

Islamic Banking Products: Its Scope and Feasibility in India

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Abstract—*Banking is the need of our time. It should be a continuous effort that maximum people involve themselves in the banking system. In this process Islamic banking can play an important role. This paper reviews the role of Islamic banking instruments in financial inclusion from theoretical aspects. It highlights the basic principles on which Islamic banking is based and describes the area of potentials and barriers in Indian economy. The basic principle is prohibition of interest and promotion of ethical business activities.*

1. INTRODUCTION

The concepts and mechanisms of Islamic Banking is as old as Islam itself, but the word and proper implementation of Islamic Banking took place in 1960's with the establishment of MIT GHAMAR LOCAL SAVINGS BANK in EGYPT. Islamic banking is based on the ethos and values of the religion ISLAM and its Islamic system which are derived from QURAN and SUNNA'H (the lifestyle of our beloved PROPHET MOHAMMAD P.B.U.H). These systems are called SHARIA'H. Sharia'h gives a complete code of life i.e. details regarding each and every aspect of life; from earning to expenditure, production to consumption, property rights, allocation of resources, distribution of income and wealth, and framework within which monetary and banking system can operate. HINDU SUTRA (700-100B.C.), BUDDHIST JATAKAS (600-400), TORAH, BIBLE, and QURAN every book prohibits INTEREST charging [1].

“Those who devour usury will not stand except as stand one whom the EVIL one by his touch hath driven to madness. That is because they say: “TRADE IS LIKE USURY”. Those after receiving direction from their LORD, desist, shall be pardoned for the past; their case is for ALLAH (to judge); but those who repeat (the offence) are the companions of the Fire: they will abide there in (forever)”_ QURAN (2:275) [2]

“Do not take Interest of any kind from him, but fear GOD, so that your countryman may continue to live among you”_ LEVITICUS (25:36) [3]

“Thou shalt not lend upon Interest to thy brothers: Interest of money, Interest of victuals, and Interest of anything that is lent upon”_ DEUTRONOMY (23:19)

The PROPHET EZEKIEL includes RIBA (Interest) in the list of “abominable things”_ EZEKIEL (18:8:3)

The PROPHET MOHAMMAD (P.B.U.H) includes RIBA (Interest) among the seven deadly sins for people.

Islamic Banking primary objective includes equal distribution of wealth and social justice. The main feature and function based on the SHARIA'H principle is ban on Interest based transactions. It encourages risk sharing between investor and entrepreneur, no right to profit if no risk involved, and promotes PROFIT-LOSS sharing transactions. It is based on asset financing and commodity trading. One of the main functions is that it prohibits investment in projects related to pornography, alcohol, weapon and defense, pork products, gambling, tobacco, speculative activities. It is an ethical business framed for the social improvement of the society. Islam has given immense importance to trade and its nobility is obvious as it was a chosen profession of PROPHET MOHAMMAD (P.B.U.H). Thus the main feature of an Islamic financial system is absence and prohibition of Interest in the different modes of trading and monetary and banking systems. It helps in institutionalization of fair and equitable markets by removing monopoly and fraud. It encourages business activities based on fair and halal profits. Giving Zakat (alms giving) is one of the main feature of Sharia'h. Returns for the investment should be based on profit and loss sharing.

Thus Islamic Banking is an institution that mobilizes financial resources and invests them in an attempt to achieve pre-determined Islamically acceptable social and financial objectives. Both mobilization and investment of funds should be conducted in accordance with the principles of Islamic Sharia'h. Islamic banking differs significantly from conventional banking in terms of interest charging [4]. Interest is the basis of conventional model bank. Islamic scholars have developed products that resemble conventional banking products, replacing interest rate payments and discounting with fees and contingent payment structures [5].

