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Islamic Leasing and Auto Financing System in Pakistan in Compliance with Islamic Sharia

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1.1: INTRODUCTION

1.1.1: Islamic Leasing

Islamic leasing is & amortization is one of the important tools of Islamic banking. Islamic leasing has been defined as banking in consonance with the Ethos and value system of Islam and governed, in addition to the conventional good governance and risk management rules, by the principle laid down by Islamic shariah. Interest free leasing is a concept denoting a number of leasing instruments or operations. Which avoid interest? Islamic leasing, the more general term is expected not only to avoid interest-based transactions, prohibited in the Islamic shariah, but also to avoid unethical practices and participate actively in achieving the goals and objectives of an Islamic economy.

With the increasing demands of everyday life, vehicle ownership has shifted from a mere luxury to a vital necessity. Purchasing a car is often the second most expensive yet important purchase, after buying a home. While doing so, an individual has two options available: either to make a hand on hand (cash) purchase or to go for car financing. However, due to the exorbitant car prices and lack of the funds available, many individuals prefer the latter option and approach the various financial institutions, which provide this facility at different rates.

1.1.2: philosophy of Islamic Leasing, Mortgages and Finance:

Islamic shariah prohibits **interest** but it does not prohibit all gains on capital. It is only the increase stipulated or sought over the principal of a loan or debt that is prohibited.

Islamic principles simply require that performance of capital should also be considered while rewarding the capital. The prohibitions of a risk free return and permission of trading, as enshrined in the verse 2:275 of the holy Quran, makes the financial activities in an Islamic set-up real asset-backed with ability to cause ‘value addition’.

Islamic leasing system is based on risk sharing, owning and handling of physical goods, involvement in the process of trading, leasing and construction contracts using various modes of finance. As such, Islamic banks deal with asset management for the purpose of income generation. They will have to prudently handle the unique risks involved in management of assets by adherence to best practices of corporate governance. Once the banks have stable stream of halal income, depositors will also receive stable and halal income.

The forms of businesses allowed by Islam at the time the holy Quran was revealed included joint ventures based on sharing of risks and profits and provisions or services through trading, both cash and credit and leasing activities. In the verse II: 275, Allah the Almighty did not deny the apparent similarity between trade profit in credit sale and Riba in loaning, but resolutely informed that Allah has permitted trade and prohibited Riba. Profit has been recognized as “reward” for use of capital and Islam permits gainful deployment of surplus resources for enhancement of their value. However along with the entitlement of profits, the liability of risk of loss on capital rests with the capital itself; no other factors can be made to bear the burden of risk of loss. Financial transactions, in order to be permissible, should be associated with goods, services or benefits. At macro level, this feature of Islamic finance can be helpful in creating better discipline in conduct of fiscal and monetary policies.

Besides trading, Islam allows leasing of assets and getting rentals against the usufruct taken by the lessee. All such things/assets corpus of which is not consumed with their use can be leased out against fixed rentals. The ownership in leased assets remains with the lessor who assumes risks and gets rewards of his ownership.

Islamic leasing is & amortization is one of the important tools of Islamic banking. The definition of Islamic leasing is banking in consonance with the Ethos and value system of Islam and governed, in addition to the conventional good governance and risk management rules, by the principle laid down by Islamic shariah.

1.2 STATEMENT OF THE PROBLEM:

The topic of this project is “Islamic Leasing & auto financing systems in Pakistan in compliance with Islamic shariat”. So the aim of the study is to see the following:

1. Why customers prefer auto leasing in comparison of Islamic leasing?
2. What is auto financing and Islamic car financing?
3. How banks can promote this leasing?
4. What is the main difference between both type of financing (leasing v/s financing and rentals v/s installments)
5. Are customers aware of this banking?
6. What are the reasons for those customers who are not using this banking?
7. What are the rules and regulation regarding financing i.e. documentation and insurance factor?
8. What is the scope and future of this banking?

1.3 SIGNIFICANCE OF STUDY:

The whole idea of the project is to identify or analyze the awareness of customers towards the auto financing, and to assess the attitude of the customers and also analyze the differences between auto car financing and Islamic leasing.

The main benefit will be for the banking institution, as they will know what is the attitude of customers towards auto financing is? They will also be able to know the reasons for those customers who are not using this new banking.

With this they will be able to develop different marketing strategies in order to attract those customers who are not utilizing the auto financing and then the bankers will be able to establish beneficial relationship between customers and the bank. And this will also help the bankers to generate extra revenue.

1.4 SCOPE:

Since this is the recent phenomena and it becomes prominent because of the competition between some of the private banks so the scope of the research is limited to Karachi city as well as I have choose the selected banks including Meezan bank, Faysal bank with respect to Islamic banking and city bank, Picic commercial bank, standard chartered bank, bank Alfalah etc with respect to corporate / Commercial bank.

1.5 DELIMITATION:

Changes can be occur at any time and we are living in a country where there on long term policies were adopted and rules and regulation can be change so the main variable which can impact on this consumer financing are imported cars or duties and laws regarding recondition cars because if they will arranges in favor of public instead of industry then automatically the prices becomes cheaper and may be few people goes to car financing.

1.6 DEFINITION OF TERMS:

Throughout this report, different terms will be used to designate the various forms of “Auto financing.” Some terms may be used interchangeably which by strict definition, are not quite equal.

- **FINANCING:**

The traditional schemes provide financing for purchasing car, i.e. in essence they are giving loan and earning interest. The Islamic car financing is entirely different. It is not a financing scheme rather it is a lease contract. The word financing here has been used as a generic term.

- **IJARAH:**

The Islamic car financing -- Ijarah is based on a lease contract. It is not a hybrid contract. *IJARAH* is an Arabic term with origins in Islamic *Fiqah*, meaning to give something to rent.

- **LEASING:**

Leasing is a contract whereby *usufruct* rights to an asset are transferred by the owner, known as the lessor, to another person, known as the lessee, at an agreed-upon price called the rent, and for an agreed-upon period of time called the term of lease.

