The Principles of Islamic Finance, Its Challenges and Policy Suggestions for Azerbaijan

Savalan Ismayilov Ismayil

Submitted to the
Institute of Graduate Studies and Research
in partial fulfillment of the requirements for the Degree of

Master of Science
in
Banking and Finance

Eastern Mediterranean University
September 2012
Gazimağusa, North Cyprus

Approval of the Institute of Graduate Studies and Research

Prof. Dr. Elvan Yılmaz
Director

I certify that this thesis satisfies the requirements as a thesis for the degree of Master of Science in Banking and Finance.

Assoc. Prof. Dr. Salih Katırcıoğlu
Chair, Department of Banking and Finance

We certify that we have read this thesis and that in our opinion it is fully adequate in scope and quality as a thesis for the degree of Master of Science in Banking and Finance.

Assoc. Prof. Dr. Eralp Bektaş
Supervisor

Examining Committee

1. Assoc. Prof. Dr. Eralp Bektaş
2. Assoc. Prof. Dr. Salih Katırcıoğlu
3. Asst. Prof. Dr. Bilge Öney

ABSTRACT

Islamic finance has been known as a new reality in the international financial scene and it derived close attention, especially, when financial recession occurred in 2008 which surrounded whole financial system. While conventional banks were impacted strictly, Islamic Banks unexpectedly emerged as less crisis-prone. Islamic banks' performance through a number of ratios produces satisfactory results. General speaking, Islamic banks are well chaptalized, stable and profitable (Iqbal and Molyneux, 2005). Due to many requests and necessity in Muslim and non-Muslim countries, the practitioners of Islamic religion can make their investments based on *Shariah* Compaliance and many different models have been occurred. The case for Azerbaijan, nowadays, the International Bank of Azerbaijan, Amrah Bank, Nikoil Bank and TuranBank are seriously interested to introduce Islamic banking services in Azerbaijan. **International Bank of Azerbaijan (IBA)**, the biggest bank has been conducting on studying viability and possibility of Islamic finance for the latest recent years and consequently set up working team on Islamic Banking and the procedure of offering Islamic finance throughout country is becoming an increasingly crucial and suitable topic.

Keywords: Islamic Finance and Banking, Mudarabah, Musharakah.

ÖZ

Bu çalışmanın amacı İslami Finans, ülkelerini ve dünyanın diğer ülkelerinde olan ülkelerdeki uygulaması ile yakından tanışlık ve Azerbaycan için uygun bir model seçmekten ibaretdir. 2008ci yılında dünyada baş göstermiş dünya genel ekonomik krizinde geleneksel bankların krizden kötü yara almasına rağmen, İslami Finansın krize bulaşmaması kendisine olan ilgiyi daha çok artırdı. Yoğun istek ve gereklilik sebebiyle ister müslüman ülkelerinde, isterse de ğayrı müslüman topraklarında olan İslam dinine inanc sahibi olanlar artık ticaret hayatlarında Şeriata uygun olarak yatırımlarını yapa bilme imkanlarına sahiblenmektedirler. Azerbaycan için olan modele gelince, Azerbaycan Uluslararası Bankası, Amrah Bankası, Nikoil ve Turan Bankaları İslamı finans hizmetlerini sunmağa ilgi duymaktadırlar. Azerbaycanın en büyük bankası olan Azerbaycan Uluslararası Bankası son yıllarda İslami Finans sisteminin olanaklarını araştırmaya başlamıştır. Bu çevreden bakıldığında, tez konusunun Azerbaycan Finanse Sistemi için faydalı olacağını düşünmekteyiz.

Anahtar Kelimeler: İslam finansı ve bankaçılığı, Mudaraba, Muşaraka

Dedicated to my family

And the

İslamic StudenT Community in

Famagusta, TRNC

ACKNOWLEDGMENTS

Firstly, I praise Almighty and Majestic for facilitating to complete my thesis and I'm thankful for that to my Lord. I would highly appreciate the word and guidance of my supervisor Assoc. Prof. Dr. Eralp Bektaş to enrich this thesis with his contribution, sharing his deep knowledge and dedicated valuable time. He helped me not only to summarize and complete thesis, but also gave guideline and background in Banking and Finance field. He has got great role in completing my work. I want also to give thanks to Assoc. Prof. Dr Salih Katircioglu, the head of the department of Banking and Finance for assisting me in methodology of my thesis.

Secondly, I express my gratitude to my close colleague for their faithful contribution throughout my research and preparation.

Furthermore, my appreciation goes to my family members, to my dad Dr. Ismail Ismail and my mum Maleika Bayramova for supporting me financially and spiritually. I'm gratefully thanking them to believing me in the life.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF ABBREVIATIONS

DIFC:	Dubai International Financial Center
SPV:	Special Purpose Vehicle
IBA:	International Bank of Azerbaijan
IIB:	International Investment Bank
CBA:	Central Bank of Azerbaijan
IDB:	Islamic Development Bank
ICD:	Islamic Corporation for the Development
IB:	Islamic Banks
PLS:	Profit Loss Sharing
IFSB:	Islamic Financial Services Board
AAOIFI:	Accounting and Auditing Organization for Islamic Financial Institution

Chapter 1

INTRODUCTION

1.1.Historical background

History of Islamic finance - Islamic finance is growing exponentially; the financial industry has historically played an important role in the economy of every society. Banks mobilize funds from investors, and apply them to investments in trade and business. The history of banking is long and varied, with the financial system as we know it today directly descending from Florentine bankers of the 14^{th}-17^{th} century. However, even before the invention of the money, people used to deposit valuable items, such as grain, cattle and agricultural implements and at a later stage, precious metals such as gold for safekeeping with religious temples.

The opinions of philosophers and theologians have also ranged from a total prohibition to the prohibition of usurious or excess interest only, with a bias towards the absolute prohibition of any form of interest.

Homer (1977) provides an excellent expose on the history of interest rates. He states that,

> "It was from exceptions to the canon law against usury that the medieval theory of interest slowly developed. Compensation for loans was not licit if it was a gain to the lender, but became licit if the compensation was not a net gain, but rather a

> reimbursement for loss or expense… It was often a compensation or penalty for delayed repayment of loan." (Homer 1977, p. 73)

The first foreign exchange contract in 1156 AD was not performed to ease exchange of one currency for another at a forward date, but also because profits from time differences in a foreign exchange contract were not met by cannon laws against usury. (Homer 1997: 69-81).

In the first centuries all financial transactions were made by precious metal coins and it was held by the Church and the Crown. Due to limited availability of silver and gold, economic circumstance belonged to some regulations. (Dr Natalia Schoon, financial service review, august 2008)

There was strong restriction by Christendom, during that time prohibition of usury or charging interest was implemented. In a time when financial contracts were mainly controlled by governments by Christianity religion principles prohibiting interest on the basis that it would be a sin in repayment more or less than what was borrowed, this was main criteria. Furthermore, interest was made impermissible in all monotheist religions. (See Exodus 22:25, Leviticus 25:35-36, Deuteronomy 23:20, Proverbs 28:8, Nehemiah 5:7, and Ezakhiel 18:8, 13, 17 and 22:12)

The main purpose to regulate the usury was to reduce or keep away the deviation of money from the origin. Money can't be labeled as a good, rather it's kind of measurement. As a result usury prohibition some crucial matters occurred in medieval

Christendom. First of all, Jews started to travel around Europe and offer money lending to the local people, at that time it was impermissible for Christians.

Gold, silver, jewelry and other valuable metals were put as deposit with people who offered safety strongboxes. The owners of these boxes were usually goldsmiths and money lenders. Later they found out that instead of keeping untouched assets it'd be better to lend it to the needed sources that could bring more profits and it worked for them to be rich and main figures in there times.

It was risky and in some case risky to carry in pocket the gold coins. That's why money lenders started to issue notes and distribute them among depositors, and they could use it in their commercial transactions easily. So, paper money appeared in the scene. As a result of that new version of usury emerged money lenders found corrupted benefit that would be gained in such circumstance. It started to be widespread by money lenders to use depositor's assets dishonestly for obtaining financial benefits which didn't cost anything to them. Furthermore, they invented the way to achieve big amount of the money from nothing. Loan givers issued payable notes that cost nothing to collect them back and insert them in turnover as interest involved loans. After making calculation they reached to the point that under security they could manage to issue the payable note up to ten times more than their belonged assets or holding gold deposits, they were sure that it was almost impossible for all depositors to take back their deposits simultaneously.

The principle of modern conventional bank was driven from that model basically which shows: create money from nothing; insert it into turnover under “the best liquid asset” which has to be disbursed back in real form of asset that is generated from labor effort, sit back and convert to well-off and strong people: unseen controllers of nations.

Even though at the present time, banking system has become deeply complicated, but the hidden and committing principles maintain the same. (Issue 5 of ‘The Anvil,’ by The Third Position, BCM ITP, London, WC1N 3XX)

1.2. Islamic Banking

During medieval times (1,000-1,500 AD), Middle East people in trade activities would tackled to financial transactions on based *Shariah* rules, which was led by as their European’s partners. During Ottoman Empire The Arabs had healthy business relationships with the Spanish and set up financial regulations without committing interest which worked on a profit and loss sharing principal. This mechanism furnished for financing for trade and other projects.

As the Middle Eastern and Asian regions turned crucial trading association for European companies such as Dutch East India Company, European Banks started to launch branch in these countries which classically were interest based. With the escalating significant mission Western countries began to attend in the world economy, traditional financial centers tended to prevail. (Molyneux and Iqbal, 2005).Credit association and similar centers based on profit and loss-sharing belief lasted to continue, but their operations mainly concentrated in small certain places. (Dr Natalia Schoon, financial service review, august 2008)

Even though it was not until the mid 1980s that Islamic Finance started to become widespread step by step. The first financial Shariah model was introduced in Egypt in last century and the project was designed by Mit Ghamr. Mit Ghamr was co-collaborating association and this cooperation enabled to depositors got right to borrow small amount of loans for business purposes.

