money to another for the purpose of making the investment in a business. The person who provides the money is called 'rab-ul-mal' and the one who manages it is called 'mudarib' (Usmani ,2002). Under this arrangement, the Islamic banks gather the money from investors and offers savings and profit or loss sharing according to the agreed formula of Sharia (Islamic law). The Islamic banks never invest funds in the entities that are indulged in prohibited businesses. The proportion of profit is decided via mutual agreement (Daly and Frikha, 2016). If the loss is there, it shall be borne by owner of capital.

Musharakah (Joint ownership):

Musharakah is used in the business context where trade and transactions take place. It is considered more ideal than the interest method of financing. It can be described as classical partnership where two or many financiers provide their finances for a project or venture and they agree to share profits as mutually agreed (Usmani, 2002). The loss is likely to be shared as per the ratio of capital provided. Each partner has the right to manage the project. The interest based approach relies on fixed percentage of return regardless of loss or profit borne by debtor. Musharakah does not promise a fixed rate of return, but relies on actual profit generated from joint venture (Sairally, 2007). The financier will have the losses if the joint venture does not bring any benefits. Interest based approach is unjust in Islam because the loss either to creditor or to debtor.

Musharakah offers some partnership modes. In Shirkh al-inan, members of the partnership act as agents and do not ensure the guarantee of each other on some terms and conditions. And on the other hand, the other mode ensures equal right and profit sharing that comes under the lens of Shirkah al-mufawadah. Another mode of financing constitutes an unending partnership until both partners agree to terminate the agreement with a proper settlement of funds, profit and other considerable terms.One of the financing modes also gives the leverage to draw one partner's share and that share can now be resettled by some other willing partner. For this, the total sum is to be finalized and passed for transparent and unbiased resettlement (Meera et al., 2012).

Ijarah (leasing):

The term Ijarah means to rent. In the Islamic law Ijarah is used for two different scenarios. The first is when the person is hired and is paid for his work. In this case the employer is mustajir and employee is ajir (Salman, 2012). In second sense, Ijarah is used for leasing purpose such as the right to sale an asset for

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certain time or receiving a rent against the asset provided for use. It is used by the Islamic bank as in the form, where lessee pays lessor the installments for the purchase of equipment (Usmani, 2014).

Murabahah (cost-plus):

Murabahah is commonly used as in terms of sale. The feature that differentiates it from other types of sale is that the cost is disclosed by the seller and how much profit is charged in addition to the cost is also told (Hanif, 2011). The intermediary can buy a specific asset such like home or car. The intermediary agrees at a specific sale price with the buyer including his profit. The purchase can be made via one-time payment or through several deferred installments. Interest-bearing loans are not permitted under Islamic laws. It works on the principle of profit markup in the market rather than interest-oriented. Conventional loans and charging interest are not permissible in Islamic laws and financing models. Both the buyer and seller agree on pre-defined terms and conditions including cost and the markup, which are supposed to be paid in installments. Additional charges are also not applicable after a due date resulting in arousing multiple problems in Islamic banking and financing models (Gundogdu, 2018).

Salam and Istisna:

Salam is also a type of sale where the payment is received in advance and the goods or commodities are delivered in future time period. The supply of products is deferred but the payment is done before the goods are delivered (Hanif, 2011). In such scenario, the seller benefits as he receives the cash price in advance and also buyer benefits for paying in advance. Usually, on the spot sales or immediate delivery, higher prices are charged than for the deferred delivery. Such means of financing is used by banks for facilitating traders and farmers. Istisna is also a type of sale where the purchaser gives order to the manufacturer to manufacture certain goods for him (Usmani, 2002). It is used as financing mode by the Islamic banks for different projects such as construction purpose, manufacturing airplanes, ships, etc.

