How Islamic is Islamic banking in Pakistan?

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Abstract

Purpose – Increasing popularity of Islamic banks in the wake of recent global financial crisis of 2008 has generated debate among researcher about practicality of Islamic banks. Critics argue that Islamic banks are not working according true spirits of *Sharia'h*. This paper aims to empirically address the question that how Islamic is Islamic banking in the case of Pakistan.

Design/methodology/approach – The target population in this paper is staff at the Islamic banks who are employees and managers. Data are also collected from customers to analyze their views. Sample comprises 63 branches of five full-fledge Islamic banks and five Islamic branches of conventional banks in Islamabad. For analysis purpose, the study uses exploratory factor analysis.

Findings – Findings indicate that Islamic banks are following *Sharia'h* excluding the provision of profit loss sharing contracts and provision of *qard-ul-hassan*. Moreover, it is found that customers are less agreed and more neutral about *Sharia'h*-based operations at Islamic banks.

Originality/value – Findings will help regulators to introduce wide range of Islamic financial contracts that involve profit loss sharing and consider the expansion of emerging industry. Moreover, findings suggest to consider promotional techniques to create awareness of Islamic banking among the customers.

Keywords Pakistan, Islamic banking, *Sharia'h*

Paper type Research paper

1. Introduction

The financial industry facilitates transactions and offers substantial amount of credit to investors, households, firms and governments, thereby enhancing economic activity (Baily and Elliott, 2013). Indeed, global financial industry has faced more than hundred crises over the past three decades (Stiglitz, 2003). The underlying reasons behind crises are unethical business practices such as mismanagement of risk, imprudent mortgage lending, debt default, inappropriate transparency, complex financial instruments and human frailty (Hassan and Kayed, 2009). Neuhauser (2015) unveils that main causes of recent financial crisis are failure of credit rating agencies and housing bubble driven by huge subprime lending in the USA. As ethics are linked with survivability[1], crisis has enforced the consideration of ethics in financial system. Consequently, Islamic financial setup has flourished into global financial market as a feasible alternative to its orthodox counterpart in the wake of recent global financial crisis of 2008 (Sekreter, 2011).

Today, Islamic banks have gained mounting popularity not only in Muslim countries but also in non-Muslim countries. In terms of statistics, the assets of Islamic banks have crossed US$2tn in 2015, and more than 775 Islamic financial institutions are registered across the world. Among them, 555 are fully fledged and 220 are operating with Islamic window (Edbiz, 2015). To stabilize the economy, Pakistan is among those countries which are striving hard to promote Islamic banking. Total number of Islamic banks in Pakistan has reached 2146 in 2016 as compared to 150 in 2007 (Islamic Banking Bulletin[2], 2015). Therefore, the rising demand for Islamic banks induces us to explore this avenue.

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Literature reveals that various studies such as Chapra (1992), Iqbal (1997), Iqbal and Molyneux (2005), Iqbal and Mirakhor (2006), Farook (2007), Mohieldin *et al.* (2012) and Usmani (2012) theoretically demonstrate fundamentals of Islamic financial system. However, some studies which are conducted in different times such as Lewis (2007), Chong and Liu (2009) and Khan (2011) have exposed that Islamic banks are not working per true spirits of *Sharia'h*. This has generated debate among researchers regarding real practice of *Sharia'h* (Islamic laws) at Islamic banks. In response to this debate, Fahmy and Yusof (2008) conduct a study for Malaysia and found out that Islamic banks are working per *Sharia'h*. Two years later, Khan (2010) addressed the same issue using the data set of global Islamic financial industry and concluded that Islamic banks are violating *Sharia'h*. It is noted that existing literature pertaining to survey of *Sharia'h* practice at Islamic banks is inadequate.

More importantly, it is observed that study scrutinizing operations at Islamic bank in Pakistan is missing. This motivates us to conduct this study. This study aims to fill this gap in the literature by empirically assessing *Sharia'h*-based working at Islamic banks in Pakistan. According to the best of authors' knowledge, this is the first study that uses primary data to evaluate whether Islamic banks follow *Sharia'h* in Pakistan. The findings of the study not only provide useful information to investors, lenders and people from academia but also provide guideline to financial regulators making better financial policies. To achieve the objective of research, our study addresses the following research question:

RQ1. How Islamic is Islamic banking in Pakistan?

