

ISLAMIC FINANCIAL PRODUCT DEVELOPMENT IN THE PAKISTAN: SHARIAH ANALYSIS

Anam Iqbal

COMSATS Institute of Information Technology, Sahiwal Campus, Pakistan

Shahzad Akhtar

Bahauddin Zakariya University, Sahiwal Campus, Pakistan

Rab Nawaz Lodhi

University of Engineering & Technology, Lahore

ABSTRACT: *Islamic banking as well as financial institutions should be able to anticipate the needs of the marketplace and also rotate available Islamic financial services prior to conventional products to make sure continual progress and also competitiveness regarding Islamic banking and also financial options. Nonetheless, Islamic bank as well as financial products tended to replicate the typical versions, causing these products dropping worth as well as leading to some distress inside their meaning. Hence, a conceptual research study will be conducted for the growth & development of Islamic financial product from Shariah perspective. Even so, this specific research aims to handle the actual Shariah aspect of Islamic financial product development in addition to focus on the problems developing in the process according to secondary sources. The actual output of this research ought to bring about the actual progression associated with process of Islamic financial product development, in particular in the Shariah aspect, as it is the majority of imperative tool for that Islamic banking institutions in order to meet the increasing concern about profitability, liquidity, asset value, risk management, along with product acceptability. The study aspires to talk about the Fiqh muamalat self-discipline that may offer enough places with regard to creating Islamic products or service development, a place by which Islamic financial institutions should emphasize their means.*

KEYWORDS: Product development, Shariah analysis, Islamic banking, Islamic finance, Pakistan.

INTRODUCTION

Having the kind of competition banking and financial services industry has, it is imperative that these institutions focus their skill and resources on customer service so that continuous market presence can be ensured. Maintaining a good reputation once it has been earned is hard in this day and age and so product quality should be paid attention to (Gainor, 2000).

The imperative of Islamic financial product development

The Islamic banks are now also a part of this competition and race that surrounds the banking world. And so to be able to survive, it is crucial that every player in this race, including the Islamic

banks develop strategies for long term presence in the market and short term competition. Keeping concerns such as liquidity and risk management in mind, continuous service development is the best tool at hand. Islamic banking systems, including the consultants need to truly be innovative to keep up with the times so that growth and profitability in business be ensured (Noman, n.d.).

This article aims at reviewing the Shariah aspects of Islamic finance and product development, since study on this topic is almost extinct. This review will be made in the Pakistani context. Also, it is hoped that this article will serve as the first step for further extensive research on the topic. The literature for the growth & development of Islamic financial product from Shariah perspective has been missing in Pakistan. The study couldn't find the actual Shariah aspect of Islamic financial product development in Pakistani context; although, we have got literature in foreign contexts. The research paper will deal with the problems developing in the process according to secondary sources.

Pakistan supports dual financial systems; Islamic and contemporary. And interestingly enough, even with the contemporary system working side by side, Islamic financial system has earned itself quite a few customers. This competition resulting from dual systems makes the Islamic banking products more sophisticated (Bakar, n.d.). By marketing and reengineering the conventional products, these Islamic ones usually come into being (Gainor, 2000). This usually prompts favourable response from the public, however, it may also bring about skepticism.

It is important that Islamic banks use foresight to predict the future needs of market and then provide products that are compatible with them. However, it was seen that instead of bringing something new to the market Islamic banking institutions merely copy the conventional banking products which causes loss of value and confusion (Business, 2005). New ideas and new products are needed to give Islamic banks the status they deserve.

Aspects of Islamic financial product development

Five stages make up the standard product development process; research and development, market intelligence, resource allocation, team selection, marketing, distribution (Khan, 2002). Competitive people with different skills should be employed in the product development. According to Gainor (2000), an Islamic product development team should ideally include shariah scholar, asset manager, advisor, custodian of administrative services, customer and project coordinator, directors and distributor. And the aspects to be covered through observation are:

1. Shariah (Islamic law)
2. (Governing) Law
3. Tax structure
4. Accounting standard
5. Technical system
6. Finance
7. Marketing

However the most important facet to be observed is compliance with shariah. And so shariah scholars, instead of just approving or disapproving the product at the end, should be involved from

the very beginning (Gainor, 2000). The product needs to be both islamically acceptable and economically viable. Therefore all doubts and confusions should be cleared with the scholars as the development progresses.

