



Analysis of Growth of Ijara Investment in Pakistan (A case study on Meezan Bank)

Nousheen Abbas Naqvi

Associate Registrar
Khadim Ali Shah Bukhari Institute of Technology

Anila Perveen

Lecturer
Khadim Ali Shah Bukhari Institute of Technology

The material presented by the authors does not necessarily represent the viewpoint of editor(s) and the management of the Khadim Ali Shah Bukhari Institute of Technology (KASBIT) as well as authors' institute.

© KBJ is published by the Khadim Ali Shah Bukhari Institute of Technology (KASBIT)
84-B, S.M.C.H.S, Off.Sharah-e-Faisal, Karachi-74400, Pakistan.

Abstract

Pakistan is among those countries that played an imperative role for promoting Islamic Banking and Finance. Islamic Banking industry has dramatically grown and its annual growth rate is more than 30 % during the past few years.(SPB-IBB-June 2014) and it has nationally achieved around 10% of the total market share of overall banking industry (SBP: Strategic Plan Islamic Banking Industry of Pakistan 2014 – 2018).Ijara financing is one of the most popular modes of Islamic finance and its total share is 8.5% of overall financing during the recent year up to June 2014 (SPB-IBB-June 2014).Currently there 5 full fledged Islamic Banks, 461 Islamic Banking branches of Conventional Banks are working as of June 30-2014 in Pakistan (Banking Policy & Regulations Department, SBP). Researcher has selected the leading Islamic Bank, Meezan bank as a case study, the aim of this study is to analyze the Ijara financing and its growth. Deposits and other accounts and Share Capital are used as an independent variables and Net Ijara Investment is taken as dependent variable. Data is collected from financial statements of bank (secondary source) for the period of 7 years from 2007 to 2013. Results of the study show that all the estimated coefficients are significant.

Keywords: Net Ijara Investment, Share Capital, Deposits and other accounts.

JEL Classification: **G11, G24, G31**

Introduction

Ijarain an Arabic word lexically means to give something or to provide some services on rent, but in this paper we particularly discussed Ijara for physical assets. **Ijara** contract is an agreement wherein a lessor (mu'ajjir) rent out the usufruits of his/her corporal asset to a lessee (musta'jur) who pays the predetermined rentals (ujrah) for the agreed period of time.

Ijara is the alternative mode of finance of conventional leasing contract; it's some characteristics are similar but, it is not identical with conventional leasing. It is one of the most popular modes of Islamic finance .In this financing methods customers are provided by bank with short to medium-term financing to lease such items which may include: real estates, buildings, equipment, machineries, computers, motor vehicles, and other acceptable (not be haraam or forbidden assets).Some feature of Ijara are given below:

Some Basic features of Ijara

- 1) Lesser transfers the usufruct of the assets not the ownership.
- 2) Period of lease must be predetermined.
- 3) Rentals should be specific and must be fixed for the particular period, after this period it can be change with the mutual consent of lessee and lessor.
- 4) Ijara cannot be made for the consumable items such as, fuel, vegetables, oil etc.
- 5) Rentals cannot be charged before the delivery of assets, if it is charged then will be adjusted with last rentals.
- 6) Any one party unilaterally promises to buy/sale the leased asset after the expiry of leased term against some specific consideration.
- 7) Lessor would be responsible for all ownership related expenses and lessee would bear the running cost.
- 8) In banking practices risk is transferred to insurance company ,and in Ijara financing by Islamic Bank ,it is transferred to Islamic insurance TAKAFUL.

- 9) In case of delayed payment of rentals of Ijara, penalty clause is added in contract, it is not included in the income of bank, and it goes to charity accounts as per the specified account, mentioned in State Bank of Pakistan's SBP guidelines for Ijara.
- 10) If the leased asset is stolen or completely destroyed, the conventional leasing company continues charging the lease rent till the settlement of the Insurance claim. Under the Islamic system, rent is consideration for usage of the leased asset, and if the asset has been stolen or destroyed, the concept of rental becomes void, no rentals would be charged by lessor.

Growth of Ijara in Pakistan

The re-launch of Islamic banking in Pakistan in 2001 has confirmed to be a big Islamic banking industry. It is rising at an attractive rapid speed and has acquired about 10 percent market share of the country's banking system.