2. DISTINCTION BETWEEN ISLAMIC AND CONVENTIONAL BANKING

ISLAMIC BANKING	CONVENTIONAL BANKING
1. Promotes risk sharing between provider of capital (investor) and user of funds (entrepreneurs).	1. Investor is assured of pre-determines rate of interest.
2. Based on Sharia'h compliant principles.	2. Based on man-made principles and regulations.
3. Encourages asset based financing and based on commodity trading.	3. Based on money trading.
4. No right to profit if no risk involved. The profit and loss sharing depositor may lose money in case of loss.	4. Risk free and depositor has no risk of losing money because interest is guaranteed.
5. Partners, investors and traders, buyers or sellers relationship.	5. Creditor debtor relationship.
6. Emphasis on soundness of project of investment.	6. Emphasis on ability to pay.
7. Co-ordination with partners in resource mobilization.	7. Dependence on borrowing in resource mobilization.

3. LITERATURE REVIEW

1. ZUBAIR IQBAL and ABBAS MIRAKHOR (1987)

Iqbal and Mirakhor in this paper discussed that Islamic banking is based on Sharia'h laws which specifies rules regarding every aspect of life from allocation of resources to their uses, production to consumption, distribution of wealth, mechanisms of market, and even the guidelines for monetary and banking system. The main feature is that rate of interest is replaced with the rate of return on real activities. They argue money is only a potential capital and requires entrepreneurial skills to transform it into real productive use and the lender has nothing to do with using it productively and converting money into capital. They are not entitled to any increment. Here the basic difference lies in shareholder and creditor. If a lender lends money, debt is created and he is not entitled to any interest for that, for idly sitting and earning the interest. This is creditor. But on the other hand if he lends money for creating investment and additional capital and wealth, then he can contract to receive the share of profit because he is a partner in the risk of the investment and thus he becomes shareholder. Thus Sharia'h allows any contract based on the consent of parties as long as they are contingent upon certain things.

2. MOHAMMED ARIFF (1988)

MOHAMMED ARIFF carried a survey on the growing literature on Islamic banking and traced the growth and development of Islamic banking and highlighted its salient

features. The first Islamic bank, MIT GHAMAR LOCAL SAVINGS BANK was set up in EGYPT in 1963 by AHMED EI NAJJAR. These banks which neither charged nor paid interest invested mostly by engaging in trade and industry, directly or in partnership with others and shared the profits with depositors (SIDDIQUI 1988). The MIT GHAMAR BANK lasted till 1967 after which DUBAI ISLAMIC BANK (1975), FAISAL ISLAMIC BANK of SUDAN (1977), FAISAL ISLAMIC BANK of EGYPT (1997), BAHRAIN ISLAMIC BANK (1979), PHILLIPINE AMMANAH BANK (1973) were set up. The base of all these banks was ban on interest. Ban on interest does not mean that capital is costless in an Islamic system. Islam recognizes capital as a factor of production but does not allow the factor to make a prior or pre-determined claim on the productive surplus in the form of interest. Alternative suggestion is profit sharing. What makes profit sharing permissible in Islam, while interest not, is that in the case of the former it is only the profit sharing ratio not the rate of return itself that is pre-determined. He argues that profit sharing can help allocate resources efficiently. Thus Islamic banking is an alternative way to provide financial services.

3. S. KABLAN and O. YOUSUFI (2011):

S. KABLAN and O. YOUSUFI in their paper studied about the efficiency of Islamic bank over the period of 2001-08 and they concluded that they are efficient at 92%. Islamic banking is flourishing in Muslim and non-Muslim country. Gulf countries hold a large concentrate of the liquidities, and to attract these liquidities to financial markets many countries including US, UK and recently FRANCE adjusted their markets according to Islamic banking system to provide these services. Their study aims at examining and evaluating the performance Islamic banks operating in countries such as MIDDLE EAST, ASIA, AFRICA, and U.K. They compared Islamic banking efficiency through the differences characterizing those countries. They used STOCHASTIC FRONTIER APPROACH (SFA) over the period 2001-08 to estimate a cost efficiency frontier and derived scores of cost efficiency. Measuring efficiency of banks leads to measuring performance level of banks in terms of financial services. Thus Islamic banking is not a monopoly of Islamic movement or its leaders. It helps all in general.