***IJTIHAD* as a mean of Islamic financial product development**

A mujtahid is a competent shariah scholar. The utmost effort of this scholar to derive teachings and instructions from shariah sources and already existing knowledge, is called ijtehad. This ijtehad should be carried forth based on a special method that has been approved by laws of Islamic jurisprudence. At the moment, ijtehad is considered to be a later stage in the development of Islamic products. But this approach delays things by some months to even an year because fatwas or religious decrees take time (Business, 2005). Therefore it is crucial that shariah scholars play an upfront and active role in the development process and in the required documentation. The al-tafri approach might prove useful in such cases, which allows the scholars to pass Islamic decrees on things without their formal existence. The decree issuance should be carried forth based on the the word of God and sunnah of Prophet Muhammad. This is therefore an intimidating and demanding job since the interpretation lies in the mujtahid's hands. The requirements which should be fulfilled for a person to be considered an Islamic scholar are; perfect knowledge of Arabic language, understanding of Quran and Hadith and different skills of legal reasoning (*ijtihad*) (Business, 2005).

Salient features of fiqh muamalat: the basis for Islamic financial product development

Islamic financial product development depends greatly on fiqh muamalat. Fiqh muamalat and fiqh ibadat are different things. Qal'ahji (2000) outlined the important aspects of muamalat vis-a-vis fiqh ibadat.

Fiqh muamalat allow quite a level of innovation and creativity to the ummah in matters of Islamic banking. The only thing that needs to be kept in mind is that the commercial practice should not contradict the shariah principles. The Islamic financial area of product development is quite dynamic and adaptable and holds a lot of room for the ummah to devise a system according to their needs.

On the basis of this knowledge it can be understood that the people involved in Islamic financial product development should categorize products into 'masalah' and 'shariah objektivies'. The products that fit into these two categories should be preferred over all others since shariah principles are meant to safeguard the interest of the community.

The beginning of shariah based analysis of product development: avoidance of factors that might invalidate or defect

All commercial contracts are permissible apart from those that go against the shariah principle thus invalidating and defect the commercial contracts on the basis of thorough consultation with the shariah sources. Therefore an invalid commercial contract cannot result in exchange of ownership.

Similarly, a defective commercial contract is such that it seems relatively sound but has forbidding characteristics as a part of it (al-Zuhayli, 1997). The primary invalidating and defecting factors in fiqh literature can be summarized in points as follows:

- i. Al-Riba' (JKLM): Interest & usury
- ii. Al-Gharar (٭LQM): Uncertainty
- iii. Al-Jahalah (RMJSTM): Ignorance
- iv. Al-Ghalat (UVQM): Mistake
- v. Al-‘Ayb (XYZM): Flaw; Defect
- vi. Al-Maysir (L[Y\M) & Al-Qimar/Al-Muqamarah (٭L_J\M ٭ J]M): Gambling/
Fortune-based game
- vii. Al-Ghabn (٭aQM): Unjustifiable/unreasonable price
- viii. Al-I‘anah ala al-Munkar (Lbc\M ٭ dVe RfJeg): Helping on unlawful purposes
- ix. Intihak Al-Hurmah al-Shar’iyyah (RYeLjM ٭ R_LkM ٭ ك ٭ JSif): Violation of
Shariah sanctity
- x. Al-Hilah (RVYkM): Legal device
- xi. Al-Dharar (٭LmM): Harm; Impairment
- xii. Al-Zulm (nVoM): Injustice; Unfairness; Oppression
- xiii. Al-Shuruth al-Mufsidah (٭q[r\M ٭ و٭ ٭ LjM): Corrupting Conditions
- xiv. Al-Najsh (uTcM): Artificial price hiking
- xv. Al-IKrah (v ٭L ٭g): Coercion; Compulsion