The emergence of Islamic banking has been driven by the increasing number of Muslims who wish to lead their lives according to the shariah, the legal code of Islam. The establishment of Nasser Social Bank in Egypt in 1971 (Iqbal and Molyneux 2005; Greuning and Iqbal, 2008.),

Furthermore, based on profit sharing, the project involved and built funds. Gradually Mit Ghamr savings project was successful due to some reasons, firstly, big amount of deposits were raised, risk finance and management policy was chosen well, and lastly, it was far away from political issues. The investment started to show its growth rate at 10-15% per year since the late of 1990s and there has been grow by over 20% annually for at least last 20 years. As a result of convincing the public the numbers of Islamic financial products have been offering rapidly and there is a big concerning. The scopes of the Islamic banks are no longer narrowed with small business profiles, rather big conventional banks started to offer Islamic financial products via their “Islamic Windows”.

It was announced that assets under management in its *Shariah*-compliant Islamic Investment Fund has hit the $1trillion mark and estimated to come close around $1.6 and $5 trillion in 2012 and 2015 respectively. The Islamic financial services sector is estimated to be growing at double digit rates, involving over 200 financial institutions with assets estimated to exceed US$200 billion (Al-Dhahiri,Al-Khamiri, and Al-Hamli, 2003). The annual grow rate is 20% on average and fastest growing industry in global finance market. Furthermore, there is prediction from Moody that the markets' financial capability is valued as a minimum USD 5 trillion due to incessant interacting activity in worldwide with commercial banks (Moody's: Shariah-Compliant Assets Could Reach $5 Trillion On April 12, 2010).

1.3. Islamic Financial Principle

The missions of Islamic *Shariah* Finance are to provide financial instruments and transactions for Muslims not to commit with usury, interest payment and gambling in their business life. The source of knowledge is taken from Qur'an, *sunnah* (sayings and actions of the Prophet (peace be upon him)), *ijma* (scholarly consensus) and *qiyas* (deduction by analogy) and the main structure of the market is based on sharing the cost and benefit. For simplicity, *Shariah* means Islamic Law, and Islamic finance is known as *Shariah*-compliant Finance. That's why Islamic Banking and Finance is secured by *Shariah* and its interpretation (Fiqh). (El-Gamal 2006, p. 17).

Islamic Banking System is defined as those banks that claim to follow *Shari'a* (Islamic law) in their business transactions, *Shari'a* requires these transactions to be in lawful

(*Halal*) form and prohibits transactions that involving interest (*Riba*) (Maali, Casson, and Napier, 2006) It promotes profit-sharing in the conduct of banking business as well as prohibiting paying or receiving interest on any transaction (Salleh and Hassan, 2004).

Islamic Finance differs for its specific principles and make up fundamental root of its mission and can be listed mainly as key rules:

a) ***The Riba* prohibition (usury)** is predetermined interest that the borrower repays to the lender more than he has before taken from him. Any predetermined payment over and above the actual amount of principal is prohibited as riba. Some just substitute “interest” for the term *Riba.* Among them are Siddiqui 2006, 1987 and 1986; Chapra 1985; Naqvi 1993; Faridi 1991; Wohles-Scharf 1983; and Anwar 1987, who argue that IBFI cannot deal with interests. Whereas, Sanhuri 1954-1959; al-Saud 1985; Tantawi 1989; Salus 1991; Suhail 1936; Yousuf Ali 1946 (in his commentaries on Quran 2:275 and 2:324); Shah 1967; Rahman 1980; and Afzal 1996, make a clear distinction between *Riba* and interest. Riba literally means increase, addition, expansion or growth which is non-trade related, e.g. a loan, advances. For example, in a usury loan, the borrower repays to the lender more than he has previously received from him. The basic principle of Islamic banking is the prohibition of Riba or interest, which has seldom been recognized as applicable beyond the Islamic world, but many of its guiding principles have, consciously or unconsciously, been accepted, M. Raquibuz Zaman and Hormoz Movassaghi (2001), in their article entitled “Islamic Banking A Performance Analysis”, study reviews the growth of Islamic banking since its inception nearly four decades ago.

b) **The prohibition of *Gharar* (uncertainty).**

Gharar can occur in the course of uncertainty of a contract, or as uncertainty in the types of the existence, ownership, deliverability, availability or in the natural form of the object. It can lead to the unexpected loss to a one side or unfair enrichment that is basically unlawful in Islaam. For instance, future contracts and options can be included to this category. (Ismail, 2001; Lewis and Hassan, 2007). The prohibition of gharar is found in ahadith forbidding as gharar the sale of such things as 'the birds in the sky or the fi sh in the water', 'the catch of the diver', the 'unborn calf in its mother's womb' (El-Gamal 2001b, p.2).

c) **Partnership contracts (profit and loss sharing).**

Mudaarabah and Musharakah contracts are partnership dealing and it can be done either by one (Mudarabah) or groups of partners (Musharakah) that can role to involve capital and or/skills and make *Shariah* compliant business development. Any profit that is earned is shared between partners according to pre-agreed ratio and results a return on capital. However, losses are allocated depending on the capital involvement and its risk. Lewis and Hassan (2007). Traditionally, this type of contract has been used for financing fixed assets and working capital of medium and long-term duration (Greuning and Iqbal, 2008).

d) ***Ijarah* (leasing**)

Ijarah is regularly preferable by Islamic Finance donors due to facility and asset used. As a result of renting lesser receives periodical rental payments from the lessee on behalf of using of asset. Iqbal and Abbas (2007).

e) ***Sukuk* (investment certificate or bond)**

Sukuk is financial securities and can be based upon different contractual instruments. It can be mentioned *ijarah* and *musharakah* and *Sukuk* al-Ijarah is most applied one. They can be structured to provide returns that closely replicate the payment profile of interest-bearing bonds (these are fixed income *sukuk*), to share the profit and losses incurred by the issuer (that are equity-type *sukuk*), or as revenue-sharing instrument where yields on a project (such as a mining operation) are shared among investors and entrepreneurs. Main part of asset belongs to *Sukuk* holder.

The topic of introducing Islamic Financial model is crucial and essential. Azerbaijan hasn’t achieved Islamic Finance regulation yet, but legislators are working to review the current banking and associated legislation to find the way how Islamic Finance could be fitted and co-operated. Central Bank of Azerbaijan has started to study the experience of some countries, it can be mentioned: Turkey, UK and Malaysia set up Islamic Finance in their jurisdiction. In addition to, the demand is not tested yet, some new initiators, such as Kauthar and Nikoil banks have attempted to serve for customers *Shariah* compliant products.

As discussed above, the main principle of Islamic Finance is to apply profit and loss sharing (PLS). This mechanism implemented through Musharakah or Mudharabah Finance methods. This is an advantage that Islamic Finance can easily allocate their recourses productively, as the assortment of investment portfolio is defined according to their effectiveness and expected rate of return. Nowadays, big conventional banks started to offer Islamic products via “Islamic Windows” that indicates the big interest to the Islamic Finance.

1.4. Aim of the Study.

The main target of this study is to get closer with Islamic Financial knowledge, its principle, and implementation of Islamic Finance over the world, its challenges and find proper Islamic model for Azerbaijan. This study determines the awareness of the Islamic home finance products compared with conventional home financing, as well as clients’ perceptions of home finance. This comparison is important since it is new in this area and gives the clients an overview about attractiveness of Islamic finance and home finance. This thesis is organized as follows: chapter 2 discusses the concept of principle of Islamic Finance and its products; chapter 3makes comparison between Islamic Finance and Conventional Finance; chapter 4 discusses the challenges of Islamic Finance; chapter 5 compares different Islamic Financial models; chapter 6 progresses an alternative model for Azerbaijan and chapter 7 concludes the study.

Chapter 2

THE CONCEPT AND PRINCIPLE OF ISLAMIC FINANCE AND FINANCE PRODUCTS

Since the source of Islamic Finance is taken from Islamic religion, we have to shortly highlight about Islam and the reason behind usury prohibition. Islam is monotheism religion and God Almighty and Majestic sent the last Prophet (peace be upon him) to the whole mankind for obeying and submitting all issues according the principles of Islaam and this term can be understood as "submission" to the God. The people who practice Islaam are called Muslim. Normally Muslims believe that Quran is the revelation word of Allaah (Muslims don't call God, just Allaah in Arabic) to His last messenger, Muhammed (peace and blessing be upon him) who received and recited the Book and preached to his companions.

Furthermore, fashion and lifestyle, action and words of Prophet (peace be upon him) have been known as Sunnah. The verdict of authentic Sunnah is equal to Quran and it's confirmed by Quranic verses. The next source of Islamic knowledge is taken from ijma which means the consensus agreement among scholarly community in technical way and ijma is evidence for making Islamic verdicts and is considered as a core basis for taking as evidence and clue.

The last one is *Qiyas* which is secondary source in Islamic jurisprudence. In Arabic terms *Qiyas* "measure the level of something based on the level of equivalency". In Islamic *Shariah* the terms of *Qiyas* can be interpreted as if there is no certain evidence from the main sources, such as from Quran, Sunnah and Ijma, and then the resemblance of the current issue will be driven from them.

Islam has covered and guided human's entire life issues and requires to follow and implement its principles in the following aspects: the faith code, the practice code, the eating and earning's code, the living code and the ethics code. After defining the scope of Islam, the action, conducts or dealings that are permissible, it's called *Halal*. Unlawful behaviors, actions and dealings are called *Haram* in Islam. The principles, codes and categorizations of *Halal* and *Haram* cooperatively are submitted to as *Shariah*.

From operational point of view, Islamic Banks (IBs) have strong similarities with Investment Funds (especially, in "mudarabah" financing). There is a dual-relationship between customer as a financier and Bank as investment manager, with no warranty on certain profit rate and even the recovery of invested capital.

2.1. Islamic Finance Principle.

These rules and principles are taken from Quran, Sunnah, Ijma and as a supplementary source of knowledge which is *Qiyas.* In our modern financial life regarding with Modern Finance sector İslamic Economic and Finance should be interpreted and applied to the financial model by well educated and skilled Islamic jurisprudence and these kinds of people are called *Shariah* scholars.

Table 2.1a. Principle and Prohibitions in Islamic Finance.

1. Principles of Profit and Loss Sharing	Islamic Finance requires participation in and sharing of profit and potential losses in financial enterprise.
2. Prohibition on Riba.	Riba is translated as an 'excess' or 'unjust increment' and is classified in two forms: Riba is translated as an 'excess' or 'unjust increment' and is classified in two forms: 1. Riba Al Fadl- which is described as excess compensation or an unequal exchange or sale of goods, usually relating to the exchange or sale of specified commodities including gold, silver, barley, wheat, salt and dates. Historically these commodities were treated as money and therefore the exchange of these commodities had to be in equal amounts. Any excess in the exchange of one or more of the commodities would be unfair to one party and was and is prohibited.