4. DR. JEET SINGH; DR. PREETI YADAV (2013)

In their paper they discussed about the report by grain research, part of US based management consultancy that India is a large market for Islamic banking as it has a large Muslim population. It can emerge as an important market for Islamic banking provided there is a favorable change in regulations, and to increase the awareness among Muslims and Indians as a whole that Islamic banking is not a religious institution only for the poor and backward Muslim community. Interest is the backbone of banking system but the difference lies here as Islamic banking works without interest and it is flourishing

and growing from JAKARTA to JEDDAH to JORDAN, 280 ISLAMIC BANKS operate in over 50 countries, with assets estimated between \$250 million and \$ 300 billion. Many foreign banks are operating Interest free windows, even many Indian banks are interested to adopt Islamic financial system but due to poor regulations are held back. An overview of the Islamic bank is portrayed that is operates in accordance with the sharia'h known as Fiqh-al-muaamlaat (Islamic rules on transactions). Setting of Islamic banks will help in covering large number of Muslims who can't use the benefits of banking system due to prevailing regulations which makes interest mandatory; moreover it will attract investments from MIDDLE EAST countries. Five INDIAN companies RELIANCE INDUSTRIES, INFOSYS TECHNOLOGIES, WIPRO, TATA MOTORS and SATYAM COMPUTER SERVICES figure in the STANDARD AND POOR'S BRIC SHARIA'H INDEX. Thus India has immense potential for the Islamic banks. The main objective of the study was to explore policies of Islamic banks and review its potential in Indian economy and its major constraints.

5. ZAMEER BHATT (2013)

Bhatt discussed about the nature scope and feasibility of Islamic banking system in India. Banking plays an important role in mobilization of funds and is one of the oldest forms of financial intermediaries in the financial system. Interest is considered crucial for the role of savings and investments of funds in the economy and thus Islamic banking is criticized here. The present Indian banking system is based on interest charging. The borrower is obliged to pay a pre determined rate of interest even though he has suffered losses and is in no position to repay them. The relationship between the bank and client is that of creditor and debtor which leads to many social evils. Thus interest has many social and economic evils. The main aim of Islamic finance is social justice and equality. It is fair and just and equitable to all. RBI has exhibited a biased dependence on interest rate structures and reserve ratios to tackle the crisis in the short term, which is leading to depreciation of rupee and inflation. Thus Islamic banking is the best alternative.

4. OBJECTIVE

1. To study Islamic bank products.
2. To study the area of Islamic banks in India
3. To find the barriers in the path of development of Islamic banks in India.

5. RESEARCH METHODOLOGY

This is an exploratory-cum-descriptive nature of research and it involves depth theoretical analysis, thus qualitative research method was adopted to explore the details of Islamic banking sector. The data is collected from secondary sources like journals, research papers, magazines, and internet. Published sources were used.