- **FINANCING LEASE:**

The financial leasing, which is also called "capital lease" grants the utilization of the equipment to the Lessee, and the title of the ownership of the equipment is transferred to the Lessee at a pre-determined symbolic price at the end of the contract term.

- **OPERATING LEASE:**

Operational leasing is the type of leasing in which the equipment is rented by the Lessee with the sole purpose of enjoying the utilization without aiming to acquire the ownership of the equipment. In operational leasing, the agreement term is shorter than the economic life of the equipment.

2.1 RESEARCH DESIGN DETAILS:

In this section I will focus on the aspects of research design, which will include the purpose of the study, the study setting, the unit of analysis, and the time horizon of the study.

2.2 THE NATURE OF THE STUDY:

This project is based on “descriptive studies” because few studies have been conducted on this topic. The other reason is that I want to identify the different variables, which are involved in this study in order to analyze their effect on the research.

- **STUDY SETTING:**

In this study various factors will be examined in their natural setting, which means without any artificial setting so that the study setting is “field studies” (non-contrived).

- **UNIT OF ANALYSIS:**

Since the main theme of the studies is to analyze the consumer awareness towards auto financing & Islamic leasing, so the unit of analysis for this project will be individual consumers and the employee in the bank sector.

- **TIME HORIZON:**

The data for this project will be collected over a three to four-month period of time. The study is cross-sectional in nature because I did not have previous research or study on this topic.

- **TYPE OF STUDY:**

The purpose of the research project is to find out the different variables, which are involved in the study thus; this project was a correlation rather than a causal study.

2.3 SOURCES OF DATA:

Data sources will be primary and secondary. The secondary sources from where the data will be gathered are:

- Newspaper / Magazines.
- Internet.
- Bank's visits.
- Questionnaires

The primary data will be gathered through surveys and unstructured interview of individual consumers as well as employees in the banks to know that how they are marketing this banking.

2.4 RESPONDANT OF THE STUDY:

The respondents of this study will be the bankers who are engaged in consumer financing and both customers (who are using as well as who are not using this form of banking). (Mr imran sumro)Auto finance manger of meezan bank shahra-I-faisal. Customers come in that branch. (Mr Faisal quraishi) Credit manager of standard charted bank accros city station. Customers come in the bank.(Mr akhtar ali)AVP of credit policy.

2.5 INSTRUMENTS:

Data will be collected by means of the following methods:

- INTERVIEWS
- SURVEYS
- QUESTIONNAIRE

For an interview a certain group of people will be selected for obtaining information regarding the problem under study to obtain the information, opinions, and intention. The groups that are interviewed are ones that works in the department of consumer financing.

The main idea of the survey is to see that how many customers are aware of this banking and what are the reasons for those customers who are not using this banking. The interview and the questionnaire survey will be used to collect the primary data.

2.6 TREATMENT OF DATA/INFORMATION/ANALYSIS:

To conduct survey, I have selected some of the banks (meezan bank, standard chartered bank & state bank). I went to some of the bank as a customer and tries to find out the interest rate which bank are charging and also find out the benefits which different banks are offering to attract the customer.

The above mention method for the treatment of the data will be change depending upon the nature of the data, which will be collected through different instruments tools.

3: Literature;

3.1 THE PREVALENCE OF RIBA IN CONVENTIONAL BANKING.

The setup of a conventional bank is interest based. On either sides of its' balance sheet it carries assets that are driven by the whims of interest. Only current accounts are devoid of this curse, the rest of the accounts - savings and fixed accounts are interest driven.

The depositors deposit their money in the hope of earning an interest on their surplus. Although the bank plays its role of a guarantor yet, the primary motive of depositors is to earn interest on their surplus. The bank invests in different ventures to generate profit over the deposits and gives to the depositors a fixed rate of return on the invested amount regardless of what it actually generates profits/losses. This is injustice to both the depositors and the bank because if the profit rate is too high the depositor's loses out and when the bank incurs losses, the bank is victimized to carry all the burden of the loss and to yet provide the fixed rate of return.

On the asset side, the bank gives out interest-based loans, both short term and long term. It indulges in interest based financing activities such as leasing, which is far too different from the Ijarah under Islamic banking and is just a long term interest based loan where interest is termed as rent and mortgage is called the leased asset. The real differences as recognized under the Islamic system are ignored here.

3.2 WHAT IS RIBA?

The word Riba means excess increase or addition. Interpreted in Shariah, it means any excess compensation without any due consideration (consideration does not include time value of money).

3.2.1 CLASSIFICATION OF RIBA

1. The first and primary type is called Riba an Nasiyah
2. The second type is called Riba al Fadl

3.2.2 WISDOM BEHIND THE PROHIBITION OF RIBA AND NASIYAH

Although everything has its own goodness and utility yet things that have more benefits and less harms are beneficial and useful. Thus the curse of sins generated by this form of Riba outweighs the benefits and hence it is rendered haram. The curser of such transitory profits is carried to the world hereafter and is punished for. The spiritual and moral loss incurred by injuring the community's peace and security is too great a cost for such monetary profits. On these grounds, this Riba is forbidden in Islam.

3.3 CONVENTIONAL FINANCING FORBIDDEN IN ISLAM

Conventional financing is forbidden in Islam due to its direct involvement with interest. A conventional car-financing scheme is actually an Interest based loan given by the financial institution and interest is charged on that loan. Also, in conventional car-leasing schemes, the lease contract is not in compliance with Islamic Shariah and has Riba and other un-Islamic elements in it.

3.4 ISLAMIC BANKING

The basic concept of Islamic banking which is also known as '**INTEREST-FREE BANKING**' is based on basic ethical standards with just one main difference- Muslims are not allowed paying or receiving interest. This does not mean that business activities or making a profit are not encouraged, they are but as long as they don't involve interest in any form. To fulfill this purpose, the Islamic financial institutions to satisfy these requirements have introduced financial instruments. An example that can be seen is that equity financing is used instead of debt financing. Furthermore, instead of giving a fixed

interest rate on the savings account, Islamic banks offer a share of the bank's profit, as a return on deposits and this is around 5% annually.