The remainder of the paper is organized as follow. Section 2 demonstrates literature review of Islamic banking theory and practice. Section 3 presents data description and methodology. Section 4 provides discussion of the empirical results. Finally, Section 5 concludes and gives policy recommendations.

2. Islamic banking: theory and practice

This section comprises two parts. First part provides overview of the literature on theory of Islamic banking, and second part presents the literature on working of Islamic banks. While considering the first part, we discuss that Islamic financial industry is based on *Sharia'h* (Islamic law) that stems from The Holy Quran and Sunnah[3]. Intrinsically, *Sharia'h* prohibits interest (Chapra, 1992). Al-Jarhi (2004) articulates various reasons behind prohibition of interest. For instance, interest represents money earned without putting any effort and such earning impedes economic activity. Second, from Islamic point of view, money is medium of exchange not a commodity. Thus, trading of money is prohibited. Third, interest contributes to miseries of the poor borrowers because lender charges fixed amount irrespective of profit or loss to borrowers. In the case of loss, repayment becomes challenge for borrowers and interest further increases on late repayment. Thus, burden of borrowers never lessens. Finally, interest disrupts the financial system such as liabilities of banks are predetermined whereas their assets involve risks particularly the risk of default.

Certainly, *Sharia'h* is not just limited to prohibition of interest; rather, it also emphasizes on risk sharing to ensure fairness in financial system (Chapra, 1992). In fact, risks involved in Islamic financial contracts and transactions are shared at pre-determined ratio between lender and borrower (Sekreter, 2011). Two Islamic financial contracts such as *Musharakah* and *Mudarabah* offer risk sharing. The description of each contract is given in %Box 1. Warde (2000) quotes Ahmad al Najar[4] who proposes that true implementation of risk sharing can solve the major macroeconomic problems for instance, unemployment, inflation and poverty. Iqbal and Molyneux (2005) state that risk sharing ensures financial stability, allocative efficiency and economic growth.

Box 1: Risk sharing Islamic financial contracts (Usmani, 2012)

Musharakah: It represents a partnership business where two or more partners make an agreement to start a lawful business. All partners equally participate in business for agreed period. Each partner invests, shares profits and losses on pre-determined ratio. For mix capital in joint pool, each partner can benefit from appreciation in value of assets even with no profit.

Mudarabah: A partnership contract in which one or more partners are capital providers and others are capital users. Capital providers have no right to manage business. The loss is born by capital provider unless misconduct by capital user is found. Profit is shared with capital user only at profitable sale.

Moreover, *Sharia'h* focuses on legal business and prohibits all morally and socially harmful businesses like gambling, tobacco, alcohol, drugs, weapons and porn industry (Iqbal, 1997). Similarly, to reduce the risk of moral hazard and information asymmetry, *Sharia'h* emphasizes on fulfillment of contractual obligation and disclosure of accurate information.

Likewise, *Sharia'h* introduces assets-backed financing which ensures that transactions and contracts are linked with tangible, original and identifiable assets. Thus, Islamic finance creates real assets and inventories leading to creation of economic activities that ultimately contributes to economic prosperity (Usmani 2012). Besides, Hassan and Lewis (2007) highlight that Islamic financial institutions are expected to achieve socio-economic goals such as full employment, high economic growth and fair distribution of income. Similarly, Farook (2007) points out that *Sharia'h* motivates for corporate social responsibility. It signifies that Islamic banks are compelled to ensure easy access to *qard-ul hassan* (interest free loan) and redistribution of wealth.

2.1 Empirical evidence on practice of Islamic banks

In this second part, we discuss the literature which focuses on practice of Islamic banks. The above theoretical literature suggests that Islamic banks offer a viable alternative financial system that ensures fairness in financial system which in turn is a key to social welfare. Nevertheless, some studies criticize the practice of Islamic banking. For instance, Lewis (2007) argues that Islamic financial instruments are just modification of conventional financing. Chong and Liu (2009) expose that operations at Islamic banks is almost identical to conventional banks. Islamic deposits are interest based and all Islamic financial contracts are not based on risk sharing. Similarly, Khan (2011) reveals that features of *Murabahah* (Islamic financial contract) are deviating from the Islamic law.