However different Islamic jurists differ in their opinions of these invalidating factors’ details and how they effect commercial contracts. In most fiqh literatures, these are discussed in relation to the contract pillars and its conditions. Based on the nature and causes of invalidity and defect, these are summarized by Prof. Dr. Wahbah al-Zuhayli (1997) as follows:

From the authors’ humble observation of these factors; they can be categorized into four main categories:

- i. contracting party’s ineligibility
- ii. contract language’s non-compliance
- iii. object’s non-compliance
- iv. non-compliance of any among description (*wasf*), condition (*sharth*), and legal prohibition. A famous Islamic scholar, Prof. Dr. M Uthman Syubayr. further divided these factors into four categories
 - subject matter’s illegality
 - helping haram activites
 - capturing other’s property unrightfully through oppression
 - violation of Islamic brotherhood (*Ukhwah Islamiyyah*)

- i. Al-Riba (JKLM)
- ii. Al-Gharar & Al-Jahalah (RMJSTM ٭ و٭ LQM)
- iii. Al-Zulm & Al-Dharar (٭LmM ٭ و٭ nVoM)
- iv. Intihak al-Hurmah al-Shar’iyyah (RYeLjM ٭ R_LkM ٭ ك ٭ JSif): Violation of the Shariah sanctity.

Discussion of these effects in detail and their consequences on commercial contracts are out of scope of this article.

Application of shariah concepts: Islamic banking and bond system analysis

In this section the Malaysian Islamic bonds and Malaysian Islamic banking system's financing are discussed.

Shariah Concepts of Islamic Bonds

Islamic bonds, based on underlying principles can be categorized into five categories.

i. bonds based on loans; *Al-Qardh al-Hasan*. Other than the loan principle this kind of bond provides nothing else to its holder and so is somewhat unattractive for investors. This was only a temporary step to facilitate Islamic banking assets in the initial stages of their development in Malaysia.

ii. sale based bonds i.e. *Murabahah*⁵, *BBA (Al-Bai' Bithaman Ajil)*⁶, *Istisna'*⁷, and *al-Wafa'*⁸. This implies that the relation between bond issuers and holders is similar to that which exists between sellers and purchasers. Most of these bonds render to the concept of *Bai' al-'Inah*⁹ in practice. These are securities that are debt based actually. In the secondary market, it involves *Bai' al-Dayn* (Sale of debt), another controversial concept in Islamic jurisprudence.

iii. lease-based bonds; *Ijarah* (Lease) and *Intifa'* (Sub-lease). In the *ijarah* concept the holders of the bonds are the actual beneficial owners of both the lease owner and the leased asset and charge. During the lease period, rental payments will be received by them and the principal will be received by them at the end of the contract once the asset has been sold at the original price (i.e. the face value of the bond issue) (LOFSA, 2002; SC, 2004). *Intifa'* bonds, *sukuk*, only surface when sub-lease contract is involved.

iv. *Musarakah* (Profit-and-loss sharing) and *Mudarabah* (Profit-sharing) are equity based bonds. There is a partner-to-partner relationship that exists between the issuers and bondholders in *musarakah* bond system. While the relation between the issuers and holder of *mudarabah* bonds is that of an entrepreneur (*mudarib*) and capital providers (*rabb al-mal*). These bonds are also relatively risky for the investor.

v. a combination of the previously stated types, known as mixed or hybrid bonds, also exists. In July 2003 Islamic development banks issued *Sukuk al-Istithmar* (Investment *Sukuk*) – worth USD400 millions. *Ijarah*, *murabahah* and *istisna'* together form this combination and thus involve both real assets and debt based assets. It is advised that *ijarah* assets make up 50% of the portfolio always (Engku Ali, 2004). *Sukuk* actually comes from *sakk* which means a certificate to provide evidence for the undivided pro-rata ownership of underlying assets (SC, 2004). However often it is wrongly considered to be the word for bonds. In fact, since sales bonds represent the value of the debt and not the real asset, in most cases, they can't even be named *sukuk*. The correct term is *sanadat al-dayn*. These are actually certificates that serve as evidence of the issuer's promise to pay the investor back. Hence Islamic debt securities is the right name for sales bonds. *Bai' al-'Inah* and *Bai' al-Dayn* are rejected by most middle east scholars.