- **ISLAMIC BANKING IN PAKISTAN**

Pakistan, which historically was formed in the name of Islam, lacks a truly Islamic economic and financial system even after more than half a century of independence. Starting from the first founder of Pakistan, vowing to establish an Islamic financial system, attempts by successive regimes have failed due to lack of initiative and determination in leaders of a country, inhabited by more than 150 million Muslims. At present there are only a handful of institutions that are truly Islamic in their functioning. Meezan bank is the pioneer of Islamic banking in Pakistan.

- **ISLAMIC CAR FINANCING: THE ULTIMATE SOLUTION**

An Islamic alternative to conventional car financing is Islamic **CAR IJARAH**, which meets the principals of Islamic Shari'ah. *IJARAH* is an Arabic term with origins in Islamic *Fiqah*, meaning to give something to rent.

Leasing is a contract whereby *usufruct* rights to an asset are transferred by the owner, known as the lessor, to another person, known as the lessee, at an agreed-upon price called the rent, and for an agreed-upon period of time called the term of lease.

Legally, the lease contract is not a sale of the object, but rather a sale of the usufruct (the right to use the object) for a specified period of time. The sale of usufruct is permissible in Islam, as evidenced by the verses (translation of meaning by Yusuf Ali (1991)):

Said one of them: 'O father, hire him on wages, for truly the best to employ is a strong and trustworthy man'. He said: 'I intend to wed one of my daughters to you, on condition that you work for me for eight years, and if you complete ten full years, that will be a grace from you'. [3]

3.5 PROBLEMS FACED IN DEVELOPING AND IMPLEMENTING CAR IJARAH

Islamic bank had to face various problems in the development and launch of their car financing project-Ijara. The problems faced are as follows:

- **CONSUMER ATTITUDE**

The prominent problem faced was the consumer's attitude toward the product. It is very difficult to educate people on the basic differences underlying between conventional car financing and Ijara. They could not differentiate between the conventional and Islamic modes of car financing and could not understand in what ways is Ijara is Islamic. They therefore were not willing to pay a higher rate charged by the Islamic mode of car financing. The consumers were reluctant to go for car financing until they were completely satisfied with this mode and were able to comprehend the concept of Ijara.

- **PROBLEMS DURING DESIGNING OF THE PRODUCT**

A number of problems were faced in the designing of the product as well. This was because Meezan bank was the introducer of Ijara in Pakistan and hence no follow up was available which would have aided them in the development of the product. There was great risk involved as to whether the product would be accepted by the consumer because product like this was not available in the market and hence consumer reaction could not have been specifically measured.

- **LACK OF EXPERIENCE**

Another problem was the inexperienced and the small size of the team responsible for the development and launch of Ijara. They had no former experience in retail banking and consumer financing and were in the initial stage of their learning curve. Because of inexperience in the market and as a team, they faced problems initially in communicating ideas to each other and in making a comprehensive, combined effort toward the development of the product.

- **UNPREDICTABILITY REGARDING CONSUMER REACTION**

How will consumers behave and competitors react to Ijara? This was the key question in everybody's mind. Since this was a new product introduced in the Pakistani market, the team had no follow up on similar products launched in the past and consumers and competitor's reaction to it. They had to undergo a market survey to identify consumer attitude towards Islamic banking and car financing. But a lot of risk was involved, as the results could not lead to the identification and measurement of competitors and consumer's attitude towards the product.

- **CAR INSURANCE (TAKAFUL)**

A major problem faced was the issues related to insurance. Takaful (the term for insurance in Islam) is available in Pakistan. Therefore conventional insurance schemes are used, as no other option is available. The explanation of this to customers is difficult because they believe that Ijara remains no more Islamic if it's insured using conventional methods. The issue with insurance is uncertainty. This is explained to consumers that the primary concern in Ijara is of interest and not of uncertainty related with the conventional insurance policies. They have to face this problem until Taqaful is not introduced in Pakistan. This problem is discussed in detail towards the end of the case study.

- **FIERCE COMPETITION IN THE MARKET**

Islamic banks had to face stiff competition from conventional banks and leasing companies involved in the activities of car financing. These banks and leasing companies have strong long term relationships built with dealers and operate on a larger scale as compared to Meezan bank in the area of car financing. These have direct sales agents aiding in the process of car financing and have proper infrastructure built with an area in the bank or the leasing company devoted to car financing.

3.6 DIFFERENCE BETWEEN CONVENTIONAL AND ISLAMIC CAR FINANCING:

‘Car Ijarah’ has been designed according to the principles of Islam and is completely interest-free. Moreover the Ijarah contract and other documentation also comply with Shariah requirements. On the other hand, a conventional car-financing scheme is actually an Interest based loan given by the financial institution and interest is charged on that loan. Also, in conventional car-leasing schemes, the lease contract is not in compliance with Islamic Shariah and has Riba and other un-Islamic elements in it.

In ‘Car Ijarah’ the asset remains in the ownership and risk of bank and the customers only pay the rentals for use of the asset; just like house rent. These differences are described in detail below:

3.6.1 BASIC DIFFERENCES

- **LEASING V/S FINANCING:**

The traditional schemes provide financing for purchasing car, i.e. in essence they are giving loan and earning interest. The Islamic car financing is entirely different. It is not a financing scheme rather it is a lease contract. The word financing here has been used as a generic term.

The Islamic car financing -- Ijarah is based on a lease contract. It is not a hybrid contract. *IJARAH* is an Arabic term with origins in Islamic *Fiqah*, meaning to give something to rent.

Leasing is a contract whereby *usufruct* rights to an asset are transferred by the owner, known as the lessor, to another person, known as the lessee, at an agreed-upon price called the rent, and for an agreed-upon period of time called the term of lease.

RENTALS V/S INSTALLMENTS:

Islamic car financing is based on pure rentals. In ‘Car Ijarah’ the asset remains in the ownership and risk of bank and the customers only pay the rentals for use of the asset; just like house rent.

On the other hand, a conventional car-financing scheme is actually an Interest based loan given by the financial institution and interest is charged on that loan.