Now question arises whether criticism on the true implementation of Islamic finance is a reality or a myth. Surprisingly, little attention has been paid to such as important research question. We find just few studies which provide empirical evidence on *Sharia'h*-based operations at Islamic banks. For example, Ahmed (2006) conducts survey to analyze whether Islamic banks are offering *Sharia'h*-based micro finance in Bangladesh and finds that Islamic banks in Bangladesh have truly implemented *Sharia'h*-based micro finance, and it has helped 294,908 poor to get rid of poverty. Similarly, Arabmazar (2007) highlights that Islamic banks in Iran have been offering *Sharia'h*-based services like *qard-ul-hassan* fund and *qard-ul-hassan* saving account in Iran. It is noted that these country-specific studies have focused on Islamic financing and have ignored practice of Islamic banks in other areas such as risk sharing, legal contract and interest-free services and transactions.

In addition, Fahmy and Yusof (2008) investigate whether Islamic banks are working per *Sharia'h* in Malaysia. They conclude that Islamic banks are *Sharia'h* compliant and offer interest-free services. In contrast, Khan (2010) empirically scrutinizes the true picture of

global Islamic banks and find that Islamic banks are violating *Sharia'h*. The scrutiny reveals that results of both studies contradict. The possible reason of this contradiction could be that former presents country-specific results, while the latter generalizes results at global level.

It is concluded from the above literature review that practice of *Sharia'h* at Islamic banks is not necessarily consistent with the true spirit of *Sharia'h*. This issue has not been well explored empirically. Moreover, available empirical studies do not show consensus on whether Islamic banks follow *Sharia'h* in practice. Do Islamic banks follow true spirit of *Sharia'h* in practice? To our knowledge, an empirical answer to this important question is missing in the case of Pakistan. This analysis is worthwhile, as it provides empirical evidence from Pakistan where Islamic banking is gradually emerging all over the country. This study contributes into the empirical literature on Islamic banking in many other ways. First, it uses primary data to evaluate the practice of *Sharia'h* at Islamic banks. Second, it uses data collected not only from employees and managers but also from customers of Islamic banks. Third, it investigates various aspects of *Sharia'h*-based banking. Finally, it evaluates the contribution of Islamic banking to social welfare.

3. Data

The relevant data set is not available; thus, we have conducted survey to collect the data using questionnaire. The questionnaire is divided into three sections. First section comprises demographic variables. Second section provides information about *Sharia'h*-based operations at Islamic banks. Third section asks questions about Islamic banking contribution toward social welfare in terms of poverty reduction, less unemployment and so forth. While designing questionnaire, statement format is followed to capture the opinion of managers, employees and customers of Islamic banks. Respondents are asked to rank each statement from 1 for strongly disagree to 5 for strongly agree.

Our target population is staff at the Islamic banks that is employees and managers. As these people are highly involved in day-to-day operations at Islamic banks, they can explain better whether Islamic banks are working per *Sharia'h*. However, we also collect some data from customers to analyze their views. Sample comprises 63 branches of five full-fledge Islamic banks (FFIB) and five Islamic branches of conventional banks (IBCB) in Islamabad which is capital city of Pakistan. We select this city for two reasons. First, with the giving time frame, it is convenient for us. Second, it is observed most small cities do not have all types of FFIB, while Islamabad has large number of both types of Islamic banks included in our sample. The names of bank branches are given in Appendix 1. We have conducted pilot survey using 30 observations to ensure the validity of statements. Following the results of pilot survey, we have revised and altered the questionnaire format into a more suitable one.

4. Methodology

The objective of the study is to investigate the criticism that whether Islamic banks are violating *Sharia'h*. We evaluate practice of Islamic banks by considering two dimensions such as *Sharia'h*-based operations and contribution to social welfare. First dimension examines whether Islamic banks are truly operating per the *Sharia'h*. Second dimension investigates whether Islamic banks are contributing to social welfare. The study also conducts exploratory factor analysis to finalize these dimensions.