6. ISLAMIC BANKING PRODUCTS

1. Prohibition of Riba (interest) based monetary system. It should be noted that Riba is prohibited, equity based returns on investment are accepted. Conceptually an Islamic bank has an equity based capital structure, composed of shareholder's equity and investment deposits based on profit and loss sharing. Just as supervisory issues such as capital adequacy ratios in conventional banking are regulate by the Basel committee on banking supervision (BCBS), Islamic banks follows the standards prescribed by the Accounting and Auditing organization for Islamic finance Institutions (AAOIFI) [6].
2. Mudarabah: Profit-Loss sharing contractual partnership. One partner provide capital (rab-ul-maal) needed other provide the human skill needed to successfully carry the economic activity undertaken. It is usually applied to short duration. Rab-ul-maal has no right to participate in the management of the business, but he only bears the loss as he only invested in the business. Profits are shared at pre-determined ratio
3. Musharakha: A joint enterprise or partnership structure with profit -loss sharing. It is a form of business arrangement in which a number of partners invest their financial capital to take commercial industrial enterprise for longer duration [7]. In musharakha all partners can participate in the business and can work for it, and loss is shared by all by the ratio of their investment.
4. Murabaha: This is a fixed income loan for the purchase of real asset, with a fixed rate of profit decided by the profit margin. Here banks purchase the goods, and thus gets around the prohibition to make a return on money lending; as a bank buys an investment good on behalf of the client and then on sells it to the client, with staggered payments and a profit margin in the form of a fee.
5. Ijara: It is hire purchase which means lease, rent or wage; where bank keeps ownership of the investment good and rents it to the client for a feasible fee.
6. Bai Salam: It is advance purchase which means a contract in which advance payment is made for goods to be delivered later.
7. Wadiah: Bank is deemed as the keeper and trustee of funds. It is treated as a safe keeping system.
8. Qard-Hasan: Loan which are interest free and given on goodwill basis. They are loans without interest and profits.
9. Takaful: It is an Islamic insurance which is against interest, gambling, uncertainty used for repayment in case of loss.
10. Halal Activities: It prohibits and abstains from investing in business projects related to alcohol, pork products, gambling, tobacco, pornography, weapons and defense, gambling, and speculative activities. It is considered haram (sinful).
11. Waqf : It refers to a religious endowment i.e. a voluntary and irrevocable dedication of one's wealth or a portion of

it in cash or kind (such as a house or garden) and its disbursements for Sharia'h compliant projects.

12. Sukuk: It refers to the Islamic equivalent bonds. However as opposed to conventional bonds which merely confer ownership of a debt, sukuk grants the investor a share of an asset, along with commensurate cash flows and risk. As such, sukuk securities adhere to Islamic laws sometimes referred to as Sharia'h principles, which prohibits charging or payment of interest.

7. SCOPE IN INDIAN ECONOMY

The present economic scenario of India indicates that apart from conventional banking system, India is in need of the much awaited reform in the form of Islamic banking system. To develop a healthy and sound economic system it is needed to implement a proper and full-fledged Islamic system. In India a large number of people live under BPL (below poverty line). One of the major factors behind this condition is unequal distribution of wealth and income among Indians. Introduction of Islamic banking can help these debt-ridden farmers, laborers and other financially poor groups by restoring equilibrium by introducing interest free financial services.

Moreover experts argue that Islamic banking will help in mobilizing large capital held by devout Muslims who very little participate in the conventional marketing system [8]. Islamic banking will help in promoting investments; and hence check the dead end investment in gold and ornaments. I am a Muslim woman, and being a Muslim I have seen my father and my husband, as many other Muslims, not able to utilize their income and wealth to properly and get the benefits of a good investment because of the lack of Islamic financial system. To channelize these incomes and wealth for the further development of economy, a full-fledged Islamic financial system is needed. Moreover Islamic banking is a banking system based on ethics, thus prohibits investment in reckless activities of gambling, alcohol, pornography, weapon, market speculation, thus facilitating investments in real economic activities and promotes social welfare on the whole.

Islam lays great emphasis on social justice, financial inclusion and sharing of resources between the haves and the have not [9]. Islamic finance focuses on the issue of financial inclusion from two directions- one through promoting risk sharing contacts which provide a viable alternative to conventional debt based financing, and the other through specific instruments of redistribution of the wealth among the society. Both risk sharing financing instruments and redistribution of the wealth among the society. Both risk sharing financing instruments and redistributive instruments such as Zakat, Sadaqaat, Waqf, Qard-e- hasan offer a comprehensive approach to eradicating poverty and to build a healthy and vibrant economy. Islam offers a rich set of instruments and unconventional approaches that can lead to reduced poverty and inequality.