3.6.2 DIFFERENCES IN SCHEME

- **OWNERSHIP**

In case of the conventional mode of car financing, the car is purchased in the name of the buyer from the dealer. This is not the case in Ijarah, where the ownership remains with the bank, that is the car is purchased from the dealer in the name of the bank. This is because it is the foremost condition of Islamic mode of leasing that an object cannot be leased out unless it is in the possession of the lessor.

- **RISK/LOSS**

Since the car is bought in the name of the buyer in the traditional mode of car financing, the risk is immediately transferred to the buyer whereas in the case of Islamic financing, this is not so. The car is purchased in the name of the bank from the dealer and so the risk remains entirely with the bank. As the corpus of the leased property remains in the ownership of the lessor, all the liabilities and risks emerging from the ownership shall be borne by the lessor. The lessee is responsible for any loss caused to the asset by his misuse or negligence. He can also be made liable to the wear and tear, which normally occurs during its use. But he cannot be made liable to a loss caused by factors beyond his control. The agreements of the traditional car financing generally don't differentiate between the two situations. In a lease based on the Islamic principles, both the situations should be dealt with separately.

- **DOWN PAYMENT V/S SECURITY DEPOSIT**

In Ijarah the buyer is required to keep a security deposit at the bank. The minimum requirement for security deposit is 20% of the car value and the maximum is 50%. The requirement is different in the case of conventional car financing. In the traditional mode there is a down payment made by the buyer of the car. The amount required for the down payment is 10% of the price plus the installment for the first year.

Both the down payment and the security deposit mentioned above are one-time payments. The major difference occurs because the buyer can buyback the car against the

security deposit in case of Ijarah, where as in case of conventional banking the down payment is entirely of the bank and no buy back of the car, occurs against the down payment.

- **RETURN**

In the Islamic mode of financing, the buyer has the right to return the car anytime during or at the end of the lease period. Since this is a lease agreement and the lessee has been paying rentals, he can return the car to the bank and take back the security deposit any time he wishes to. On the other hand in a traditional car financing scheme the customer takes a loan to purchase the car and which he cannot return in any case what so ever.

- **TERMINATION**

The buyer of the car has the option and right to terminate the contract and return the car before the contract reaches its maturity in both the conventional and Islamic mode of car financing. The difference lies in post termination phase. In the conventional car-financing scheme if the customer wants to terminate the contact the only option he has is to buy the car by paying the rest of the installments. Whereas in the Islamic car financing scheme the customer has two options; either he can return the car and get back the security deposit or he can buy the car from the bank at the market value plus a certain percentage of spread for the bank.

3.6.3 FEATURES OF CAR FINANCING

- ◆ Low loan Processing Charges.
- ◆ The Total Monthly Installment (TMP) consists of the Equal Monthly Installment plus 1/12th of the annual insurance premium of the following year.
- ◆ First year insurance is taken up-front with the down payment.
- ◆ Bank Financing Counters offer the convenience of sales officers trained in providing with the best financing option.
- ◆ Largest network of authorized dealerships ensures that you get the car of your choice in the color of your choice.

- ◆ Comprehensive insurance at reduced premium rates from AIG, New Hampshire and EFU.
- ◆ Special pricing breaks for selected Credit Card members.

3.6.4 CAR IJARAH'S UNIQUE FEATURES

- ◆ Free from Interest/Riba
- ◆ No applying fee
- ◆ Ease of acquiring any new locally assembled car
- ◆ No up-front Insurance Payment
- ◆ No advance Rental
- ◆ Available in tenures of 3, 4 and 5 years
- ◆ As little as 10% security deposit

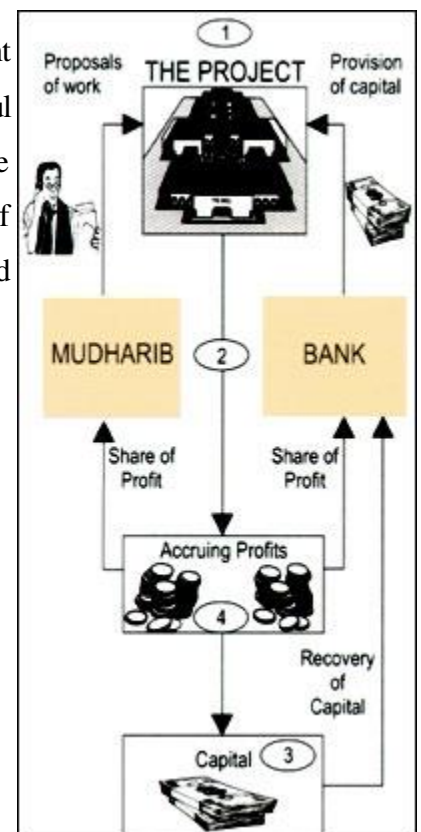
It is not a Hire-Purchase agreement [4]

3.7: Different products offered by Islamic Banks in Pakistan;

3.7.1: Mudharabah;

In Mudharabah, the Islamic bank contributes funds, and the client contributes expertise and works to execute a potentially successful project. Profits are distributed in percentage agreed beforehand. The bank shall bear any loss if the client is not negligent or in violation of the terms. Mudharabah can cover one deal, several deals, or a specified period of time up to a specified ceiling.

The Practical steps of Mudharabah:



1. Establishing a Mudharabah project

The bank: provides the capital as a capital owner.

The Mudharib: provides his effort and expertise for the investment of capital in exchange for a share in profit agreed upon.

2. The results of Mudharabah

The two parties calculate the earnings and divide profits at the end of Mudharabah. This can also be done periodically in accordance with the agreement and legal compliance.

3. Payment of Mudharabah capital

the bank: Recovers the Mudharabah capital it contributed before dividing the profits between the two parties because profit is protection to capital. In case of agreement to distribute profits periodically before the final settlement it must be on account until the security of capital is assured.