Unfortunately, we do not find any relevant baseline empirical model to find the answer of research question. Nevertheless, we formulate theoretical framework (Figure 1) to perform regression where dependent variable is "Islamic bank (IB) follow *Sharia'h*", while independent variables are divided into two components; *Sharia'h*-based operations

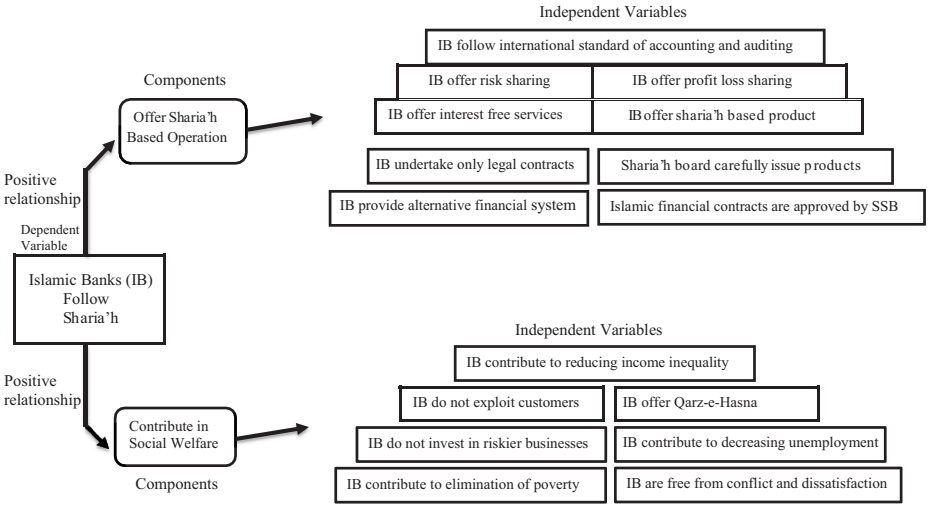

Figure 1.
Theoretical framework of Islamic banking

and contribution to social welfare. Figure 1 shows that first component "IB offer *Sharia'h* based operation" includes nine independent variables, whereas second component "IB contribute to social welfare" considers seven independent variables. The detailed description and measurement of all variables is given in Table AI. The expected relationship between dependent and independent variables is positive. Our dependent variable is categorical (Likert scale) and the value of each category has a significant chronological order and each value is certainly higher than the previous one. Therefore, we use ordinal logistic regression which is most appropriate to handle categorical dependent variable.

5. Results and discussion

The empirical evidence is based on 318 responses gathered from managers, employees and customers of Islamic banks. Descriptive statistics given in Table I shows that the age profile of majority of respondents lies between 25 and 35 years and under 25 years. This indicates that many respondents are amateur or on probation. However, it is observed that a large group of respondents is well qualified having graduate and post-graduate degrees. Furthermore, most of the responses (216) have been collected from FFIB. This is because staff of FFIB are more in number than the staff at the IBCB in Islamabad. Many respondents like 77 per cent of the total respondents are employees. Least number of respondents are managers as most of the managers refused to fill the questionnaire due to heavy work load. Similarly, small numbers of customers (only 16 per cent of total respondents) provide responses. The data are collected even from illiterate customers, and the questionnaire is filled by the surveyor in these cases. Descriptive statistics of all variables is given in Table AII.

5.1 Results of factor analysis

This study uses factor analysis to eliminate irrelevant question from survey. Primarily, the outcome value 0.91 of Kaiser–Meyer–Olkin indicates that our sample size is good enough for

Variables	Sample distribution	Frequency	(%)
Age of respondent	Under 25	96	30.2
	25 to 35	172	54.1
	35 to 45	37	11.6
	Over 45	13	4.1
	Total	318	100.0
Education of respondent	Intermediate	06	1.9
	Under graduate	10	3.1
	Graduate	137	43.1
	Post graduate	151	47.5
	Other	14	4.4
	Total	318	100.0
Linkedwith Islamic bank (IB)	Employee of IB	244	76.7
	Manager of IB	24	7.5
	Customers of IB	50	15.7
	Total	318	100.0
Respondent from each Bank	Full-Fledge IB	216	67.9
	Islamic Branch of IB	102	32.1
	Total	318	100.0

Table I.
Descriptive statistics of demographic variables

factor analysis. We also perform Bartlett's Test of Sphericity and find the value of Bartlett's Test which is highly significant at 1 per cent level of significance suggesting high scope for factor analysis. At initial stage of factor analysis, we get values for communalities and the results show that we do not have any value lower than 3. It indicates that all variables are well presented in factor analysis. Then, we estimate Eigenvalue and find the first factor with highest value that explains the most variance. The second factor explains much of the remaining variance. Similarly, each other factor explains small ratio of left over variance.