	2. Riba Al Nasiah- is described as any excess over the principal amount paid which is charged for the delay in repayment. It is Riba Al Nasiah which is associated with the prohibition on interest.
	in the exchange of one or more of the commodities would be unfair to one party and was and is prohibited. 2. Riba Al Nasiah- is described as any excess over the principal amount paid which is charged for the delay in repayment. It is Riba Al Nasiah which is associated with the prohibition on interest.

Table 2.1b. Principle and Prohibitions in Islamic Finance

3. Avoidance of speculation (Maisr) and uncertainty (Girar)	Transactions have to be real and be certain and not based on uncertainty or speculation.Islamic Finance is essentially about real transactions which are based on identifiable assets and transparent contractual terms. Derivatives are often prohibited where the transaction is purely speculative.
4. Prohibition on dealing in items which are Haram and the requirement to deal only in Halal items.	All dealings, commercial or otherwise in prohibited items, i.e. those denoted as 'haram' are strictly prohibited. Prohibited items include: • Riba • Pork • Pornography (as this corrupts morality) • Tobacco and Alcohol (any form of intoxication which impairs the senses removing responsibility is prohibited) • Weapons and arms (Islam is a religion which promotes peace, tolerance and acceptability, unjust wars are prohibited). • Conventional financial services (as conventional financial services may deal in prohibited or haram

	items, such as interest and debt). • Speculation and uncertainty (including casinos).
5. Requirement for fair and transparent dealings.	Islam requires that commercial dealings are fair and transparent to ensure that all parties are aware of their respective rights and obligations.

2.2. Islamic Finance Products.

2.2.1. Musharakah.

Musharakah-in Arabic meaning, the origin of this word is *sharaka* which indicates "participating cooperatively". In linguistic terms, it means cooperative association between two or more companies or individuals. This is a kind of transaction between two or more individuals through mutual contract and dealings, as a result of that losses or profits are distributed regarding of having in business percentage shares among them. Earned profits through venture business are allocated under the terms of Musharakah, earned losses are distributed in according to share of partners capital that they've invested.

Rahman (1979) stated that the literal meaning of Musharakah is "sharing".

The proof for allowance of Musharaka is established in Quran, Sunnah and Ijma. Evidence for the approval of partnership principles in Islam is seen in the Quran and it is mentioned:

I) “But if they are more than two, they share a third,…” (4:12)

II) Many associates oppress one another, except for those who believe and do righteous deeds - and few are they." (38:24)

We can see from the verse, Allah didn’t prohibit coming together and contributing in good deeds.

The next one, validity of Musharakah can be found in Holy Sunnah. Abu Hurayrah (may Allaah be pleased with him) narrated that the Prophet (peace and blessings be upon him) said: “Allah says: I am the third [partner] of the two partners as long as they do not betray each other. When one of them betrays the other, I depart from them”. (Sunan Abu Dawood)

Thirdly, it’s permissible to conduct with Musharakah, because Ijma allows it. Imam Ibn al-Munzir states: “And they (Muslim jurists) agree on the validity of partnership where each of the two partners contributes capital in dinar or dirham, and co-mingles the two capitals to form a single property which is indistinguishable, and they would sell and buy what they see as (beneficial) for the business, and the surplus will be distributed between them whilst the deficit will be borne together by them, and when they really carry out [as prescribed], the partnership is valid.” (Ibn al-Muthir, al-Ijma)

Since the commitments of usury and uncertainty is not allowed, Muslim investors must seek *Shariah* Complaint for their investments and should keep away dealing with banks that based on interest earning. Investments via venture between Muslim entrepreneurs and Islamic Financial Institutions are crucial for having safety atmosphere for both religious and advertisement points.

2.2.2. Mudarabah

Mudarabah is a kind of transactions between the capital provider (rabb-ul-maal) and entrepreneur as the executive partner (mudarib), making available financial funds for investment purposes (Alkassim, 2005). Rahman (1979) Profits are shared in according to negotiated pre-determined ratio. Many researhers have discussed in According to Al-Zuhaily (2007); Abdullah M., Shahimi. S & Arshad N.C (2008); and Ismail A.G & Arshad N.C (2009), mudarabah is defined as a form of partnership between one who contributes capital (rabb al-mal or capital provider) and the other who contributes efforts in the form of managerial skills (mudarib or manager). Mudaraba-is called silent partnership, because there is no serious role in controlling and running the business by capital provider, he or she is just seen as observing the procedure of investment. Bello (2000) Meanwhile, all setting up employment and management teams are carried out by entrepreneur and has got full controlling of capital right. (Zaher and Hassan, 2001).

Regarding the evidence for the permissibility of Mudaraba, there is no clear proof from Quran. But in hadeeth it's narrated:

"There are blessings in three transactions: credit sales, silent partnership and mixing wheat and barley for home not for trading."[1]

---

[1] Sunan ibn Majah, Chapters on Sales, Bab: "Partnership and Mudarabah", p 263.

There is general rule in Islamic *Shariah*, everything is permissible until it's made unlawful, now the origin of mudaraba is lawful and there is no proof for invalidity.

2.2.3. The difference between mudarabah and musharakah.

The difference between mushurakah and mudarabah can be summarized in the following points:

- The investment in musharakah comes from all the partners, while in mudarabah, investment is the sole responsibility of rabb-ul-mal.

- In musharakah, all the partners can participate in the management of the business and can work for it, while in mudarabah, the rabb-ul-mal has no right to participate in the management which is carried out by the mudarib only.

- In musharakah all the partners share the loss to the extent of the ratio of their investment while in mudarabah the loss, if any, is suffered by the rabb-ul-mal only, because the mudarib does not invest anything. His loss is restricted to the fact that his labor has gone in vain and his work has not brought any fruit to him. However, this principle is subject to a condition that the mudarib has worked with due diligence which is normally required for the business of that type. If he has worked with negligence or has committed dishonesty, he shall be liable for the loss caused by his negligence or misconduct.

- The liability of the partners in musharakah is normally unlimited. Therefore, if the liabilities of the business exceed its assets and the business goes in liquidation, all the exceeding liabilities shall be borne pro rata by all the partners. However, if all the partners have agreed that no partner shall incur any debt during the course of business, then the exceeding liabilities shall be borne by that partner alone who has incurred a debt on the business in violation of the aforesaid condition. Contrary to this is the case of mudarabah. Here the liability of rabb-ul-mal is limited to his investment, unless he has permitted the mudarib to incur debts on his behalf.

- In musharakah, as soon as the partners mix up their capital in a joint pool, all the assets of the musharakah become jointly owned by all of them according to the proportion of their respective investment. Therefore, each one of them can benefit from the appreciation in the value of the assets, even if profit has not accrued through sales. (Mufti Muhammad Taqi Usmani, an introduction to Islamic Finance)

2.2.4. Diminishing Musharakah

This allows equity participation and sharing of profits on a pro rata basis, and provides a method through which the bank keeps on reducing its equity in the project, ultimately transferring ownership of the asset to the participants. The contract provides for payment over and above the bank's share in the profit for the equity held by the bank. Simultaneously the entrepreneur purchases some of the bank's equity, progressively reducing it until the bank has no equity and thus ceases to be a partner. (Almutairi, Humoud (2010) a comparison between islamic and conventional home financing in Kuwait: client perceptions of the facilities offered by the national bank of Kuwait and Kuwait finance house. Doctoral thesis, Durham University.)

2.2.5. Ijarah:

Ijarah-is derived from Arabic and *Ijarah* means that "giving something on rent". As it's clear from the meaning, an asset is given for to be leased out for rental purpose. After ending of the contract arranging of ijarah can be shift to the sale that an asset can be sold to the lessee at the end of the period. Obaidullah (2005) state *Ijara* in simple terms, implies leasing or hiring of a physical asset.

Ijarah is sound in Islamic religion and proof for that can be shown from Quran:

"The best one you can hire is the strong and the trustworthy." (28:26)

Proof supported from hadeeth which is well known that it was reported from Ibn Umar (may Allaah be) and narrated by Ibn Majah that empoyers are ordered to *"pay the hired worker his wages before his sweat dries."*

There are several conditions for implementing of Ijarah Financing:

1) ***Halal*** (the permissibility of using, selling, and buying of something In Islam) assets should be targeted. House, car or machine can be shown as a example as a subject of İjara.

2) During the setting of İjarah contract the assets have to exist, if the assets are not available at that time, the contact can't be done.

3) An individual can’t lease any kind of assets or property in a non-Islamic manner, the subject should be used in permissible ways.

4) The expiration of the contact has to be set up for predetermined future date.

2.2.6. *Sukuk*:

In lexical term of *Sukuk* in Arabic is coming from the word of “certificate”, it was firstly coined in Islamic Financial Sector in the beginning of the 1990s. The reason for using this word was to show Islamic financial securities and derivatives that pays back to the purchaser of it and it is the way of raising funds *Sukuk* could be structured on ijarah, mudarabah and musharakah. (Siddiqi 2006). They are investment certificates with both bond and stock-like fea-tures issued to finance trade or the production of tangible assets. Like bonds, *sukuk* have a maturity date and holders are entitled to a regular stream of income over the life of the *sukuk* along with a final balloon payment at maturity. However, *sukuk* are asset-based rather than asset-backed securi-ties, with the underlying asset being necessarily *Shari’a*-compliant in both nature and use. The eli-gibility of s*ukuk* rests on identifying an existing or a well-defined asset, service, or project capable of being certified by a third party, and for which ownership can be recorded in some form. *Sukuk* holders might be responsible for asset-related expenses, and the sale of *sukuk* results in the sale of a share of an asset. Bonds, in contrast, are pure debt obligations issued to finance any activity and whose value rests on the creditworthiness of the issuer. *Sukuk* prices can vary both with the credit-worthiness of the issuer and the market value of the underlying asset. Also, it leaves no opportunity in creating secondary financial market (AlKhan, 2003: 28).

The term of *Sukuk* sometimes are referred to conventional bonds, in spite of this there are great dissimilarities between them. As it's clear from the meaning, *sukuk* is based on asset back and *sukuk* holders are deemed to be the owners of the underlying assets and therefore entitled to the profit generated from those assets. The typical *sukuk* formation is based on underlying Ijarah contract (lease structure), whereby initial funds are raised from *sukuk* holders with asset(s) identified as a part of the structure lease out.