4. Distribution of wealth resulting from Mudharabah

- In case of loss, the capital owner (the bank) bears the loss.
- Profits are divided between the two parties in accordance with the agreement between them with observance to the principle "profit is protection to capital". [5]

3.8: Policies By State Bank of Pakistan for Promotion of Islamic leasing:

1. In order to promote Islamic Banking in Pakistan, State Bank is following a three-pronged strategy as under:

- I) Establishment of full-fledged Islamic bank(s) in the private sector;
- II) Setting up of subsidiaries for Islamic Banking by existing commercial banks;
- III) Allowing Stand-alone branches for Islamic banking in the existing commercial banks.

2. In line with Part-I of this strategy, on 1 st December, 2001, State Bank of Pakistan had issued detailed criteria for setting up of Scheduled Islamic Commercial banks based on Shariah Principles in the Private Sector in the form of a Press Release.

3. As regards Part-II of this strategy, in terms of Banking Companies (Amendment) Ordinance, 2002 notified in the Gazette of Pakistan dated November 4, 2002, inter alia, a new clause (aa) has now been inserted in sub-section (1) of section 23 of the Banking Companies Ordinance as follows:

“(aa) the carrying on of banking business strictly in conformity with the Injunctions of Islam as laid down in the Holy Quran and Sunnah”.

4. Therefore, the scheduled commercial banks are henceforth allowed to open subsidiaries for Islamic Banking operations. Accordingly, a Detailed Criteria for setting up of Islamic Banking Subsidiaries by existing Commercial Banks has been prepared.

5. For Part-III of this strategy, Guidelines for opening of Stand-alone branches for Islamic banking by existing commercial banks, enlisting Eligibility Criteria, Licensing Requirements and other operational guidelines on the subject have been prepared. [6]

3.9: Unique Risks of Islamic Banks;

- Liquidity originated market risk
- Transformation of credit risk to market risk and market risk to credit risk at various stages of a contract
- Bundling of credit risk and market risk

- Market risk arising from owning the underlying non-financial asset until maturity of a contract or until the ownership is transferred to customer
- Treatment of default.

3.9.1: Unique credit risks of IBs;

- Mudharabah / Musharakah

- Default event undefined
- Collateral not allowed

- Salam / Istisna'

- Counterparty performance risk
- Separation of market risk from default risk difficult
- Catastrophic risk high

- Murabahah

- Baseline default risk, but counterparty risk due to embedded option (Murabahah, binding non-binding matter) also exists
- Conglomeration of risks – each mode having various risks, credit, liquidity, market, reputation

The research asked Islamic banks to rank the Islamic modes of finance used by them from 1 (least severe) to 5 (most severe) in terms of risks. Responses of 15 Major Islamic banks are included. [7]

3.10: Gaps to bridge by this Study;

Islam is not a new religion; it is the same truth that God revealed through all His prophets. All religions are the same in essence, whether given, for example, to Noah, Abraham, Moses, or Jesus, or to the holy Prophet of Islam. For a fifth of the world's population, Islam is both a religion and a complete code of life. Economic growth is the main transmission channel for development. Islam does not contradict growth; it promotes sustainable development and growth.

So the research is going to bridge the gap between Islamic banking and Pakistani economy that Islamic banking is a growing industry in Pakistan what are the product/services or offered by Islamic Banks what is the structure of Islamic Banking and how it is capturing the finance needs of the customers.

Islamic banking is a new phenomenon that has taken many observers by surprise. There are some thirty Islamic banks in operation in all parts of the globe, including the Jeddah-based Islamic Development Bank (IDB) but excluding numerous non-bank Islamic financial institutions. What is more, the speed with which Islamic banks have sprung up and the rate at which they have progressed make it worth-while to study them systematically. An attempt is made in this paper (a) to survey the growing literature on Islamic banking, in particular (b) to trace the growth and development of Islamic banking, and (c) to highlight its salient characteristics.

3.11: Areas for Further Studies;

Areas for further studies after this research is the research about the Islamic mode of financing with regard to Islamic Banking and challenges of Islamic banking its importance growth in Pakistani economy which have been highlighted in this project

report. Because Islam is a complete way of life and also have given the rules and way of financing and State Bank has also trying to facilitate it so it is issued the criteria for establishment of Islamic banks in private sector and subsidiaries and stand-alone branches by existing commercial banks to conduct Islamic banking in the country.

The Government enacted the “Enforcement of Shariah Act, 1991” under which the State is required to “take steps to ensure that the economic system of Pakistan is constructed on the basis of Islamic economic objectives, principles, and priorities”.

4.1 Presentation of analysis

Here I analyze the questions that what customer wants and how we made Islamic leasing be more useful.

Q. 1 your occupation?

Researcher asked this question because he wants to know that which customers prefer to lease?

Many customers gives different occupations but researcher analyze them on two basis either job or business.

70% customers are employees and 30% do there business in this 30%, 20% have business of rent a car.

The total sample size is hundred and researcher evaluate it on percentage basics.

TABLE 4.1

Nature Of Occupation	100%
Business	30%
Job	70%

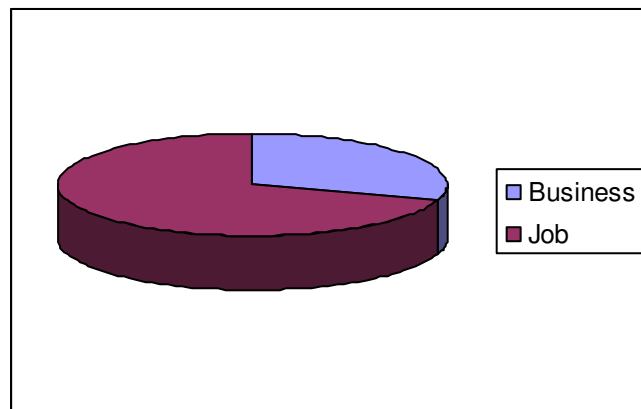


FIGURE 4.1

Q. 2 why do you come here?

Researcher ask this question because he wants to know that how many customers come here only to get information about leasing and how many of them come for leasing contract.

20% of them come for lease contract and 80% of them come for getting information.