Musawamah:

In Islamic banking and finance, Musawamah is a commonly used term in a type of transaction where the seller offers some local goods and services to a buyer. The Buyer does not know the real cost of the products and services that have been offered. In order to permit this mode of financing, Islamic banking and finance have laid some predefined principles to avail it. In Musawamah, the buyer can negotiate over cost with the seller by which both parties can attain a fair agreement (Ahmad et al., 2010).

This means of financing has substantial changes with respect to other modes. Unlike other modes of financing, where the buyer knows the cost of a local good or service, but in this case, the seller is not allowed to disclose the cost of a product. In the mode, exchange of items goods must take place at the time of money exchange. It also prohibits any future deal because of the nature of item goods as they vary from time to time. The seller and buyer cannot get into a pre-fixed contract that is supposed to happen in the future (Iqbal et al., 2006).

External and Global Issues:

Several international organizations (International Monetary Fund) have hinted at a prophecy about risks associated with Islamic banking and finance. International institutions have put forward the summary that is associated with Islamic banking and finance. The complex banking system and strict Islamic laws and principles have a door open to some terror financing and money laundering crimes. As the whole world is striving hard to eradicate such heinous crimes from the globe, it is mandatory for all Islamic and

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conventional banks to have a meticulous monitoring system on their mode of finance. Terrorism and money laundering watchdogs have also formed a plan to fight the root causes and ongoing symptoms of TF and ML crimes. Proposed plans have a number of recommendations for Islamic banking and finance to mitigate the effect of Terrorism and curb terror financing. Islamic complex mode of financing is found to be the first and foremost hurdle in addressing the genuine issues associated with it. An issue of compliance to the proposed framework of financing requires understanding and timely resolve.

(Rachel Ehrenfeld)As Islam stresses the importance of Zakat, equal wealth distribution, social justice, and uplifting fellow human beings not only change the lives of people around the globe but also ignited an issue of an international form of terror financing through its financing model. This has placed the Islamic banking to a greater scrutiny and evaluation to ensure that no transaction should be made in favor of terror financing and money laundering. This issue have also created isolation for the Muslims residing in other countries as minorities. International institutions has not found any definite node connecting to terror financing. But the early precautions have been placed to the Islamic banking and financing sector to address it earlier and formulate proper strategy in order to meet the contemporary and future terror prevention.

Deposit Section of Islamic Banking:

People use saving accounts to deposit their amounts which in return also helps Islamic banking to gain more financial strength and capacity. It also helps increase profit for all stakeholders. Islamic bank uses arrangements like wadiah etc. to maximize funds. In general, there are two categories that fall in the deposit section of Islamic banking and finance. One of them is Current account saving and the other one is saving deposits. Banks also avails permanent or redeemable share through investment and business deposits and that form the running partnership with the customer (Farooq, 2011).

Amanah and Wadiah are two of the basic principles on which current account deposit is based. It is further categorized into two types. In the first type, the interest-free deposits are either kept in the safe lock or trust. Funds kept as trust cannot be used for bank operations under the Amanah accord. A Deposit refund cannot be guaranteed if any damage happens or loss to the Amanah due to any out-of-control circumstances. In Wadiah, the bank is considered a keeper of funds. The funds can be used for bank operations with the depositor’s permission. Islamic banks take the loans from the depositor and guarantee the full return to the deposit under the Wadiah model.

The depositor can withdraw the amount at any time but without any profit. A gift or any thankful gesture may be given to the depositor upon the bank’s approval. In the second type of current account, the bank has the authority to utilize the client’s current account funds for multipurpose operations. Hence, it is considered a non-interest loan fund by the depositor to the bank. Bank is obliged to return the credit balance upon the client’s demand.