71.4% of the bonds by SC in 2005 complied with shariah. Also, six equity based bonds were also introduced; musharakah 5, and mudharabah 1. This was a milestone in Malaysian Islamic capital market as it is seen that prior to this time the shariah concepts were not fully utilized like this. It is advisable that more research on the shariah concepts of bonds and their link with profitability, assets, liquidity and risk management should take place.

Shariah Concepts of Financing in the Pakistani Islamic Banking System

From above study it can be seen that the concepts of financing according to shariah in the Malaysian banking system can be divided into five categories; equity-based, lease-based, hybrid, sale-based and loan-based. Equity based financing as compared to the rest is very small. This contradicts the fact, prevalent in Islamic financing literature, that musharakah and mudharabah dominate the system. This is because now it can be seen that Islamic banking system relies on mark-up, lease, and commissioned manufacturing the most. According to association of Islamic banks, less than 20 percent of the investments made worldwide did so on the basis of profit and loss sharing instruments (Dar & Presley, 2000). In Malaysia for instance only 0.3 percent of the financing is made up by musharakah and mudharabah out of a total of RM 9.5 billion as at end-2005. BBA-based financing remains dominant making up 40.7 percent of the total financing while ijarah constituted 31.6 percent (BNM, 2005). This is shown in table 3. There are various constraints upon the Islamic banking system to adopt musharakah and mudharabah as their modes of financing.

Main shariah issues in islamic financial product development

A few shariah issues should be discussed to point the future development of Islamic banking products in the right direction. The main issues are:

1. extreme reliance on fixed mode of Islamic concepts
2. Islamic partnership concepts' underutilization
3. Legal device's practice
4. Harmony of opinions

Heavy Reliance on the Fixed-Return Mode of Islamic Concepts

Initially, Islamic financing products were considered to be strictly fixed-return financing mode. But this is not the case. This was only because of the complete reliance of Islamic banking systems on this mode of financing at the very onset. This approach has been harmful for the Islamic banking system in a way because it gave the impression that Islamic banking system is inadaptible and inflexible. This also puts the Islamic banking system in a tough spot where matching assets and liabilities is concerned since most of their liabilities comprise of floating rate instruments. Management of funds is the question here and not the superiority or inferiority of either mode of Islamic financing, fixed or unfixed.

If the focus is strictly kept on the fixed mode of Islamic banking concepts, they would eventually lose their characteristic features that distinguish them and would start resembling conventional banks (Errico and Farahbaksh 1998). Therefore, Islamic scholars have been found warning against such strict reliance on these fixed concepts for fear of becoming exactly like the conventional banks with their services and products. In order to gain advantage and distinction it is demanded

of Islamic banking systems that they evolve mechanisms for application of variable return modes (Tag El-Din 1999).

The Underutilization on Islamic Partnership Concept

In order to take full advantage of the shariah concepts in product development, it is important that we pay attention to Islamic partnership contracts, apart from the fixed-mode ones, too. It has been seen that most of the Islamic products are developed on the basis of sale and lease based Islamic concepts. Islamic partnership contracts occur in various modes on fiqh muamalat. Generally in Islamic jurisprudence there are two types of partnerships; holding and contract partnership. The joint ownership by two or more persons in the situation of inheritance, or wills or combined purchase forms a holding partnership. The situation that results in this may be compulsory or optional. While a joint commercial enterprise constitutes a contract partnership. This is a mutual agreement by two or more parties that then share in the profit or loss (AAOFI, 1998; Usmani, 2002).