8. BARRIERS IN DEVELOPING ISLAMIC BANKING IN INDIA

Many debates, meetings, conferences are held to promote and establish Islamic banking in India, still it is not implemented as a full-fledged system. The hindrances in its path are:-

- 1) The Banking Regulation Act (1949) prohibits the operation of banks on a profit and loss basis (5b), forbids Murabaha (buying and selling or barter of goods) (8), impedes Ijara or bars the holding of immovable property for a period of greater than seven years (9), and requires the payment of interest (21).
- 2) In India banks cannot raise deposits without promising a pre-scribed rate return, but under Sharia'h returns can be determined only afterwards.
- 3) Banks have to maintain Statutory Liquid Ratio (SLR) which involves freezing a large portion of funds as cash, gold or government securities. Cash will not get you any return, gold is risky as it could depreciate and government securities are interest bearing which is unacceptable under Sharia'h.
- 4) One of the major hindrances is the misconception regarding the belief that Islamic banking is only for Muslims.
- 5) Few hurdles involve restrictions on equity investment and trading.
- 6) Last but not the least opponents say Islamic banking could be exploited politically as well as used to gather funding from Gulf Coast Countries (GCC) for terrorist activities, although it is wrong.

9. ISLAMIC BANK SYSTEM WORLDWIDE

Today Islamic banks total assets stands at \$1.1 trillion (2012) as against \$826 billion in 2010. There are around 275 ISLAMIC financial institutions in 75 countries. Islamic banking has covered all the continents today. INDONESIA, SAUDI ARABIA, BAHRAIN, SUDAN, JORDAN, TURKEY, IRAN, PAKISTAN, PHILLIPINES, BANGLADESH, DUBAI, U.K, RUSSIA, AUSTRALIA are few of the many countries who have established the Islamic financial system. Major multinational banks like Lloyds TSB, HSBC AMANAH, STANDARD CHARTERED SAADIQ and CITIGROUP offer products in sync with ISLAMIC BANKING principles.

According to the SACHAR COMMITTEE commissioned in 2005 says approximately 50% of MUSLIMS in INDIA are financially excluded, and it is here the potential of ISLAMIC BANKING lies. If countries such as FRANCE, SINGAPORE, CHINA, U.K, can adjust their financial systems to ISLAMIC BANKING, INDIA with a MUSLIM population of over 160 million could consider the same and bring certain much awaited reforms in its BANKING REGULATIONS whose purpose is to ensure smooth and standardized operations and not a vet business model.

10. LIST OF ISLAMIC BANKS WORLDWIDE

1. AMANA'H BANK of SRI LANKA
2. BANK of WHITTIER USA
3. JAIZ ISLAMIC BANK, NIGERIA
4. DUBAI ISLAMIC BANK
5. YEMEN ISLAMIC BANK
6. QATAR ISLAMIC BANK
7. BAHRAIN ISLAMIC BANK
8. SYRIA ISLAMICBANK
9. PALESTINE ISLAMIC BANK
10. FAISAL ISLAMIC BANK of EGYPT
11. FAISAL ISLAMIC BANK of Sudan
12. JORDAN ISLAMIC BANK
13. ARAB BANKING CORPORATION
14. ALBARAKA BANKING GROUP
15. MEEZAN BANK PAKISTAN
16. BANK of PALESTINE
17. BANK MUAMALAT INDONESIA
18. CENTRAL BANK of MALAYSIA
19. JORDAN KUWAIT BANK
20. ABU DHABI ISLAMIC BANK
21. BANK SYARIAH MANDIRI INDONESIA
22. BANK ISLAM BRUNEI DARUSSALAM
23. AL RAJHI SUADI ARABIA
24. KUWAIT FINANCE HOUSE