Saving deposit account works differently. In this Islamic banking deposit model, the bank is allowed to utilize the depositor’s money in investing in a profitable business which is legal and right in Islamic laws. In the model, the depositor is an investor and the bank is responsible for managing the funds. It is a joint venture between the depositor and bank. Investment deposits in saving accounts are fixed for a period of time and are formulated by Islamic laws. In such conditions, early withdrawn is not allowed and is only permissible until the end of the term. Early withdrawal is only permissible on an agreed period time. Being an investor, the depositor takes some profit from the investment and avail it on term deposits. The deposited money is distributed in several investment pools under the Islamic sharih compliant business. Each investment pool has different direct expenses. The net expense is distributed between the bank and pool

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and among the depositor. The profits from the investment pools are equally shared between the depositor and bank on a pre-defined profit share value. In case of loss, the depositor has to suffer it and the bank goes unrewarded (Akhtar et al., 2017).

Debt Recovery Regulations and Processes of Conventional Banking Industry in Pakistan

The debt recovery by the banking industry of Pakistan is functioning under the Debt Recovery Ordinance of 2002. Under such an ordinance the banks are likely to recover more debts and could sell the property that was mortgaged. This will not require any court involvement (Financial Institute Ordinance, 2001). Further, the 'fair debt collection process' is operational under the State Bank of Pakistan and is applicable for all kinds of credit cards, housing loan, personal loan and consumer loans. The regulations for recovery of debts by conventional banking system have some definite regulations which the State Bank ensures are complied with.

- Conventional banks shall convey all information regarding the account statements to the borrowers before the recovery of debts starts. Initially the fourteen days' notice is given to the borrower or customer via SMS and letter being sent. The purpose is to advise them to make the outstanding payments before a visit is made to their homes and insisted for recoveries. Several notices are given to customers and often phone call made for asking them for recovery once a due period is passed.
- The banks should make sure that customers are not disturbed at inconvenient time and they should address professionally such as where they calling from, their name and purpose of call.
- Banks should ensure the calls are properly recorded and customers or borrowers are contacted at the given contact number and address. It is essential to have six month visit report records with the banks. It is officially allowed for banks to get any necessary information about borrower by reaching friends, relatives, family members or third party if the first payment still is not made within a period of thirty days.
- For a leased vehicle if agreement is breached then a fourteen notice is given by bank to repossesses it. An agency or recovery teams is appointed to repossess the good or valuables from the customer.
- All information of customer shall be kept confidential and not to passed to any other entity without permission. The recovery teams appointed by banks should be affiliated or officially recognized by Pakistan Banks Association according to the established guidelines.
- For effective recoveries, the agencies and bank staff are instructed to establish a process for addressing complains. Regular review of recovery measures should be made which shall be in line with law of Pakistan and hire professional staff for recovery, provide them training and monitor their performances.

Debt Recovery Regulations and Processes of Islamic Banking Industry in Pakistan

The Islamic banks foundations are based on Shariah. This means the banking and all transactions are free from riba or interest (Usmani, 2002). To minimize the losses, the banks can identify the credit risk. Often it's a big challenge for Islamic banks to manage the risks due to the complex nature of borrowing and to comply with contracts under Shariah. For the purpose of making the recoveries, the Islamic banks are fair in their operations (Financial Insititute Ordinance, 2001). All of the recoveries steps are same as for conventional banking except with few points to consider:

The payment or receiving of interest is haram (forbidden) on any investment mode.

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- There is no penalty on the borrower or customer if fails to make the payment, but there is an additional undertaking when the agreement is signed. The undertaking mentions if in any case the person fails to make payment (defaulter), he or she will pay charity to the bank by making them agent. The bank accumulates these funds and provides to different NGOs on per annum basis.
- It is important and necessary that the financial institutions or Islamic banks maintains separate fund or account for the purpose of charity collection from the defaulter and all spent amount on charity shall be enclosed to the debtor.
- Similarly for leased cases, the lessee is asked for undertaking, if he or she fails to pay rent on the due time period, charity amount has to be paid and for this the financier (lessor) will maintain charity funds. The charity should be spent on per annum basis and given to the poor and needy.

Comparison and Critical Analysis on Islamic and Modern Banking in Pakistan.