TABLE 4.2

Coming Purpose	Percentage
Lease contract	20%
Lease information	80%

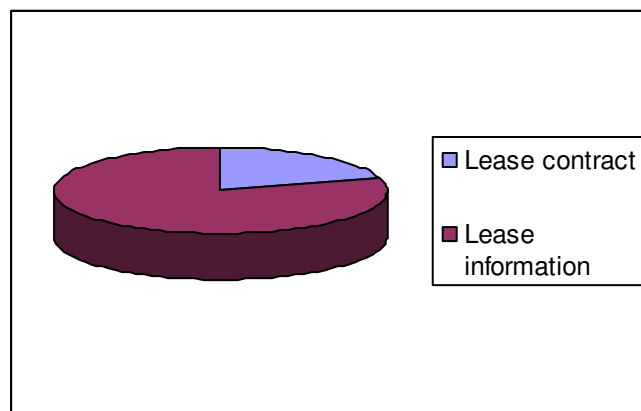


FIGURE 4.2

Q. 3 you know about leasing (buy a car on installments)?

Researcher asked this question because he wants to know that how many people know about leasing.
he get 100% response in the reply of this question. All customers fully aware of leasing

TABLE 4.3

AWARE	100%
NOT AWARE	0%

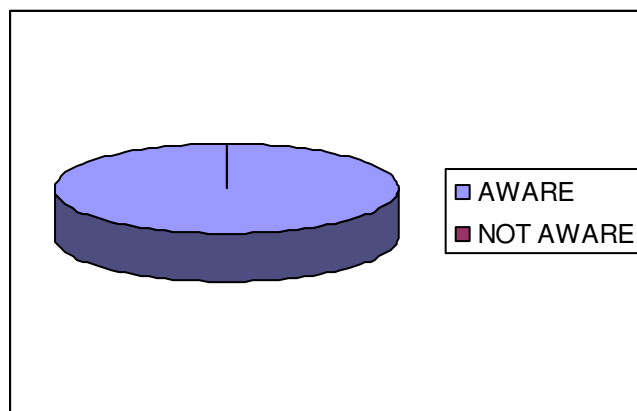


FIGURE 4.3

Q. 4 you know about Islamic leasing?

Researcher asked this question because he wants to know the awareness of customers towards Islamic leasing.

80% customers know about Islamic leasing.
20% customers don't know about Islamic leasing.

TABLE 4.4

YES	80%
NO	20%

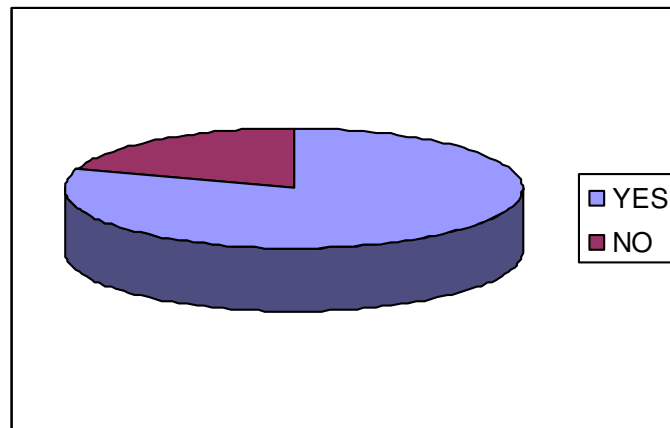


FIGURE 4.4

Q. 5 which leasing you prefer?

researcher asked this question because he wants to know that how many customers prefer which type of leasing.

a) 20% people say that they don't know about Islamic leasing. So they use auto leasing.

b) 10% people say that they know about Islamic leasing and prefer to use it because this leasing is according to Islam.

C) 70% people say that they know about Islamic leasing but they always prefer auto leasing on Islamic leasing.

TABLE 4.5

Auto leasing	90%
Islamic leasing	10%

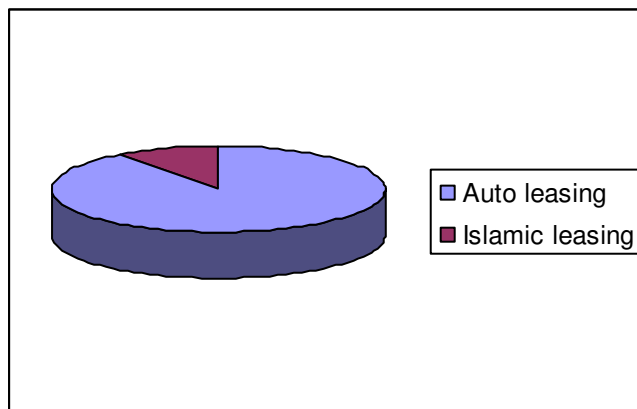


FIGURE 4.5

Q. 6 why you prefer this leasing?

Researcher asked this question because I want to know that why customers prefer this types of leasing.

The reason they are giving for using there preferred leasing by customers as follow.

A. Islamic leasing is nothing only a fraud.	(10%)
B. Only change the words for making the customers fool.	(20%)
C. They also charge interest but in the form of rent.	(5%)
D. Ownership is not transferring so great chance of default.	(15%)
E. Auto lease is safer.	(5%)
F. Auto lease is according to Islam.	(0%)
G. I prefer Islamic leasing because it is in accordance of Islam	(5%)
H. They are not following the Islamic ethos.	(5%)
I. Islamic leasing is more expensive.	(15%)
J. Islamic leasing is not safe.	(5%)
K. Islamic leasing is more expensive.	(7%)
L. Islamic leasing is not secure.	(0%)
M. Islamic leasing is not following the Islamic shariat.	(0%)
N. Auto leasing involves interest rate.	(5%)
O. Islamic leasing process is very difficult as compare to auto leasing.	(3%)

TABLE 4.6

Customers using auto leasing.	90%
Customers go for a Islamic leasing.	10%

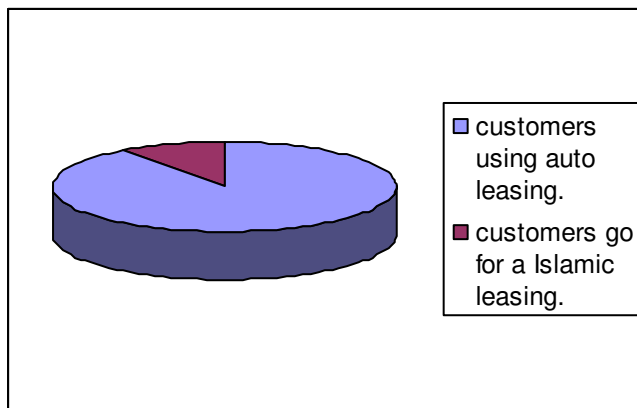


FIGURE 4.6

Q. 7 why not you prefer other leasing?

I asked this question because I want to know that why they are not preferred other leasing.