Estimation of total variance explained suggests to consider three components which have Eigenvalue greater than 1. It is observed that the Eigenvalue for Component 4 drops down to 0.85. For a double check, we use parallel analysis, and it also verifies that we should retain three components. The results of scree plot (Figure A1) are also consistent with parallel analysis. In short, total variance explained, parallel analysis and scree plot suggest to retain first three components. It is worth mentioning that factor analysis treats dimensions as components. Thus, focusing on dimensions we consider "*Sharia'h* based operations at Islamic banks" as first component, "Islamic banking contribution to social welfare" as second component and finally, "overall Islamic banks strictly follow *Sharia'h*" as third component.

To determine whether these three components are orthogonal or oblique, we estimate component correlation matrix. The results show that correlation for first two new components is moderate; however, it is not strong because no value is greater than 0.5. In addition, the value for third component is close to zero indicating its weakness. As the correlation value is not greater than 0.5, we assume these components are orthogonally related.

Finally, we re-estimate by switching the rotation to varimax that is orthogonal choice. The outcome of rotated component matrix tells us that Factor 1 includes nine questions (Table AIII). These questions are strongly related and measuring the same thing. Similarly, Factor 2 includes seven questions. However, Factor 3 includes only one question. We have already determined weakness of third factor in analysis of component correlation matrix. Thus, third factor is required to be removed. However, before removing third factor, we

check the reliability of each factor using Cronbach's alpha reliability test. Outcome shows that reliability values are 0.90 and 0.82 for first two factors, respectively. However, only single question is found for the third factor, and reliability test does not work for single question. Therefore, we do not consider the third factor and remove single question from the survey and run the regression using rest of the items. The details of the factor analysis are available upon request.

5.2 Regression analysis

The results of regression analysis help us to understand that how dependent variable is effected by various independent variables included in two components: *Sharia'h*-based operations and contribution to social welfare. These two components are measured using separate regressions.

The results of first component reported in Table II show that variables such as offer of *Sharia'h*-based products, interest-free services, provision of alternative financial system and standard of auditing and accounting have a strong positive relationship with *Sharia'h*-based operations at Islamic banks. For example, one-unit increase in the offer of *Sharia'h*-based products increases likelihood by 1.18 units that Islamic banks follow *Sharia'h* in their operations, while all other variables in the model are held constant. These results are consistent with the theory of Siddiqi (1983), Chapra (1985) and Iqbal (1997). In addition, legal contract and risk sharing also increase the likelihood of *Sharia'h*-based operations at Islamic banks. However, the level of significance indicates that this relationship is weak.

In contrast, profit loss sharing investment contracts and role of *Sharia'h* supervisory board are negatively related with *Sharia'h* based operations at Islamic banks. Nevertheless, this relationship is not much reliable because both variables are insignificant. Moreover, it is observed these results are inconsistent with previous studies such as Greuning and Iqbal (2008) and Usmani (2012). The reasons of inconsistency are twofold. First, only few financial contracts involve profit loss sharing. It limits the *Sharia'h*-based operations at Islamic banks. Second, *Sharia'h* supervisory board cannot play its true role until Islamic banks have separate central bank. We also consider model fitted information and find that the overall fit of model is good, as it is evident from the probability of chi-square which is less than 1 per cent.