Liability Side Products of Conventional Banking

- Conventional Current Account
- Conventional PLS Savings Account
- Conventional Term Deposit

Liability Side Products of Islamic Banking

- Islamic Current Account
- Islamic Savings Account
- Islamic Term Deposit

Comparison of Liability Side Products of Conventional and Islamic Banking

Following comparisons are consistent with Allied Islamic & Conventional Bank and National Bank (Pakistan)

Conventional Banking System **(Current Account)**	**Islamic Banking System** **(Current Account)**
No type of restriction on investment of finances and Shariah law is absent.	Strict compliance to Shariah and funds are invested in permissible areas.
Can impose charges on customer for not maintaining least balance in the account	Does not charge customer if there is no minimum amount in the account since it is on Qard.

Conventional Banking System **(Savings Account)**	**Islamic Banking System** **(Savings Account)**

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Creditor and Debtor relation is seen as bank and account holder relation is based on it.	Depositor and bank relation is based on Mudarabah where depositor/account holder is Rab ul Mal and bank is Mudarib.
Markup or profit percentage is pre-determined.	Profit is not pre-determined but paid as per the agreed ratio.
There is no Shariah restriction on fund investments.	Shariah based mode of financing.
Account holder gets markup even if loss is incurred by bank.	If there is a loss, Rab ul Mal or depositor shares it based on the proportion of their investment.
May impose service charges.	No service charges imposed.

Conventional Banking System **(Term Deposit)**	**Islamic Banking System** **(Term Deposit)**
The relation of bank and depositor is based on debtor and creditor.	Account holder and bank relation is based as Rab ul Mal and Mudarib.
The percentage of markup is pre-determined.	The markup or profit is never pre-determined but depends on agreed ratio weightages.
Shariah restrictions are completely absent.	Investment of funds is as per Shariah.
The markup is still paid to account holder even if there is a loss.	Loss is borne by depositor as per the ratio of his invested amount.
Service charges may apply.	No service charges applied.

Asset Side Products of Conventional Banking

- Investment Securities
- Loans and advances
- Cash Equivalents
- Investment in subsidiaries
- Fixed and other assets
- Agency Services

Asset Side Products of Islamic Banking

- Murabaha (cost plus profit)
- Musharakah (joint venture or partnership)

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- Ijarah (leasing)

DATA ANALYSIS AND DISCUSSION:

The key purpose of this chapter is to offer the analysis of the data obtained from interviews. It has been mentioned in the previous chapter that the researcher has gathered information from interview, therefore, thematic analysis has been chosen for data analysis. This chapter is divided into sections such as thematic analysis and discussion. Thematic analysis included themes such as the key differences between the features of Islamic banking and conventional banking system in Pakistan, a number of investment modes of Islamic and conventional banking system, the modern and Islamic banking and its impact on investment and recoveries, debt recovery regulations and processes of conventional and Islamic banking industry in Pakistan, recovery modes under Islamic banking and conventional banking, the challenges and opportunities associated with Islamic and conventional banking practices with regard to recoveries and investment in Pakistan and major regulatory requirements for Islamic banks and conventional banks regarding investment and recovery. The second section has includes discussion of key findings and comparison and contrasting of these findings with the previously conducted studies.

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Disparity between Islamic and Modern Banking

While comparing different banks, it is important to study how commercial and Islamic banks are different from each other. For this, two Islamic banks and two conventional banks are discussed here in which salient features are discussed. For Islamic banking, Meezan and Bank Islami have been taken for study where as Standard Chartered and MCB Bank have been taken for commercial or conventional banking systems. Meezan bank is currently leading the chain of Islamic banking in Pakistan. This bank is breaking all the records of previous banks and the average growth of this bank is above 55%. More than 10 billion was deposited in this bank, back in 2009. Profit was above 10 billion and import/export business of this bank was above 100 billion in around 7 years. There are also different steps taken against the glob`al recession in this bank. Whenever one looks at the mission of Meezan Bank, it conveys message with vision of "setting up Islamic banking as consumer's first choice (MBL, 2009).