Customers give different reasons.

- | | |
|--|-------|
| A. Islamic leasing is more expensive. | (25%) |
| B. Islamic leasing is not secure. | (10%) |
| C. Islamic leasing is not following the Islamic shariat. | (5%) |
| D. Auto leasing involves interest rate. | (10%) |
| E. Islamic leasing process is very difficult as compare to auto leasing. | (3%) |
| F. Islamic leasing is nothing only a fraud. | (7%) |
| G. Only change the words for making the customers fool. | (2%) |
| H. They also charge interest but in the form of rent. | (13%) |
| I. Ownership is not transferring so great chance of default. | (11%) |
| J. Auto lease is safer. | (0%) |
| K. Auto lease is according to Islam. | (0%) |
| L. I prefer Islamic leasing because it is in accordance of Islam. | (0%) |
| M. They are not following the Islamic ethos. | (4%) |
| N. Islamic leasing is more expensive. | (10%) |
| O. Islamic leasing is not safe. | (0%) |

TABLE 4.7

A	25%
B	10%
C	5%
D	10%
E	3%
F	7%
G	2%
H	13%
I	11%
J	0%
K	0%
L	0%
M	4%
N	10%
O	0%

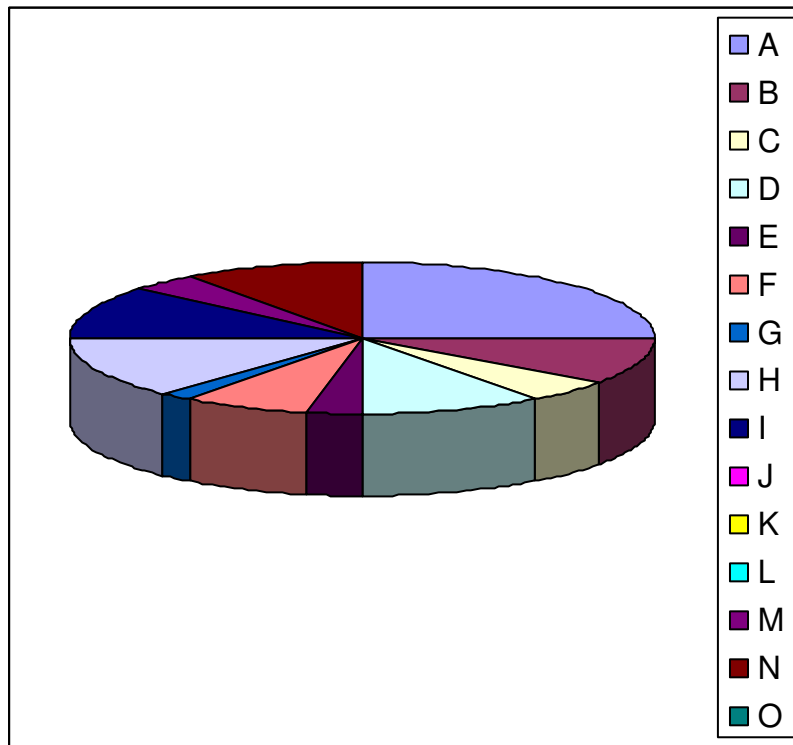


FIGURE 7.7

Q.8 Any type of change you want in Islamic leasing?

Here customers give many suggestions but I pick only those, which are related and possible. I conclude all the suggestions.

They want security within Islamic leasing they want that they should reduce their rent and come in competition with auto leasing. Gives surety for transfer of ownership. They also want that banks clarify that what is the real concept of Islamic leasing they are bit confused. They also want the transfer of ownership.

4.2 Results of managers interviews (Meezan bank, standard chartered)

Here I conclude all the results I gather from the interviews of managers.

- a) They say that Pakistan is an Islamic country and we are the Muslims and Islam strictly prohibited the interest so we made the alternative that assures us to safe from interest.
- b) They did not face any challenges but problem is there that they think customers will transfer from auto leasing but not sure why customers not promote the Islamic leasing.
- c) In initial planning they do many surveys but customers show desirability towards Islamic leasing.
- d) Yes Islamic leasing is according to Islam because we are not using the interest we are working on a profit bases.
- e) We are not getting the more rent our rent is according to market.

4.3 COMPARATIVE ANALYSIS OF ISLAMIC BANKING AND CONVENTIONAL BANKING ON THE BASIS OF CAR LEASING.

COST CALCULATED AS PER STANDARD CHARTERED BANK.

Car description: Mehran VXR non metallic color.

Car price: Rs. 390000.

Equity (%): 15 %.

Financing (%): 85 %.

Tenure: 5 years.

Security deposit: Rs. 58500.

Car financing: Rs.331500

Up front insurance: Rs.15800

Monthly installment: Rs. 6819

Processing fees: Rs.5000

Total initial payment: Rs. 86119.

Total cost after 5 years: Rs. 488440.

4.4 COST CALCULATION AS PER MEEZAN BANK.

Car description: Mehran VXR non metallic color.

Car price: Rs. 390000.

Equity (%): 15 %.

Tenure: 5 years.

Security deposit:	Rs. 58500.
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Processing fees.	Rs.2000
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Monthly rents:	Rs. 8420.
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Total cost after 5 years: Rs. 557280.

Now here researcher gathers over all analysis.