The typical *sukuk* structure requires the establishment of an incorporated SPV that holds assets in its own name, or the establishment of a trust SPV (Special Purpose Vehicle) where the trustee holds assets for stated beneficiaries (these being the *sukuk* holders). In both cases, the presumption is that what is permissible for an individual to do (for example, to receive rent on a property) is also permissible for a group of individuals to do through an intermediary vehicle. The SPV will receive the payment of cash-flows from the financed party (for example rental yields on a property) and will distribute these to the *sukuk* holders in an agreed amount after deduction of administration and other expenses.

Sukuk SPVs are often registered in off-shore locations in order to provide tax advantages for high-net-worth and institutional investors. The contractual obligation of the SPV and related parties will be set out in the prospectus, along with the details of the issuer and the intended use of funds.

Chapter 3

COMPARISON OF ISLAMIC FINANCE AND CONVENTIONAL FINANCE AND ITS ADVANTAGES

If we look to the conventional financial System, it's built upon the debtor-creditor relationship and there are normally two sides:

-Bank

-Borrower

According modern commercial financial system usury (interest) is considered as a gain from the credit which is the profit for the bank. In addition, interest is taken into account as a price of credit which has got impact over the opportunity cost of money. However, it's not allowed to make business based on interest earning in Islamic finance. The main distinguish point is that Islamic Finance is structured on Islamic *Shariah* and all financial transactions, dealings, businesses, investment portfolios and financial products are designed according to Islamic Law that's opposite to most sectors procedures of conventional financial system. (Lewis and Algaoud, 2001).

The working principle of Islamic Finance is founded Islamic belief and creed. The person should pay attention the permissibility and impermissibility of Islamic *Shariah* share in all actions and performances. The lexical term of *Shariah* in Arabic means *the guideline to the basis of the life*.

The key principles of Islamic Finance are:

- Abstaining from transactions based on usury (interest);
- The absence of economic performance between supremacy (*zulm*, oppression);
- Refraining of commitment of Gharar (uncertainty, conjecture) in economic behavior;
- Disappointment of non-Islamic products and services that's prohibited in Islamic Law;
- Offering Islamic taxation system, known as ***Zakat.*** (Lewis and Hassan 2007).

Furthermore, Islamic *Shariah* reckons the loan that is given or taken without committing interest, so in Islamic banking the borrower can't be targeted as a source of profit by creditor.

3.1. Theoretical comparison.

Islamic Finance has evolved significantly over 40 years based on above mentioned principles. There are fundamental differences between conventional and Finance and Islamic Finance in the table:[2]

Table 3.1. CONVENTIONAL BANKING AND ISLAMIC BANKING

[2] Ust HJ Zaharuddin Hj Abd Rahman. http://www.zaharuddin.net; Almutairi, Humoud (2010) a comparison between Islamic and conventional home financing in Kuwait: Client perceptions of the facilites offered by the National Bank of Kuwait and Kuwait finance house. Doctoral thesis, Durham University. available at durham e-theses online: http://etheses.dur.ac.uk/543/

CONVENTIONAL FINANCE	ISLAMIC FINANCE
The function and operating mode of conventional banks are based fully on manual or a manmade principle	The functions and working modes of Islamic banks are based on the principles of Islamic Shari’ah.
The investor is guaranteed a determined rate of interest	In dissimilarity, it promotes risk sharing between provider of capital (investor) and the user of funds (capitalist).
It aims at maximizing profit without any limitation.	It aims at maximizing profit, but subject to Shari'ah Limitations
It does not deal with Zakat	In the modern Islamic banking system, it has developed into one of the service oriented functions of the Islamic banks to be a Zakat Collection Centre; they also pay out their Zakat.
Lending money and getting it back with compounding interest is the fundamental function of the conventional banks.	The Islamic banks have no stipulation to charge any extra money from the defaulter. Only small amount of reimbursement and these proceeds are given to charity. Rebates are given for early settlement at the bank’s discretion.

Islamic Banking System is the featured outcome of financial theory that the rules and standards are rooted in Islamic *Shariah* which is crucial for its operations. The key principle of Islamic Banking is deemed the prohibition of usury (excessive interest). The main concern of Islamic Banking ethic and finance could be devoted to work for welfare of society. Moreover, usury *(riba)* was made impermissible in other religions, such as in Christianity, in Judaism. The core reason for the invalidity of usury *(riba)* is to reduce the prevalent economical unfairness in society.

In addition, regarding with the source of financing, the difference between commercial finance and Islamic finance is that Equity is the initial point for Islamic Banking, whilst, money owning is basis for conventional banking. Money owning mechanisms operate as money exchange. But it can’t be found in based on equity financial mechanisms. It’s prohibited in Islam to make money through injustice trading operations, as a result of that predetermined interest or *riba* is invalid in Islam. (Almutairi, Humoud (2010) a comparison between islamic and conventional home financing in Kuwait: client perceptions of the facilities offered by the national bank of Kuwait and Kuwait finance house. Doctoral thesis, Durham University.)

3.2. Practical Comparison

Islamic banking is an important feature of the financial sectors mainly in developing countries; indeed some Muslim countries have considered converting their entire banking sector to Islamic principles. Since the growth, efficiency and competitive environment of the financial sector are vital for economic development and stability (Al-

Jarrah and Molyneux 2005; Bris-simis et al 2009) it is important to assess the efficiency of Islamic compared to conventional banking.

Khan and Jain (2007) define the analysis of financial statements as a process of evaluating the relationship between component parts of financial statements to obtain a better understanding of the firm’s position and performance. Bhatawdkar (2010) defines ratio analysis as the systematic use of ratio to interpret the financial statements so that the strength and weaknesses of a firm as well as historical performance and current financial condition can be determined.

Financial ratios are popular for a number of reasons: they are easy to calculate and interpret (Hassan and Bashir 2005); they allow comparisons to be made between banks; they permit comparisons between banks and the benchmark, which is usually the average of the industry sector (Halkos and Salamouris 2004). Performance evaluation can, moreover, be examined from various perspectives including costs, revenue and profit.

Banks are complex organizations, however, which produce an array of outputs from a range of inputs. One ratio cannot capture the complete picture of performance of such an organization over the breadth of its activities, and there is no criterion for selecting a ratio that is appropriate for all interested parties (Ho and Zhu 2004). In addition, the assumption underlying financial ratios that banks are interested in cost minimization, profit maximization, or revenue maximisation is a severe drawback of their application in the context of Islamic banking where these are not the most pressing objectives

(Abdul-Majid et al 2008a). Islamic banks might be expected to have lower e¢ ciency than conventional banks for a number of reasons. First, the strict application of Shariah rules means that many of the Islamic banking products are unstandardied thereby increasing operational costs in Islamic banks relative to those of conventional banks. Second, Islamic banks tend to be small compared to conventional banks, and there is evidence that technical efficiency increases with size in the banking industry (Bhattacharyya et al 1997; Miller and Noulas 1996; Jackson and Fethi 2000; Isik and Hassan 2002; Drake and Hall 2003; Sathye 2003; Chen et al 2005; Abdul-Majid et al 2005; Drake etal 2006). Third, Islamic banks are often domestically owned. The majority of the evidence suggests that foreign-owned banks are more technically efficient than their domestically-owned counterparts (Isik and Hassan 2002; Hasan and Marton 2003; Sturm and Williams 2004; Kasman and Yildirim2006; Matthews and Ismail 2006; Mokhtar et al 2008) Commercial banks, however, have a more favorable operations ratio (Hassan and Bashir 2005).

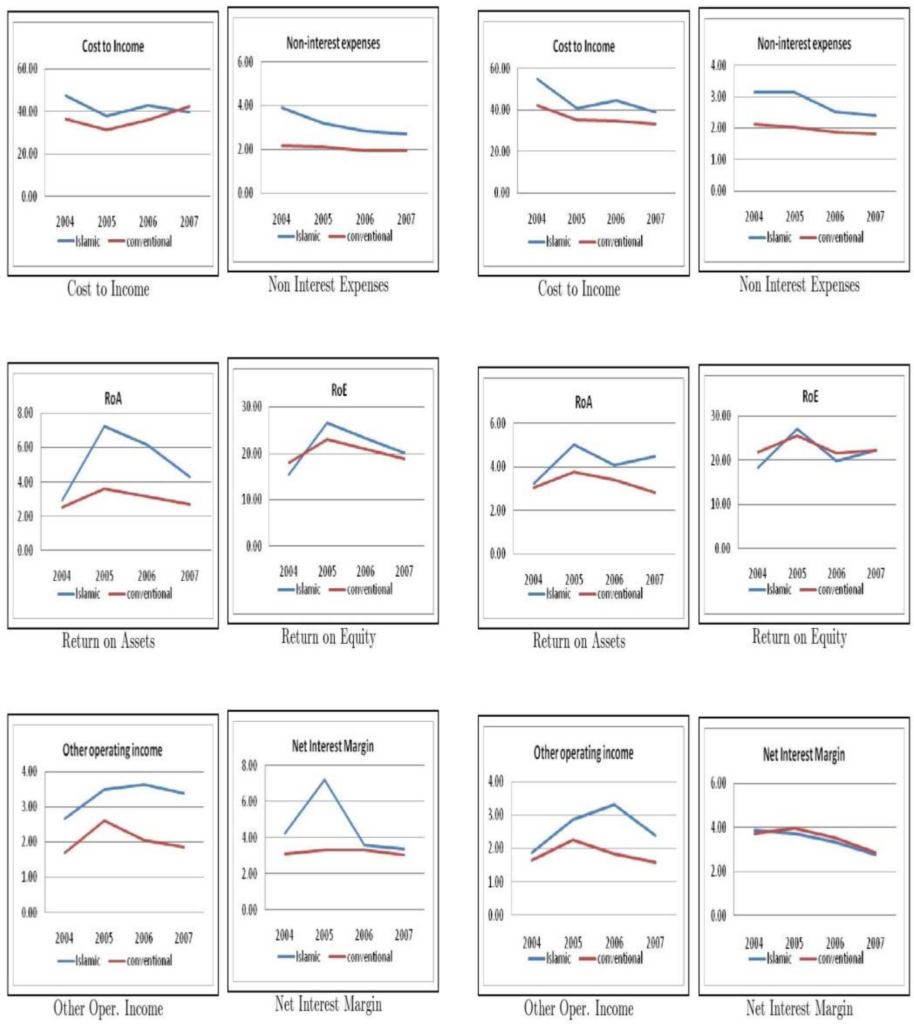
After comparison between Islamic finance and conventional finance based on theoretical analysis, financial ratios should also be mentioned. Sequential progression of cost, revenue and profit efficiency of Islamic and conventional banks can be shown in Figure:

Figure: Practical Comparison Between Islamic Finance and Conventional Finance:

Figure 4a-b: Evolution of Financial Ratios - Mean and Median Values

a) Means

b) Medians



Note: Cost efficiency is represented by Cost-to-Income and Non-Interest-Expenses. Profit efficiency is represented by Return on Assets (RoA) and Return on. Equity (RoE). Revenue efficiency is represented by Net-Interest-Margin and Other-Operating-Income.