Table II.
Estimated results for first component (*Sharia'h*-based operations)

Variables	Estimate	Standard error	Wald	Significance
Threshold				
[IB follow *Sharia'h* = 1.00]	4.615	0.840	30.22	0.000
[IB follow *Sharia'h* = 2.00]	7.702	0.878	76.96	0.000
[IB follow *Sharia'h* = 3.00]	9.378	0.937	100.1	0.000
[IB follow *Sharia'h* = 4.00]	13.308	1.097	147.1	0.000
Location				
Islamic bank offer *Sharia'h*-based product	0.995	0.200	24.71	0.000
Sharia'h board carefully issue products	0.365	0.209	3.037	0.081
IB provide interest-free services	0.414	0.180	5.280	0.002
IB offer legal contract	0.211	0.168	1.567	0.211
IB offer profit loss sharing account	−0.258	0.182	2.009	0.156
IB follow international standard of auditing and accounting	0.406	0.181	5.009	0.025
IB offer risk sharing	0.086	0.166	0.269	0.604
Islamic financial contracts are approved by SSB	−0.041	0.161	0.065	0.798
IB offer alternative financial system	0.638	0.151	17.96	0.000

Overall, Islamic banks in Pakistan are operating per *Sharia'h*. It attributes to the Central Bank of Pakistan (i.e. State Bank of Pakistan) that has taken various steps to ensure provision of *Sharia'h*-based banking. However, some areas, particularly provision of profit loss sharing investment contracts, still need considerations.

The results for second component are presented in Table III. It is observed that three variables, namely, provision of conflict free, exploitation free services and promotion of fairness, have strong positive association with Islamic banking contribution to social welfare. These variables are highly significant at 1 per cent level of significance.

Similarly, two other variables, that is decline in income inequality and unemployment, also increase the likelihood of Islamic banking contribution to social welfare. These variables are also significant at 1 and 5 per cent, respectively. These results are in line with Farook (2007) and (Usmani 2012). Certainly, the number of Islamic banks branches in Pakistan has crossed 1,700 in 2015 as compared to 150 branches in 2007 (Islamic Banking Bulletin, 2015). This rapid growth is creating employment opportunities and reducing income inequality to some extent. It indicates better contribution of Islamic banks to social welfare.

Contrary to previous studies by Mirakhor (1986) and Iqbal (1997), we find that two variables reduction in poverty and provision of Qard-ul-hassan negatively affect Islamic banking contribution to social welfare. It describes that neither Islamic banking are providing *qard-ul- hassan* nor reducing poverty; therefore, IB are not contributing to social welfare. However, these variables are insignificant revealing that relationship among these variables is weak. Usmani (2012) mentions two reasons behind low contribution of Islamic banks to social welfare. First, it is a long run phenomenon and cannot be achieved in the short run. Second, the share of Islamic banking in financial system is very small. The Islamic banks hold 13.1 per cent share of financial industry in Pakistan (Islamic Banking Bulletin, 2015). The objective of social welfare can be achieved in the long run only if Islamic banks capture substantial space in financial industry. The overall fit of model is good, as it is evident from the probability of chi-square which is less than 1 per cent.

In sum, the study finds that Islamic banks are contributing to social welfare in terms of job creation, wealth circulation, provision of conflict free and exploitation free products. Though contribution to reduction in poverty and provision of *qard-ul-hassan* is unsatisfactory, there is potential to solve these problems in the long run.

Variables	Estimate	Standard error	Wald	Significance
Threshold				
[IB follow *Sharia'h* = 1.00]	0.809	0.681	1.410	0.235
[IB follow *Sharia'h* = 2.00]	3.022	0.605	24.96	0.000
[IB follow *Sharia'h* = 3.00]	4.134	0.620	44.51	0.000
[IB follow *Sharia'h* = 4.00]	7.078	0.702	101.5	0.000
Location				
IB contribute to elimination of poverty	−0.182	0.144	1.592	0.207
IB contribute to reduction in income inequality	0.303	0.133	5.211	0.022
IB contribute to decrease the rate of unemployment	0.252	0.132	3.631	0.057
IB provide *qard-ul-hassan*	−0.024	0.110	0.049	0.825
IB provide conflict free services and contracts	0.411	0.157	6.908	0.009
IB do not exploit customers	0.389	0.146	7.123	0.008
IB promote fairness in the society	0.377	0.139	7.367	0.007

Table III. Estimated results for second component (contribution to social welfare)

The study also investigates whether customers' responses are same as responses from employees and managers. Astonishingly, it is found that fewer customers are agree with *Sharia'h*-based operations at Islamic banks and their contribution to social welfare. It is observed that the percentage of neutral responses of customers is more than double as compared to their counterparts (Table IV). Moreover, it is noticed that percentage of strongly disagreed customers is nine times higher than employees and managers. In sum, data collected from customers help us to understand that unlike employees and managers, customers are less agreed and more neutral about *Sharia'h*-based operations at Islamic banks and their contribution to social welfare. It is because customers lack awareness about Islamic banking. Further reason could be that customers are not much satisfied. It also indicates that Islamic banks are not fulfilling their true spirits of *Sharia'h*.