Analysis on Islamic and Modern Banking products

Different modern banks do offer a lot of products and offers. There are different investment options provided by conventional banking. Islamic banking systems do provide less options for the investments since this banking system is new as compared to modern banking system. Respondents also added that different banks offer different methods to increase your capital but Islamic banks do not offer a number of choices. In some respondent's view, conventional banks are more efficient than the Islamic banks. Also, there are three basic things which are observed by different researchers and that are profitability, liquidity and efficiency. There are different researchers conducted by various researchers. Different conclusions were observed depending upon their statistical data. One of the researches was conducted by three Malaysian researchers. A comparison between both, Islamic and conventional banking was conducted. The main element around which the whole research revolved was "efficiency". According to their techniques and evaluation process, there was no significant number difference in between both banking operations. However, these researchers also added that Islamic banking system results were more positive than conventional banks as more people are considering to invest through the Islamic banking methods (Abdul-Majid, Nor, & Said, 2005).

Recommendations

Islamic banks should ensure all their transactions and operations are available for inspection and comply with Shariah. For effective recoveries, the agencies and bank staff should be instructed to establish a process for addressing complains. Regular review of recovery measures should be made which shall be in line with law of Pakistan and hire professional staff for recovery, provide them training and monitor their performances. It is important and necessary that the financial institutions or Islamic banks maintains separate fund or account for the purpose of charity collection from the defaulter and all spent amount on charity shall be enclosed to the debtor.

Future Research

For future researchers, it has been recommended that research should be focused on more quantitative paradigm of the topic. It can be done through conducting survey questionnaire from the respondents of the study. Moreover, this study has the limitation of external validity which means that future researchers should focus on a region other than Pakistan. In addition to this, future researchers can conduct a comparative study between Pakistan and any other region for finding difference amid conventional banking systems of the two regions.

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Conclusion

Conclusively, in order to provide the critical analysis of conventional banking products it is important to recall some points. Interest is the amount of money that is charged against the borrowed amount. It is calculated as percentage of funds acquired. Islamic banks are often competing among themselves than with conventional banking system. In addition to this SBP has allowed all conventional banks to operate with Islamic banking branches. For less literate people it becomes quiet confusing regarding this. Another challenge is need for more Islamic scholars that can help banks to develop new financial products as per Shariah. More number of staff should be trained and given knowledge about Islamic banking products. Often under Islamic financing such as sale, lease or purchase of goods, the issue of double taxing occurs since buying and selling is counted as two transactions and this erodes profitability. The most used means of finance in Islamic banks is Murabaha followed by Musharakah, Mudarabah, Ijarah and others. Most of the financing is raised for the purpose of trade related finance and for partnership financing, equity based, etc. Hence, Mudarabah is considered often risky because once the contract is initiated between agent and rab-ul-mal, there is a financial risk on amount lent to mudarib. The central bank in Pakistan is State Bank and responsible for the effective supervision of the banking industry. It has the authority to conduct bank inspections under Banking Companies Ordinance of 1962, Financial Institutions Ordinance of 2011 and Statutory Regulatory Orders. According to Banking Companies Ordinance of 1962 (under section 40-A) SBP is authorized to regulate financial institutions and their performance. Islamic financing system complies with Shariah laws. In financial institutions and banks the Shariah boards are developed to regulate the operations. There is no room for interest based banking and funds are forbidden to be invested in conventional banks, alcohol, gambling, speculation, pornography and tobacco related areas of business. Islamic banks can make investments in businesses or shares which are Shariah compliant. The regulatory limits set by SBP are to be followed for investing in shares. Under Musharakah contracts, profit ratio should be decided and ratio of profit depends on profit depends by business.

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