Figure 3.2.

The cost-to-income and non-interest-expenses-to-average-assets ratio are normally less for conventional banks compared to Islamic banks, and the variation is considerable in non-interest-expenses-to-average-assets ratio.[3] This case should not be caution for Islamic banking as an opposite to conventional. For instance, for achieving high level of *Shariah* Complaint standard extra wages cost will be occurred by Islamic Banking, as a result of that *Shariah* Board can be maintained. The reason for bringing it, Islamic products should be designed according Islamic Laws, furthermore, due to complexity of Islamic law and deal with international laws *Shariah* Board can role as a bridge. In addition, the development of what are essentially bespoke products is a highly manual process (Willison 2009).

There is gradual upright movement in the return-on the average-assets ratio for Islamic finance in comparison to conventional finance. There is significant difference in 2006 and 2007. investing in real asset form for Islamic finance could be possible, as in conventional finance it's preferable to invest in debt transactions, such as Deposit Certificate, Bond, Stocks.

In addition, it can be observed that there is direct relationship between real economy and banking sector and this is one of the reason that Islamic finance is not involved for world financial crisis and there is no deep experience for debt instruments in Islamic

[3] Bhattaacharyya, A., Lovell, C. A. K., and Sahay, P., 1997, .The impact of liberalization on the productive efficiency of Indian commercial banks., European Journal of Operational Research, 98, pp 332-345

finance. There is similarity for both Islamic finance and conventional finance in return on equity average equity ratio.

Furthermore, it can be observed that efficieny of Islamic finance is higher than conventional finance in terms of revenue ratio. Operating income to average assets ratio for conventional less than Islamic banks and the ratio tells us there is higher return for investment in Islamic banks in 2006 and 2007. Moreover , it’s clear from the chart that net interest margin ratio for Islamic banks overtakes conventional banks.

In conclusion, conventional financial system gives high weight to debtor-creditor relationship which is assumed as injustice. Because creditors play a role as a domain over creditors, this is kind of oppression.

Chapter 4

CHALLENGES OF ISLAMIC FINANCE

4.1. Challenges of Islamic Finance.

Over last 4 decades Islamic finance and banking system has been struggling and facing some challenges. The topic can be broken down into two parts (Challenges facing Islamic Banking, Munawar Iqbal Ausaf Ahmad Tariqullah Khan, Islamic Research and Training Institute Islamic Development Bank, first edition):

- Theory side;
- Practical side.

4.1.1. Proper theory aspect

In any procedures, all routines should be run according its theoretical aspect. But in Islamic banking system there is no institutional outline and tries to get some guideline from conventional baking systems outline. One of the biggest faced challenges by Islamic finance is to set-up its relevant institutional framework.

4.1.2. Relevant institutional framework:

Zaher and Hassan (2001) provide a comparative study on the salient features of Islamic banking supervisory system in 15 countries, explaining the lack of regulatory framework in IFIs, which poses a great challenge on IFIs to uniform their standards and policies and mandate them on all IFIs regardless their countries.

The commercial and economic environments and laws in Islamic countries are designed according to Western countries, as a result of that doesn’t give much priority for Islamic Banks to operate based on *Shariah* Compaliance. But companies and parties can establish their pact based on Islamic Law and implementation of those pacts can cause superfluous cost and endeavor. These rules from others makes it to be incumbent that several laws to be introduced and practiced by Islamic Banks should be taken into account and start up. This is one of the ways to make it easy the performance of Islamic Finance next to conventional banking. Furthermore, in regulations there should be allowance for financial institutions to work in accordance Islamic *Shariah* Compaliance and marketplace for Islamic transactions should be selected.

4.1.3. Managerial theory aspect.

IFIs are in need for accumulation of human capital as it proved to be an important driver of endogenous growth for IFIs (Elhiraika et al., 2003; Barro 1991, 407).

Management of Islamic Bank has great role as in conventional system. Nowadays, in need of operative managerial theory aspect is one of the faintness of the dominating system and it requires close awareness. Streamlining and strengthening the relation between *Shariah* managerial board and Central banks should be done.

The reason why controlling and management of banking sector is worthy:

- Guaranteeing reliability of financial system;
- Making data and information available for investors;
- Enriching of regulation of monetary policy.

4.1.4. Accounting Standards.

The first element of the Islamic supervisory network is AAOIFI, which was established in 1991 for the purpose of issuing standards in accounting, auditing, governance, and *Shari'a* for IFIs in accordance with International Financial Reporting Standards (IFRS) (Thomas, Cox and Kraty 2005, 207).

Conventional banks have the same similarity in accounting system over the world. Central banks distribute the aggregated balance sheet of the conventional banks constantly and it happens without having trouble. However, differences in accounting system among Islamic Banks create another trouble if any evaluating or comprising is required among their balance sheet, it turns to be tough duty, and sometimes it becomes impossible. In addition, definitions in balance sheets or profit and loss accounts are carefully determined.

On the other hand, for the last few recent years, some advances have been done to prevail over this difficulty. Under Islamic Development Bank's instruction, certain Islamic Banks have set up Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) with the intention to bring standardization in the accounting cycle of Islamic banks. The institution is located in Bahrain and regulated by managerial committee. The responsibilities of Financial Accounting Standard Board can be included: to prepare, issue and edit the accounting standards of certain Islamic banks and financial intuitions due to agreement to submit application which made by the Board.

The different characteristics of IFIs transactions and their religious foundation lead to customers' cautiousness and add extra challenge before IFIs in promoting their products internationally (Iqbal and Mirakhor 1999, 381).

4.1.5. Insufficiency of Equity institutions.

For long-term business cycle, capital and source of finance are incumbent and this scenario can be found in conventional system through bound and equity. Regarding to public, investment banks, pension funds, insurance companies and mutual funds have key role in long-term investment and they are main source of investment portfolio. So, Islamic Finance is not dealing with interest-based bonds that are why they are in need of equity market.

The limited capital of IFIs compared with the total capital of the financial institutions in any country leads to marginal recognition by the central banks and enforces the IFIs to accommodate with the existing rules which might not be compliant with Islamic *Shari'a* (Al- Omar and Abdel-Haq, 1996).

4.1.6. Establishing well-organized Secondary Financial Market.

The scope of banking system can flourish on the availability of secondary financial markets. It's common in conventional banking system to invest for short-term assets, because it's easy to convert it to cash, and mostly it's done at negotiable price. So, the procedures of financial market in the way of making banks assets liquid, Islamic Banks should emerge secondary financial market. Moreover, it'll give temptation to shareholders to mobilize funds.

IFIs in money and capital markets results in limited contributions to the country's macro economy (Ahmad, Pradhan and Ahmad, 2005).

4.1.7. Establishment of short-term marketplace of funds.

Majority of Islamic banks are run as single entities. The reason why commercial banks are strength is not only to benefit from particulate foundation, but rather elaborating all banks collectively. The condition of Inter-bank operation in Islamic banks is poor. The development of short-term financial assets which can be possessed and traded among Islamic banks might take long to make Islamic money market. Islamic banks face with short-term funds and instruments which it'd be more lucrative and investment could be done within short time.

Absence of sufficient degree of financial innovation may pose a serious risk to the competitiveness of interest free banks in the fast changing financial market (Naser and Moutinho 1997).

Islamic banks face the following challenges in regard practical side.

4.2. Practical side.

In the long run, for its viability and survival, Islamic banking has to rely on its strength as an alternative model. The commendable achievements during the last twenty years should not lead us to ignore the problems that Islamic Banking is facing, and there is no dearth of these. While many of these are a result of the difficult environment in which Islamic banks are working, there are many others which have arisen from the practice of Islamic banks themselves.

4.2.1. Financial Engineering.

"Financial Engineering" - as it's clear from the phrase that shows the origin of commercial products to respond latest taste, such as riskiness, maturity and yield and designing in financial market. Day-by-day financial markets resentment with rapid changes and strong rival. To benefit from dynamic improvement and stand before competition, financial innovation and engineering are crucial in financial market. Islamic Financial instruments couldn't be linked to financial market changes; rather it has been designed to classical form created centuries ago.

Ebhrahim and Joo (2001) argued that IFIs internationalization process greatly depends on the regulators who should develop a modern financial engineering system for the advancement of IFIs.

4.2.2. Some Shariah principles and matters.

This is rule in Islamic financial system that any new product can't be established until *Shariah* scholars must allow or confirm it. When new product is introduced into the market, *Shariah* Auditing Institutions have got great role to check if the reality of the product meets for *Shariah* principle requirements. Moreover, it's also advantage for Islamic banks with regard trustworthy business loyalty, as Islamic banks customers will not have trust in their performance until *Shariah* scholars confirm operations. In that regard specialist of *fiqh* (jurisprudence) are turned to be dominant in qualification of current financial instruments and appraisal of intended products turn out to be imperative. (Karim, 1994).

The majority of Islamic banks have their own *Shariah* boards or counselors. Many other alternative ways are taken by them before issuing verdict. One of the options is to arrange a meeting between *Shariah* scholars and financial specialists in order to discuss the issue. However, this case is not representing the real scenario. The reason is they have dissimilar background, use different technical languages that interaction between them necessitates strong skills. In consequence, the procedure tends to be slow moving.

Furthermore, the significant shortage of qualified manpower and management inside IFIs leads to limited customer service (Elhiraika and Hamad, 2003).