For commercial purposes partnership projects can take two forms i.e. agriculture and trading. These can take place in different forms as are explained below (Al-Masri, 1999; Nyazee, 2002):

Agricultural Partnerships (*Al-Sharikat Al-Zira'iyah*). There are three further divisions of this category:

- *Muzara'ah* (Share-cropping): a kind of agricultural partnership in which the land is contributed by a party while the other party cultivates it and does all the work and then the yield is divided between the two.
- *Musaqah* (Share-watering): this is another kind of agricultural partnership in which the land and trees are provided by one partner and the other does all the work and takes care of the trees. And then the fruit is shared between the two.
- *Mugharabah* (Share-planting): this is a kind of agricultural partnership. In this kind of partnership, the land and plants are provided by one party and the other party does the planting work and gets a share in the crops.
- Trading Partnerships (*Al-Sharikat Al-Tijariyyah*): in this kind of partnership the parties only share profit, not crops or plants. It can be further divided into two categories:
- *Mudarabah*: in this kind of partnership capital and labour are provided by the capital provider (*rabb al-mal*) and entrepreneur (*mudarib*) respectively. They share the profit between themselves. In case of loss, capital provider is made to bear with it, the only thing that the entrepreneur suffers with is fruitless effort.
- *Shirkah*: this is a profit-loss relationship and takes three forms.

- *Shirkat al-Amwal*: the contribution of capital by all partners forms the basis of this kind of partnership.
- *Shirkat al-Abdan*: in this kind of partnership the main concern is labour and skill.
- *Shirkat al-Wujuh*: this kind of partnership is based on the creditworthiness of the other partner. The loss ratio is based on the liability borne while the profit ratio could be based on either a mutual agreement between the two parties or the liability borne by each.

The muwafadah partnership declares each partner to be an agent and surety for the other. It is based on *wakalah* (agency) and *kafalah* (surety). This entails commitment from both partners. To achieve this kind of partnership each partner should equality in tasks such as labour, legal capacity and liability. However in *'inan* partnership such equality is not required (Nyazee, 2002).

Discussing the Islamic partnership concepts allows the idea of using these concepts in product development. However the reason why these concepts are not used that much in the product development can be summarized as follows (Dar & Presley, 2000)

Harmonization of Opinions

It is in the nature of fiqh muamalat that you will find different opinions on one subject. In order to form a juristic opinion about such a matter, it is important that the juristic standing of customers be taken into account. It is crucial for the developers to make their products acceptable. Some Malaysian product failed to make a place for themselves in the middle east because of difference of opinions. The developers might have their set of proof, justifying their product to be abiding with the laws of shariah, but it is the customer whose views matter here. The customer is responsible for a product's success or failure. Therefore, a study should be carried out about the juristic beliefs of the target audience to be able to sell the product. To avoid any confusion among muslims, it is advised that products be developed on those aspects of shariah that are widely known and accepted. Such an approach, to bring about harmony in this regard, can be observed in the Malaysian Islamic capital market along with its success.

CONCLUSIONS AND RECOMMENDATIONS

Since, Islamic banking has a lot of weight on its shoulders for providing the world with a system of finance that is not only practical but also better than the conventional system, it is advised that Islamic financial institutions forsake the adoption of conventional products and come up with new ideas. The shariah concept should be looked upon from the beginning till the end. Malaysian Islamic banking system has a lot to offer where innovation and success in Islamic finance is concerned, that has also received acceptance at a global scale. It can be taken as a model for Islamic financial product development in Pakistani context. They have based their products on shariah concepts. Their extensive experience in this regard should be discussed and pondered upon. This will help the customers and players of such a shariah based system and give a boost to Islamic banking's development in Pakistan. The study also found that to bring about the actual

progression associated with process of Islamic financial product development, in particular in the Shariah aspect, a complete analysis on Islamic product development is necessary in Pakistan. Islamic banking has been an imperative tool for that Islamic banking institutions in order to meet the increasing concern about profitability, liquidity, asset value, risk management, along with product acceptability. The study aspires to talk about the Fiqh muamalat self-discipline that may offer enough places with regard to creating Islamic products or service development, a place by which Islamic financial institutions should emphasize their means.

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