4.5 Result of customers questionnaires:(conclude)

- a) 20% people say that they don't know about Islamic leasing.
- b) 10% people say that they know about Islamic leasing and prefer to use it because this leasing is according to Islam.
- c) 70% people say that they know about Islamic leasing but they always prefer auto leasing on Islamic leasing.
- d) The reason they are giving for not using the Islamic leasing by customers as follow.
 - Islamic leasing is nothing only a fraud.
 - Only change the words for making the customers fool.
 - They also charge interest but in the form of rent.
 - Ownership is not transfer so great chance of default.

4.6 Results of managers interviews (conclude)

- f) They say that Pakistan is a Islamic country and we are the Muslims and Islam strictly prohibited the interest so we made the alternative that assures us to safe from interest.
- g) They did not face any challenges but problem is there that they think customers will transfer from auto leasing but not sure why customers not promote the Islamic leasing.
- h) In initial planning they do many surveys but customers show desirability towards Islamic leasing.
- i) Yes Islamic leasing is according to Islam because we are not using the interest we are working on a profit bases.
- j) We are not getting the more rent our rent is according to market.

4.7 Analysis

- a) Customers do not know about the true concept of islamic leasing they have many misconceptions.
- b) Rent as compare to interest rate is high.
- c) Chances of default are high.
- d) To some extend ownership should be transfer.
- e) Less confidence on Islamic leasing.
- f) Banks have to prove their compatibility.
- g) There is not any powerful promotional campaign.

5.1: Findings;

Following are the findings, which have been found out during the research.

Islamic leasing & mortgages gives us totally a different concept in accordance of Islam. Basically they are (bankers) are not working for interest purpose they are working on profit purpose because risk is involved here. Customers are also not fully aware of this type of leasing they fear of the chance of default. They want to hedge risk and also hedge from paying more rent.

I made these findings on the basis of questionnaire, manager's interviews and literature I read.

- h) Customers do not know about the true concept of Islamic leasing they have many misconceptions.
- i) Rent as compare to interest rate is high.
- j) Chances of default are high.
- k) To some extend ownership should be transfer.
- l) Less confidence on Islamic leasing.
- m) Banks have to prove there compatibility.
- n) There is not any powerful promotional campaign.

5.2 CONCLUSION

Islamic banking, though a relatively new concept, compared to the centuries old conventional banking, has developed at a very fast pace. The introduction of various Islamic financial products around the world is itself a success story.

Meezan Bank, the pioneer in Islamic banking in Pakistan, has also progressed a great deal. Though it faced initial problems at the soft launch of its car Ijarah scheme, but its team of dedicated people has been working continuously to upgrade the product and bring it in complete compliance with Shariah principles.

The acceptance of the product can be seen by the large number of consumers applying for the scheme. The teams employed by various banks and leasing companies managing their operations according to the Islamic mode of financing to carry out Ijarah are able to fulfill their job quite successfully. This is due to the fact that they have become well trained and they have gained experience. The lack of experience was deterrent to their performance initially but they have been able to cope up with this deficiency and have come up with amazing results.

It still has a problem with regard to insurance that is the Islamic insurance— Takaful is yet not introduced and the scheme of car Ijarah has to carry out its operations with the help of conventional insurance available to all. The significant factor in Islamic car financing is that of corpus of ownership of the asset remains with the lessor and only the usufruct of the asset is transferred to the lessee.

5.3 RECOMMENDATION.

Since it has proved from the cost of Suzuki Mehran that Islamic car financing is much more costly than conventional car financing so Islamic institution should have to lower their rents and other expenses as well as they have to remake their policies according to the current economic scenario to compete with other institution, for which we can say that the trust of people increase and people will starts going to finance their car by Islamic institution and also my survey shows that customers have many misconceptions about Islamic leasing and also they think that in this leasing there is a great chance of default so the banks have also start some promotion campaigns which clarifies the concepts of customers. They have to make sure that all the predefined rules and regulations will be following.

RECOMMENDATIONS FOR ISLAMIC LEASING WHICH ALL FINANCIAL INSTITUTION SHOULD FOLLOW?

I Design detail recommendation for banks those want to promote Islamic leasing.

1)

The clause of repossession in case of default should be clearly stated in the lease agreement mentioning specific default period after which the repossession can be initiated. The repossession expenses charged to the borrower shall not be more than actual incurred by the bank / DFI. However, the maximum amount of repossession charges shall be listed in the schedule of charges provided to customers. The banks / DFIs shall develop an appropriate procedure for repossession of the vehicles and shall ensure that the procedure is strictly in accordance with law.

2)

A detailed repayment schedule should be provided to the customer at the outset. Where alterations become imminent because of late payments or prepayments and the installment amount or period changes significantly, the revised schedule should be provided to the lessee at the earliest convenience of the bank / DFI but not later than 15 days of the change. Further, even in case of insignificant changes, upon the request of the customer, the bank / DFI shall provide him revised repayment schedule free of cost.

3)

The banks / DFIs desirous of financing the purchase of used cars shall prepare uniform guidelines for determining the value of the used vehicles. However, in no case the bank / DFI shall finance the cars older than five years.

4)

The banks / DFIs should ensure that a good number of authorized auto dealers are placed at their panel to eliminate the chances of collusion or other unethical practices.

The vehicles to be utilized for commercial purposes shall not be covered under the Prudential Regulations for Consumer Financing. Any such financing shall ensure compliance with Prudential Regulations for Corporate / Commercial Banking or Prudential Regulations for SMEs Financing. These regulations shall only apply for financing vehicles for personal use.

5)

The maximum tenure of the auto lease finance shall not exceed seven years.

6)

While allowing auto lease, the banks / DFIs shall ensure that the minimum down payment does not fall below 10% of the value of vehicle

7)

In addition to any other security arrangement on the discretion of the banks / DFIs, the vehicles financed by the banks / DFIs shall be properly secured by way of hypothecation. Payments against the sale orders issued by the manufacturers are allowed till the time of delivery of the vehicle subject to the condition that payment will directly be made to the manufacturer / authorized dealer by the bank / DFI and upon delivery, the vehicle will immediately be hypothecated to the bank / DFI.

8)

The banks / DFIs shall ensure that the vehicle remains properly insured at all times during the tenure of the lease.

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