6. Conclusion

Sharia'h-based operations at Islamic banks is an attention-grabbing area for researchers. It is observed that theoretical literature about Islamic banks is extensively available. However, there is an apparent lack of empirical work. This study aims to fill this gap in the literature by empirically evaluating how Islamic is Islamic banking and finds that overall Islamic banks are operating per *Sharia'h*. Besides, the study finds that Islamic banks are contributing to social welfare by decreasing unemployment and income inequality. It is due to fast growth of emerging financial industry. It represents that it is creating employment opportunities which in turn increasing the level of income, thereby, reducing income disparities.

In contrast, it is determined that Islamic banks are violating *Sharia'h* regarding provision of profit loss sharing investment contracts and *qard-ul-hassan*. It is justified that being an infant industry, profit loss sharing instruments are limited, and Islamic banks in Pakistan are not offering *qard-ul-hassan* so far. However, this matter is under consideration (Islamic Banking Bulletin, 2015). In addition, it is found that the role of *Sharia'h* supervisory board is not up to the mark, and Islamic banks are not contributing toward poverty reduction. It is because Islamic banking industry lack human capital. Indeed, the role of *Sharia'h* supervisory board cannot be improved without ensuring the availability of adequate human capital. It is also argued that the objective of social welfare can be achieved only in the long run with the condition of large share of Islamic banks in financial industry.

Finally, findings highlight that many customers lack awareness about Islamic banking and some are not satisfied with the performance of Islamic banking. In sum, Islamic banking is Islamic in Pakistan with some exceptions. However, it has potential to overcome all deficiencies in the long run with better management and prudent financial policies.

This study is perception based and relies on data limited to a single city. These are the limitations of this study. For further research, data set can be enhanced considering other cities or similar analysis can be conducted in other regions of Pakistan. Moreover, survey

Table IV.
Response frequency

Response scale	Employees (%)	Customers (%)	Managers (%)
Strongly disagree	1	09	01
Disagree	8	13	06
Neutral	13	28	03
Agree	46	36	56
Strongly agree	32	14	34
Total	100	100	100

needs to be designed in different way to capture actual evidence of *Sharia'h* practice rather than perceptions. Our findings suggest that Islamic banks must ensure the provision of *qard-ul-hassan* and introduce wide range of *Sharia'h*-based financial contract that involve profit loss sharing. Regulators should consider promotional techniques such as advertisement, seminar, workshop and conferences to create awareness and coordinate with educational institutions to resolve the problem of human capital. Finally, it is recommended that the share of Islamic banks in financial industry should be enhanced to reap all fruits of social welfare.

Notes

1. For details, see Zarqa (1997).
2. Islamic Banking Bulletin (2015) published by the State Bank of Pakistan.
3. The sayings and actions of Allah's beloved and last prophet Hazrat Muhammad (Peace Be Upon Him).
4. He introduced first Islamic saving bank in Egypt in 1963.
5. *Sharia'h* Supervisory Board.

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Appendix. Name of sample banks

Full-fledge Islamic banks.

Burj Bank
Bank Islami
Meezan Bank Limited
Dubai Islamic Bank
Bank Al Baraka

Islamic branches of conventional banks.