Investment banking is what continues to set these Islamic banks apart from conventional banking. Bank ISLAM BRUNEI DARUSSALAM has around \$4.8 billion of assets and total equity of \$766 million generating pre-tax profit of \$87 million in 2011. MEEZAN BANK PAKISTAN, has deposits of PKR230.43BILLION (\$2.34 BILLION) and total assets of PKR274 billion and bank reported 24.34% return on average equity in 2012. AL RAJHI SAUDI ARABIA has assets of \$65.92 billion and net profit of SAR7.885billion in 2015. AL BARAKA ISLAMIC BANK has an asset of \$19billion by the end of 2012 and is active in 15 countries through 400 branches. KUWAIT FINANCE HOUSE total assets in 2012 grew 9% to KWD14.7billion with deposits up 6% to KWD9.4billion. QATAR ISLAMIC BANK has an asset base of \$183.35million in 2012 and net profit of QAR1.13billion. ABU DHABI ISLAMIC BANK has total assets up 14% in the year 2012 to AED85.7billion with customer financing up 11%, customer deposits 13%, capital resources 23%, revenues 13% and net profits 9%.

Global Islamic banking assets attained compound annual growth rate (CAGR) of around 17% from 2009 to 2013. The Islamic industry has gone mainstream in several core markets. International Islamic bank assets exceed US\$778 billion in 2014. The global profit pool of ISLAMC BANK is set to triple by 2019. (SOURCE: WORLD ISLAMIC COMPETITIVENESS REPORT 2014-15).

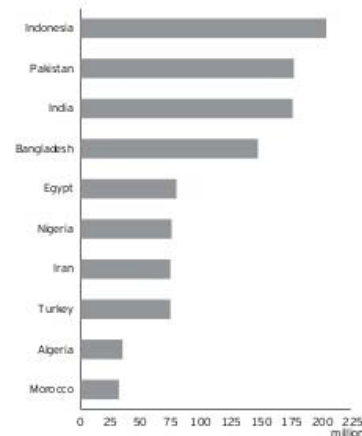
The below charts explain the growth rate of Islamic bank worldwide and their growing assets in the period of four years (2008-2012). It also shows the overall population of Muslims worldwide. India is the third country with the largest population of Muslims; government should consider adopting the Islamic banking system to include them also in the financial system and overall growth of the economy.

Global distribution of Islamic banking assets

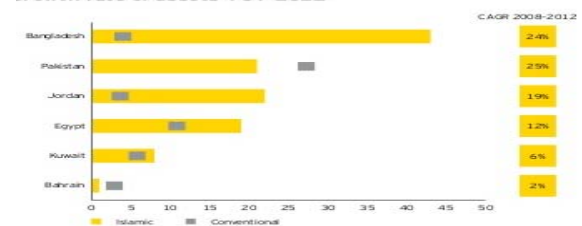


Sources:
Central Banks, BM, EY analysis

Countries with the largest Muslim population



Growth rate of assets YOY 2012



World Islamic Banking Competitiveness Report 2013-14 1.7

11. SCOPE OF THE STUDY

Its framework will be helpful for general public and for their knowledge and future researches. It will be helpful for banking Sector. Political system will get more resources to take decision and making law on banking system.

12. SUGGESTIONS

ISLAMIC BANKING is increasingly gaining acceptance in high growth emerging markets as an effective means to build an inclusive financial system. RBI and ministry of finance should consider ISLAMIC BANKING as a viable alternative to handle the economic problems as it has all the features of modern banking except interest charging. ISLAMIC BANKING holds promising opportunities for fuller market operations. Moreover market itself will be the best judge for the efficiency and pitfalls of ISLAMIC BANKING in INDIA. ISLAMIC BANKING is an ethical business model and works for the overall welfare of the society, which is much needed for the development of the INDIAN ECONOMY.

13. CONCLUSION

Islamic banking continues to be an enticing growth story characterized by increasing share of Islamic finance markets. It is gaining acceptance especially in high growth emerging markets, as an effective means to build a financial inclusive system and replace the old shadow economy. RBI and ministry of finance should consider Islamic banking as a viable alternative to tackle the economic and social problems.

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