4.2.3. Training, Educating, Investigation and Development.

Training, Educating and investigating are initial point for development of any subject. In Islamic banking and finance discipline, as earlier mentioned, there is terrible deficiency of scholars, who can give guidance through modern economic experts' attendance. Likewise, most of Islamic banks management is not educated and trained based on Islamic *Shariah* knowledge. Until now, a few attempts have been done for easing the matter.

The implications of this widespread ignorance along with a propensity to religious-based preferences needsmore carefulanalysis in future research, inorder to determine the risks to consumers and the potential abuse bysuppliers in these markets.As already suggested byNaser andMoutinho (1997), Islamic banks need to improve their marketing effectiveness by addressing market ignorance of, even indifference to learning about, Islamic products and services.

In addition, IFIs need to educate the international investors with their Islamic ethical foundation that is embedded in their products and their mark-up in each transaction (Hassan, 1999; Baldwin; Humayon and John, 2000; Suseno, 2002).

4.2.4. Availability of Deposits and deficiency of Fund placement.

For last years, deposits have been made remarkably available in Islamic banks. It has to born in mind that such mobilized funds didn't come, because of attractiveness of high return, but rather it has been saved for religious zeal of customers. Before introduction of Islamic banks, majority of clients were putting their money in conventional banks account, and due to religious prohibition they'd refuse to take any kind of usury, as well many of them use to put their savings in their trunk.

However, big amount of deposits and financial alternatives have been available in Islamic financial institution, high percentage of these capitals have been flooded to Western financial centers. There should be financial association to direct savings and capitals towards Muslim lands, because there is tremendous need for these kinds of capital sources in these countries.

4.2.5. Competition.

Remarkable uprising trend in development area in Islamic banks has been giving challenges to conventional banks, its increasing day-by-day among conventional banks to offer Islamic *Shariah* products and the numbers of these banks are countless. Even, giant conventional international banks started to open Islamic windows based Islamic banking principles, such as Chase Manhattan, Citibank, ANZ Grindlays, Klienwort Benson, in addition, Union Bank of Switzerland, Girozentale of Australia, and the ABC

International can be listed. Moreover, commercial banks in Muslim countries are not behind of plan in offering Islamic banking services in comparing to above mentioned big world banks.

Siddiqi (2001) argued that IFIs internationalization is challenged by developing the risk management and analysis tools in Islamic financial theory and practice to hedge against the volatility in the international markets.

Chapter 5

DIFFERENT ISLAMIC FINANCIAL MODELS

After the first Islamic banking introduced by the Mit Ghamar in Egypt in 1963 There has been tremendous concerning about Islamic Financial System and started to be practice in Muslim and non-Muslim countries due to excellent performance in World Financial scene. The increase in asset volume and numbers of branches Islamic finance offers its products over 50 countries in the world. (Oman Islamic Economic Forum 2011, Islamic Finance Overview) In many Islamic countries, Islamic financial model have been set up parallel with conventional financial system that it could be choicely for businessmen to act as they want.

There is only allowance for Islamic banks in Iran, Sudan and Pakistan. In these three countries discipline of economics was chosen to avoid totally from interest based transactions, implement *Shariah* Compliance system and not give any privilege to conventional financial system. But in other countries such as Egypt, Jordan, Indonesia, King of Saudi Arabia, Bangladesh and Malaysia, Islamic Banks incorporate with conventional banks. (Tarawneh, 2006**)**. Furthermore, it shouldn't be thought that Islamic Finance could be applied in Islamic countries and not narrowed within these countries; rather it's open to the world to be practiced. The best evidence can be brought about the Islamic Bank of Britain which got the first bank license by a non-Muslim country to collaborate in Islamic Banking. Due to rapid growing in Islamic field HSBC, Citibank and other big interest based banks in western world started to offer Islamic Financial production through "Islamic windows" and it is well known as one of the branch of conventional financial system that takes places under Shariah Compliance working cycle.

Pakistan.

Pakistan started to implement procedure for Islamisation of the economy and banking systems in 1979 via decree of President Zia-ul-Haq. The context of decree was intended to eliminate usury from the economy within three years. After that Central Bank instructed singling 12 financial modes and they could be summarized into three classifications:

-Loan financing;

-Trade-related finance modes;

-Investment finance modes.

Loan financing was done through *qadr hasan* which were distributed on compassionate grounds interest free. It was condition for borrowers to make repayment if they were able to do so.

In trade-related finance modes, merchandising of goods through banks and selling of them at determined price on a deferred payment principle, trade bills' purchasing, mortgage by banks from customers on a buy-back principle, hiring-purchasing, leasing and infrastructure advancement financing were included.

In investment finance modes musharakah, equity holders and shares selling and buying, term certificates and mudarabah certificates and rent sharing were selected. (Islamic Banking and Finance, “What it is and What it Could be”, by Tarek el Diwany)

Sudan.

After presidential declaration was given as guidance for whole banking system to abandon interest based transactions and convert the current pre-determined interest deposits and credits to Islamic *Shairah* Complaince, the first effort to Islamize the whole economy and financial system started in 1984. Such urgent adjustment had results that all banks turned their financial transactions on *murabahah*[4] performance. (Islamic Banking and Finance, “What it is and What it Could be”, by Tarek el Diwany)

Iran.

Mohammad Hassani (2010), in his article entitled “Islamic Banking and Monetary policy: Experience of Iran (1982- 2006)”, addresses some of the issues and challenge that is islamic banking has been facing in Iran. It also seeks to exam modes of Islamic banking law, Hamid Zangeneh , in his paper entitled “Islamic Banking: Theory and Practicing Iran”, attempts to explain the theoretical as well as operational issues and

[4] Murabahah is a trust sale, where the seller names the profit mark-up that he is applying to the cost price of goods that he is selling and agrees a sale price with the seller on that basis. As an example of murabahah, a businessman purchases a property for $100,000 and then agrees to sell it to buyer for a mark-up of 20% payable in cash. The customer therefore pays $120, 000 for the building, in the knowledge that price includes a profit margin of $20,000 for the seller.

problems of Islamic banking, AbdusSamad, Norman D. Gardner and Bradley J. cook(2005).

After Iranian revolution in 1979, a new legislated banking draft, the *"Law for Usury Free Banking Operation"* was introduced in 1983 to remove banking system based on interest. The requirement of legislation were that they had to implement the draft's principle, convert client's depositors to non-interest basis up to one year and have free-interest transaction in their operations. Furthermore, next requirement of the draft was to control and regulate from the Central bank. There were three directions in classifying of deposits:

-*Qadr hasan;*

-General term investment deposit;

-Project-specific investment deposits.

Qadr hasan – is a kind of savings and current account deposits and insured to return it back to its holders with safety under principle amount, moreover, this deposit is not allowed to take any contractual gain. (Kettell, 2007).

General term investment deposit owners are defined to get a fluctuated return, it depends on return of bank and it's linked to a central bank's minimum and maximum fixed rate. (Hassani Mohammad (2010). Islamic Banking and Monetary policy: Experience of Iran, International Review of Business Research Papers, Volume 6. Number 4. September 2010. Pp. 430 –443, Melbourne, Australia. Islamic Banking and Finance, "What it is and What it Could be", by Tarek el Diwany)

Project – specific investment deposit, the banks presents as an agent by making an investment and they have full making decisions on behalf of the deposit holders in particular investment cases. As a result of that, after the distribution of returns from the investment project to depositors, banks also gain for administration services.

Chapter 6

AN ALTERNATIVE MODEL FOR AZERBAIJAN

It has been around ten years in the path of studying and researching practical implementation of Islamic Finance in Azerbaijan by various banks. At present, the International Bank of Azerbaijan, Amrah Bank, Nikoil Bank and TuranBank[5] show interest to introduce Islamic banking services in Azerbaijan.

6.1. Islamic Finance Atmosphere in Azerbaijan

International Bank of Azerbaijan (IBA), the biggest bank of the country, has been contemplating on studying viability of Islamic finance for the past few years and consequently created working group on Islamic Banking. This interest has turned into concrete action, when it announced a tender for consultant to build infrastructure for its future "Islamic Window" in May 2011. Recently, it was reported that IBA is nearing the launch of Islamic Finance operations. It has implicitly indicated parallel works with Central Bank, in order to make necessary amendments for Islamic Finance regulation in the country.

In 2008, International Investment Bank, based in Bahrain (IIB) bought 49 percent shares of **Amrahbank**. A strategic partnership with IIB played a key role in the rapid

[5] Source: Zawya – Islamic Globe journal; http://www.zawya.com/story.cfm/sidZAWYA20110529084406/Fears_grow_for_Azerbaijani_IF

development of Amrahbank over the past 2-3 years. Currently, the Bank together with foreign consultants is working on the plan of offering Shari'ah compliant financial products, in order to benefit from the untapped Islamic finance market both in Azerbaijan and the neighbouring regions.

Kauthar Bank has also been working under interest-free banking mechanism, after its rebranding in 2002. It had only four offerings – investment accounts based on mudarabah, loans to businesses based on musharakah, loans for retail and corporate clients by purchase and sale of bills of exchange (like Islamic bonds) and consumer loans based on ijarah wa iqtina (leasing and subsequent purchase. Due to restrictions on banks' trading activity as per Banking Law, Kauthar could not use murabaha mechanism (trading commodity on cost-plus basis). In November 2010, the bank's license was annulled by Central Bank of Azerbaijan (CBA), due to violation of banking legislation, not implementation of management and operation proxy and prudentially, not observing the CBA's regular and durable instructions. (Today.az; 1 December 2010, http://www.today.az/news/business/77481.html)

In 2011, **Nikoil Bank** has also made an impressive debut of a Shari'ah compliant product - Wadiah yad Damanah, as an interest-free deposit product, which is segregated from Bank's other funds and used solely for forex trading activity.

Since joining **Islamic Development Bank (IDB)** in July 1992, IDB has been active in Azerbaijan, with total of $528m allocated for project financing. Its private sector arm, Islamic Corporation for the Development of the Private Sector (ICD) started its activities since 2003 through extending a line of financing to local Azerbaijani banks. Since then, its assistance has increased from an initial of $0.8 million to more than $65 million. (IDB Group Presentation, 21 June 2010, Business Forum Investment Opportunities in Azerbaijan & Other CIS Countries)

For the past 3 years, ICD had shifted its focus from traditional intervention to a more pragmatic approach towards reaching wider clients through expanding or establishing new Islamic Financial Institutions. This resulted in:

- Establishment of the first Shari'ah compliant investment company (Caspian International Investment Company);
- Creation of first Shari'ah compliant leasing company ("Ansar Leasing");
- A study on establishment of takaful (Islamic Insurance) company is underway.