Habib Bank Limited
Askari Bank

Variable notations	Description	Measurement scale
FSH	IB follow *Sharia'h*	1 = strongly disagree
NR	IB do not invest in riskier businesses	2 = disagree
LC	IB undertake only legal (halal) contract	3 = neutral
SSB	Islamic financial contracts are approved by SSB[5]	4 = agree
SAA	IB follow international standard of accounting and auditing	5 = strongly agree
SHP	Products offered by IB are truly *Sharia'h* based	
SHB	*Sharia'h* board carefully issue products	
PL	IB offer profit loss sharing investment contracts	
IF	IB offer interest-free services	
RS	IB offer risk sharing in investment	
NCD	IB are free from conflict and dissatisfaction	
NEX	IB do not exploit customers	
QH	IB offer Qarz-e-Hasna	
YIN	IB contributes toward reducing income inequality	
POV	IB contributes toward elimination of poverty	
UEM	IB contributes toward decreasing unemployment	
PF	IB are promoting fairness in the society	
AFS	IB provide alternative financial system	

Table AI.
Description of survey items

Fysal Bank
Bank of Khyber
Bank Alfalah

Table AII.
Descriptive statistics

Variables name	Strongly disagree Frequency	(%)	Disagree Frequency	(%)	Neutral Frequency	(%)	Agree Frequency	(%)	Strongly agree Frequency	(%)
FSH	05	1.6	27	8.50	37	11.6	172	54.1	77	24.2
Independent variables included in first component										
SAA	04	1.3	11	3.50	59	18.6	155	48.7	89	28.0
LC	06	1.9	11	3.50	22	6.90	95	29.9	184	57.9
AFS	09	2.8	22	6.90	42	13.2	155	48.7	90	28.3
SSB	06	1.9	09	2.80	65	20.4	138	43.4	99	31.1
SHP	07	2.2	24	7.50	19	06.0	163	51.3	105	33
SHB	06	1.9	12	3.80	41	12.9	140	44.0	119	37.4
PL	03	0.9	23	7.20	33	10.4	151	47.5	108	34.0
IF	06	1.9	24	7.50	35	11.0	140	44.0	113	35.5
RS	06	1.9	23	7.20	46	14.5	156	49.1	87	27.4
Independent variables included in second component										
NCD	06	1.9	34	10.7	73	23.0	152	47.8	53	16.7
NR	13	4.1	60	18.9	78	24.5	112	35.2	55	17.3
QH	24	7.5	81	25.5	68	21.4	102	32.1	43	13.5
YIN	15	4.7	40	12.6	87	27.4	125	39.3	51	16.0
POV	14	4.4	70	22.0	87	27.4	103	32.4	44	13.8
UEM	17	5.3	49	15.4	72	22.6	129	40.6	51	16.0
PF	11	3.5	19	06.0	43	13.5	176	55.3	69	21.7
NEX	07	2.2	34	10.7	58	18.2	153	48.1	66	20.8

Variable	Component 1	Variable	Component 2	Variable	Component 3
SHP	0.821	POV	0.828	NR	0.832
SHB	0.798	YIN	0.717		
IF	0.748	UEM	0.703		
LC	0.731	QH	0.657		
FSH	0.726	NCD	0.569		
PL	0.665	NEX	0.558		
SAA	0.662	PF	0.511		
RS	0.644				
SSB	0.639				
AFS	0.584				

Table AIII.
Results of rotated component matrix

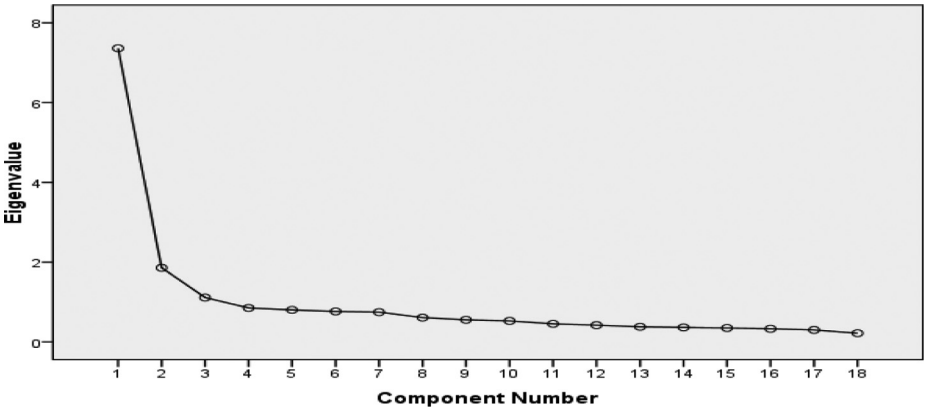

Figure A1.
Scree plot