Another memorable milestone was Azerbaijan's hosting of 35th Annual Meeting of the Islamic Development Bank during the period 23-24 June 2010, where Ministers of Finance, Economy, and Planning attended the Meeting on behalf of the (56) member countries. Additionally, Kuwait Fund for Arab Economic Development, Abu-Dhabi Fund for Development, OPEC Fund for International Development and Saudi Fund for Development increased their financing activities in Azerbaijan.

Above mentioned landmarks indicate that Azerbaijan can greatly benefit from Islamic finance, which can act as a financing intermediary for strengthening economic ties with OIC countries, attracting Gulf capital for investment in non-oil sector, which in turn will lead to new jobs creation and increase competitiveness of the economy. As a firstadopter of Islamic finance, Azerbaijan can play as a regional financial hub and take advantage of strong relationships with IDB and other Gulf funds, and build partnership for long-term investment and sustainability of economy beyond oil/gas production period. ("Perspectives of lslamic Banking and Finance in Azerbaijan", Mahir Humbatov, News Bulletin issued during Annual Meeting of the IDB Board of Governors, 2010) Additionally, development of alternative financial services will increase competitiveness in conventional finance sector as well and provide incentive for further development of finance sector and increase its contribution towards country's economic development.

6.2. Implementation of Islamic Finance in Azerbaijan

One of the key characteristics of Islamic finance is profit and loss sharing (PLS) mechanism. This is done through either Musharakah or Mudarabah financing. Thanks to this PLS paradigm, the Islamic banks are able to deliver their resource allocation more effectively, because the selection of investment options is determined based on their productivity and expected rate of return. (Iqbal, 1997)

Some of the most important functions necessary for an Islamic Finance system are socio-economic justice and equitable distribution of income and wealth, that's why it can be considered as ethics-based financial services. (Association of Islamic Banking and Institutions Malaysia, article, 2006)

Currently, the world's largest banks open "Islamic windows", which in fact testifies the growing interest in the Islamic finance. Islamic finance has at least 14 basic instruments, ("Hopes for the Future of Islamic Finance", Dr. Abbas Mirakhor, http://www.islamic-banking.com/iarticle_6.aspx) which can span into a much larger set of choices to provide greater security, liquidity, and diversity to meet the demand of investors.

Considering above mentioned advantages of Islamic Finance, the process of introducing it in the country is becoming an increasingly important and relevant subject. There is no Islamic finance regulation in Azerbaijan yet, but legislators are currently reviewing the existing banking and allied legislation to see how Islamic finance could best be incorporated and regulated. CBA is also studying the experiences of other countries, including Turkey, Malaysia and UK, which has, over the past several years, established Islamic finance in their jurisdictions. Moreover, market's demand is untested so far, though Kauthar and Nikoil, as mentioned earlier, have made some attempts to introduce Shari'ah compliant products to wide customer base.

Bearing in mind these circumstances, the best viable option for making major step in introducing Islamic Finance in the country, would be through "Islamic Window" within existing conventional banks. It is less costly and risky, requires not significant effort to make a change in existing operations of a bank, rather than to convert it to a fully-fledged Islamic Bank.

At the inception of the Islamic window, the products typically offered are safekeeping deposits - on the liability side of the bank, such as Wadiah yad Damanah and Islamic trade-finance products for small and medium companies - on the asset side of the bank, such as Murabaha and Ijarah contracts, which can be aimed at meeting strong housing finance (through Diminishing Musharakah) demand as well.

6.3. Matching of Islamic Financial Principles with Practice.

In the light of this transformation option, four areas are of top importance that practitioners and regulators need to take into account of, in order for Islamic finance to be successfully introduced into an existing conventional system:

(i) Compliance with the Shari'ah

(ii) Segregation of Islamic and conventional funds;

(iii) Accounting standards;

(iv) Awareness campaigns. (Sole Juan (2007), "Introducing Islamic Banks into Conventional Systems", IMF Working Paper)

6.3.1. Compliance with the Shari'ah

Islamic finance is based on the principles established by the Shari'ah as well as other jurisprudence or rulings, known as fatwa, issued by qualified Muslim scholars. Establishment of two multilateral institutions has contributed to the development in this matter:

- Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), which issues internationally, recognized Shari'ah standards on accounting, auditing, and governance issues; and
- Islamic Financial Services Board (IFSB), which issues standards for the effective supervision and regulation of Islamic financial institutions.

6.3.2. Segregation of Funds

In operational terms, this requires that banks establish different capital funds, accounts, and reporting systems for Shari'ah compliant and non-compliant activities. In this sense then, when a conventional bank opens an Islamic window, it is in fact establishing a separate entity from the rest of the bank. However, as the treasury department of the parent bank is typically in charge of managing the liquidity requirements of the bank as a whole, this might pose a threat of mixing conventional and Islamic funds.

6.3.3. Accounting and Auditing Standards

The application of already tested accounting and auditing conventions set by AAOIFI could alleviate the burden on supervisors facing the new challenges imposed by Islamic finance.

6.3.4. Awareness Campaigns

Raising awareness on Islamic finance is one of the key factors for sector's successful development. Because without fully appreciating strengths and weaknesses of Islamic finance compared to conventional, investor won't be interested to risk their funds. Banks can organize investor forums to interested parties and facilitate training of professional staff, in order to promote its Islamic finance products. Unfortunately, we haven't witnessed major promotion and investor fairs on Islamic finance yet. However, it is worth to mention that the "IV Baku Banking Conference" held in December 2011 dedicated a separate day for discussing the perspectives of development of Islamic finance in CIS member countries. IBA also expressed interest in holding "Khazar Banking Forum", which extensively covers Islamic finance subject. But if we want to build a viable Islamic finance sector in the country, which can exist in line with conventional finance, then a strong customer base needed to be built through investor engagement and awareness events.

Governments in Europe and South-East Asia have rapidly accommodated their existing regulations for Islamic Finance, in order to attract Shari'ah compliant funds, and as an example, UK has passed a legislation which eliminates double taxation of property buyers using murabaha financing facility.

6.3.5. Contributing Factors

There are several factors that can contribute to the development of Islamic Finance in Azerbaijan, which include:

- Development of oil/gas industry and increasing revenues from the high level of oil price, which need to be invested in local economy
- Fast-paced industrialization and expanding foreign economic relations
- Growing need to develop non-oil sector
- Muslim dominated population

Islamic finance has been growing steadily with double-digit numbers over the last 30 years and has already passed the test of being a stand-alone alternative of doing finance. The industry exceeds $1 trillion and set to grow at annual average rate of 15-20%.[6] Increase in Islamic finance activities throughout GCC, South-East Asia, as well as Western Europe countries indicates increasing demand for these products and attractive returns offered by it.

[6] http://www.gulf-daily-news.com/NewsDetails.aspx?storyid=330415

Islamic finance has great potential to facilitate economic growth of Azerbaijan as a fair, ethical way of doing finance and it can work as catalyst for boosting development of non-oil sector, which can provide a sustainable system for our country with many talented young professionals. The implementation of these activities requires political will and proper regulatory framework, as well as mutual efforts of society at large.

Whether the industry development in the country will be incentivized by catering to the needs of local population, or attracting excessive Gulf capital funds, or developing capital markets and attracting FDI (foreign direct investment), as well as positioning Azerbaijan as a financial hub (which will be further emphasized by introduction of Islamic finance) or any other purpose, this is yet to be seen. One thing is for sure that we are on the verge of significant developments in the finance sector of not only Azerbaijan, but whole CIS countries. In turn, this will increase the need for thorough research and empirical analysis for policy recommendations.

Chapter 7

CONCLUSION AND SUGGESTION

Islamic finance is an especially interesting phenomenon because it presents itself as an alternative to conventional finance not only in Muslim countries but in the rest of the world as well, in Azerbaijan. The aim of this study, after investigation the field of Islamic finance, is to suggest an alternative model for Azerbaijan.

Firstly, the concept and principle of Islamic Finance and Finance products have been highlighted with concise and brief with evidence and statements. Secondly, a, to know the difference between Islamic Finance and conventional finance

This study determines the awareness of the Islamic home finance products compared with conventional home financing, as well as clients' perceptions of home finance. This comparison is important since it is new in this area and gives the clients an overview about attractiveness of Islamic finance and home finance.

The recent financial crisis experienced in the conventional banking sectors around the world has focused attention on the Islamic banking sector where banks, which emphasize transparency and undue risk avoidance, have been largely insulated from the crisis (Hamdan 2009; Willison 2009), Islamic Banks surprisingly emerged as less crisis-prone. Islamic banking is guided by Shariah principles whereby interest (riba) is prohibited; money is not treated as a commodity; there is prevalence of justice; and uncertainty (gharar) is prohibited (Hamdan 2009).

At present, there are some specific banks in Azerbaijan have taken serious steps in the ways of implementation of Islamic Finance. The biggest bank of the country declared a tender for consultant to establish root of “Islamic Windows” for prospect in Azerbaijan.

Under guidance of investigation, 5 sphere of peak significance that regulators and practitioners bear in mind for having successful Islamic Finance into present conventional system:

(i) Compliance with the Shari’ah

(ii) Segregation of Islamic and conventional funds;

(iii) Accounting standards;

(iv) Awareness campaigns.

(v) Trainings, Teaching, Preaching, Research and Development.

Normally, majority of the employees of the Islamic banks, including managers and financial experts come from traditional sources lacking necessary experts in Islamic Finance. An institution is what its employees make it. Therefore, it’s extremely important to have the people with the right kind of skills and commitment. For case of Azerbaijan, Islamic atmosphere is flourishing day-by-day and practitioners are keen about observing Islamic rules in their business daily life. But real situation doesn’t enable any more for both banks and people to spread Islamic financial knowledge in society due to lack of Islamic Scholars and Experts, there is famous statement and it's said:

"The one who doesn't have can't give".

That's why there are two choices to remove the being ignorance about Islamic Financial knowledge and train them properly:

- Either foreign experts and Islamic scholars should be invited to Azerbaijan;
- Or group of students, or study group should be sent abroad for gaining deep knowledge in order not to confront in confirmation or giving allowance for Islamic Financial products.

Therefore, the successful development of Islamic finance on the domestic market would depend on the further improvement of legislation, regulatory prudential norms, and supply and demand. In the near future, it might become a subject of debate.

By developing Islamic financial infrastructure, Azerbaijan might indeed attract investments and financing from the Islamic capital market, not only from Arab countries.

Alternative financial tools could be provided for Azerbaijani investors in this way. Also, the number of practicing Muslims who could not and did not want to use traditional financial services was growing in Azerbaijan.

We should take into account that the best way of taking step to bring Islamic Finance to the country would be done through "Islamic Window" throughout existing conventional banks. Cost and riskiness are not high, because further requirements are not needed to make alteration in banks operation rather than converting whole banking sector entirely Islamic Bank. Secondly, even the implementation of Islamic finance is desirable, but it's not attractive with local commercial banks, because the competition between Islamic banks and conventional banks is inevitable and it's easy to see the overcoming of Islamic finance is not sensitive for financial crisis as conventional banks. That's why predetermined conditions and policy should be verified carefully in order not to having trouble in future.

REFERENCES

Abdul Ghafar Ismail & Noraziah Che Arshad (2009) Sukuk Structure. *Seminar on Sukuk and Regional Economic Development*, Syari‟ah Economics Department, Faculty of Economics, Airlangga University, Surabaya.

Abdul-Majid, A, Saal, D S & Battisti, G (2008a) .Efficiency in Islamic and conventional banking: an international comparison.Aston Business School Research Papers ISBN 978-1-85449-733-8.

Ahmad, S., Pradhan, H. K. & Ahmad, I. 2005. *Islamic banking and financial systems: Future strategies facing the challenges towards market leadership.* Paper presented to Union of Arab Banks in Beirut: Lebanon.

Alkhan, R. K. 2003. *Islamic securitization: A revolution in the banking industry.* Manama: Bahrain. Kuwait Finance House: 16, 28

Almutairi, Humoud (2010) a comparison between Islamic and conventional home financing in Kuwait: client perceptions of the facilities offered by the national bank of Kuwait and Kuwait finance house. Doctoral thesis, Durham University.

Al-Omar, F. and Abdel-Haq, M. K. 1996. *Islamic banking: Theory, practice and challenges*. London: Oxford University Press.

Baldwin, K.; Humayon, D. and John, P. 2000. On determining moral hazard and adverse selection in the Islamic firm. *Economic Research Paper*. No. 00/12. Loughborough University.

Bashir, A., Hassan, M. (2004),"Determinants of Islamic Banking Profitability", ERF Paper, 10th Conference.

Bhattaacharyya, A., Lovell, C. A. K., and Sahay, P., 1997, .The impact of liberalization on the productive efficiency of Indian commercial banks. European Journal of Operational Research, 98, pp 332-345.

Bhatawdekar, S (2010), " Financial Ratios and Financial Analysis", available online at http://shyam.bhatawdekar.net/index.php/2010/01/13/financial-ratios-and-financial-ratioanalysis/

El-Gamal, Mahmoud A. (2001b), 'An economic explication of the prohibition of gharar in classical Islamic jurisprudence', paper presented at the 4th International Conference on Islamic Economics, Leicester, 13–15.
August, www.ruf.rice.edu/~elgamal.

Kuwait Chapter of Arabian Journal of Business and Management Review Vol. 1, No.2; October 2011. Dar, Humayon (2010). Islamic Banking In Iran and Sudan. Business Asia, June 27, 2010.

Ebrahim, S. and Joo, T. K. 2001. Islamic banking in Brunei Darussalam. *International Journal of Social Economics.* Vol. 28(4): 314-337.

Elhiraika, A. B. & Hamed, A. H. 2003. *Explaining growth in an oil-dependent economy: The case of the United Arab Emirates*. Paper presented to the Department of Economics, CBE, UAE University, Al-Am, United Arab Emirates**.**

Faisal A. Alkassim (2005), “The Profitability of Islamic and Conventional Banking in the GCC Countries: A Comparative Study” 10/2005; 52341(11):70-48.

Greuning H.and Iqbal Z. (2008),”Risk Analysis for Islamic Banks”, Kevin W. Lu, Gero Verheyen, and Srilal M. Perera Editors the International Bank for Reconstruction and Development the World Bank IP: 192.86.100.29 Mon, 16 Nov 2009 14:35:36.

Hassani Mohammad (2010). Islamic Banking and Monetary policy: Experience of Iran, International Review of Business Research Papers, Volume 6. Number 4. September 2010. Pp. 430 –443, Melbourne, Australia.

Hassan, K. 1999. Islamic Banking in theory and practice, the experience of Bangladesh. *Managerial Finance.* Vol. 25(5) p. 60-113.

Homer, S. (1977) *A History of Interest Rates* (Second Edition), New Brunswick, New Jersey: Rutgers University Press.

Profit sharing ratios in mudarabah contract Zubair Hassan, International Journal of Banking and Finance, Vol. 6, Iss. 1 [2008], Art. 1.

Iqbal, Z. (1997). A National of Pakistan, is an Information Officer in the World Bank's Treasury Information Services Department. Islamic financial systems, Finance & Development, June, Vol 34(2) p. 42-45.

Iqbal, Z. (1997),"Islamic Financial System", Finance and Development, The World Bank Publication Ismail, S. (2001)," Islamic Finance Explained", published by Ethical banks in UK.

Iqbal, Z. and Mirakhor, A. 1999. Progress and Challenges of Islamic Banking. *Thunderbird International Business Review*. Vol. 41(4/5): 381-405.

Issue 5 of 'The Anvil,' by The Third Position, BCM ITP, London, WC1N 3XX.

Karim, R. A. A. 1994. Regulation of Financial Reporting by Islamic Banks. *Accounting Issues in Islamic Banking*, London: Institute of Islamic Banking and Insurance.

Khan, M. and Jain P. (2007), "Financial Management: Text, Problems and Cases", fifth edition, Tata McGraw-Hill.

Mahir Humbatov, Perspectives of lslamic Banking and Finance in Azerbaijan", News Bulletin issued during Annual Meeting of the IDB Board of Governors, 2010.

Marliana Abdullah, Shahida Shahimi & Noraziah Che Arshad (2008) Sukuk Mudharabah. *Proceeding of the Workshop in Islamic Economics and Finance 2008 (WIEF`08)* Center for Publication and Printing, UKM. *(ISBN: 978-983-3198-25-2)*

Molyneux, P. and Iqbal, M. (2005),"Banking and Financial Systems in the Arab World", PALGRAVE MACMILLAN.

Munawar Iqbal Ausaf Ahmad Tariqullah Khan, Challenges facing Islamic Banking, Islamic Research and Training Institute Islamic Development Bank, first edition.

Naser, K., andMoutinho, L. [1997], "StrategicMarketingManagement: the Case of Islamic Banks", *International Journal of Bank Marketing* 15, No. 6, 187 – 203.

Noor Ahmed Memon (2007). Islamic Banking: Present and Future Challenges, Journal of Management and Social Sciences,Vol. 3, No. 1, (Spring 2007) pp.01-10.

Obaidullah, M. (2005), *Islamic Financial Services*, International Center for Research in Islamic Economics, Jeddah. 'Islamic Risk Management : Towards Greater Ethics and Efficiency, International journal of Islamic Financial Services , Volume 3, number 4.

Rahman, A. (1979), *Economic Doctrines of Islamic Banking and Insurance,* The Muslim Schools Trusts, London.

Salleh, H. and Hassan, F. 2004. *Islamic banking system in Malaysia performance and challenges*. Samad, Abdus (1999), "Comparative Efficiency of the Islamic Bank Malaysia vis-à-vis Conventional Banks." *IIUM Journal of Economics and Management* 7, no.1: 1-25.

Siddiqi, M. 2001. *Problems and prospects of Islamic banking and finance*. Lecture delivered at the Center for Near Eastern Studies at the University of California on Nov. 13, 2001. http://siddiqi.com/mns/

Juan Solé, *Introducing Islamic Banks into Conventional Systems* 5 (Int'l Monetary Fund, Working Paper No. 07/175, 2007).

Suddin Haron,(1998). A Comparative Study of Islamic Banking Practices, School of Management, University Utara Malaysia, J.KAU: Islamic Econ., Vol. 10, pp. 23-50.

Sunan ibn Majah, Chapters on Sales, Bab: "Partnership and Mudarabah", p.263 (*Ibn* al-Qayyim, 1977, Vol. 4, *p*. 373).

Franz Magnis-Suseno, *Etika Jawa, Sebuah Analisa Falsafi tentang Kebijaksanaan Hidup Jawa* (Jakarta: Gramedia, 1985), p. 56-72P. 2002.

Tarawneh, M. (2006), “Comparison of Financial Performance in the Banking Sector: Some Evidence from Omani Commercial Banks”, International Research Journal of Finance and Economics, Issue 3 (2006), p. 101-111

Tarek el Diwany. Islamic Banking and Finance, What it is and What it Could be. Bolton, UK: 1st Ethical Charitable Trust, 2010 536 pp.

Thomas, A., Cox, S. & Kraty, B. 2005. *Structuring Islamic finance transactions*. London: Euromoney Books.

Wahba Al Zuhaili (2007) Financial transaction in Islamic jurisprudence, Beirut: Dar al-Fikr al-Mouaser, First Edition.

Zaher, T. S. and Hassan, M. K. 2001. A comparative literature survey of Islamic finance and banking. *Financial Markets, Institutions and Instruments*. Blackwell Publishers. Vol. 10(4): 185-187.

Zaher, T., and Hassan, K. (2001), “ A Comparative Literature Survey of Islamic Finance and Banking”, financial Markets, Institutions and Instruments, p. 155-199.

Gulf Daily News. Sunday, May 20, 2012 http://www.gulf-daily-news.com/NewsDetails.aspx?storyid=330415

"Hopes for the Future of Islamic Finance", Dr. Abbas Mirakhor, http://www.islamic-banking.com/iarticle_6.aspx

Country Focus: "Azerbaijan - emerging market", New Horizon, *01 October, 2008; Renat Bekkin;* http://www.newhorizonislamicbanking.com/index.cfm?section=features&action=view&id=10707

Today.az; 1 December 2010, http://www.today.az/news/business/77481.html