Ijara is one of the most popular modes of Islamic finance, after major financing share of Murabaha and Diminishing Musharaka, Ijara share is 8.5% of overall financing during the recent year up to June 2014 (SPB-IBB-June 2014).

Currently there are five full fledge Islamic Banks, 461 Islamic Banking branches of Conventional Banks are working as of June 30-2014 in Pakistan (Banking Policy & Regulations Department, SBP).

Researcher has selected the leading Islamic Bank, ***Meezan Bank Ltd. as a case study***, the aim of this study is to analyze the Ijara financing and its growth. Deposits and other accounts and Share Capital are used as an independent variables and Net Ijara Investment is taken as dependent variable. Data is collected from the financial statements of Meezan Bank Ltd's website.

Literature Review

International Scenario

On International level, all over the world various researches were conducted on Ijara model the most significant mode of finance in Islamic Banking Industry, Nurdiana watiIrwani Abdullah and Asyraf Wajdi Dusuki(2006) conducted their research in Malaysia and received response from 203 AITAB customers for knowing their perception towards Ijara. Overall result findings revealed that majority of customers were satisfied with said mode of finance, they further highlighted, for the growth of ijara financing, there is a need to train adequately bank's staff for disseminate awareness regarding ijara to those customers who avoid or confuse to invest in it.

Hashim Kamali (2007) conducted his research in Kuala Lumpur, Malaysia in which he brightened the concept of Ijara financing and explained that how it can be employed to avoid interest based financing, he further highlighted this point that Ijara can be used for the growth of economic development because it is not adversely effected from inflationary pressure than conventional leasing methods.

Malaysia is among those countries who have initiated and played a vital role in promoting Islamic banking industry that is why various researches were conducted by the people of Malaysia in this field. Seif I. Tag El-Din and N. Irwani Abdullah(2007) also conducted research in Malaysia, he highlighted the issues of implementing AITAB or Ijara Muntahiya Bittamleek, he analyzed the comparative study with non Islamic practices and discussed that there is a need to prove proper legitimate frame work to implement AITAB and government has to play a vital role in it.

Saba, Irum and AlSayyed, Nidal (2010-Malaysia) highlighted that there is a need of separate price mechanism for the growth of Islamic Banking product because people want to invest in Islamic products and they are very conscious about pricing methodology.

Wan Muhammad. Muhammad Ridhwan Syadiyah Abdul Shukor(2013) conducted research on two most popular banks of Malaysia. According to his findings Ijara is totally different from conventional lease in terms of process, nature and characteristics, but generally it is offered with the same amenities as offered by conventional lease. It is vide scope for Islamic banks to provide better services in order to get high advantage against their competitors

Nurul, Mahfuzur, Mohamed (2014) in Malaysia conducted their research on Issues and Prospects of Islamic Hire Purchase Financing, researchers highlighted the current issues and explained the various ways to provide the better and structured lawful Islamic banking product in the most competitive environment

Aisyah Abdul Rahman (2014) conducted a research study on Evaluation on *Al-Ijarah Thumma Al-Bay'* (AITAB) Facility as a case study of one Islamic bank in Malaysia, researcher highlighted the real difference between theory of AITAB which is based in Islamic sharia principles and the actual operations of it, furthermore she also identified the similarities between Islamic and conventional leasing. Researcher recommended that government should make supportive laws and people should be aware about the AITAB services.

National Level

In 2008 Saira Sabir conducted research on prospects of Ijarah in banking sector of Pakistan since 2005 to 2008; the financial data collected from four banks (Askari commercial bank, Bank alfallah, Standard Chartered and Muslim Commercial bank) in Islamabad covering both in conventional as well as in Islamic banking. She found that Ijara financing progressively rising due the interest free mode of finance in comparison with conventional lease.

Mehwish Shams conducted research and discussed the comparison between Ijara and conventional lease (2011), she discussed the concept of Ijara and conventional lease and their practical issues. Researcher conducted qualitative research with the Sharia concept and applicability of Ijara, she further highlighted that Islamic financial market can be captured through different sharia compliant products.

Fahad Zafar (2012) conducted research as a case study of an Islamic bank discussed practical issues and problems of Ijara and highlighted the loopholes in the contract and suggested the management of bank to take action for it and restructure said contract so that customer could not get undue advantage from Ijara .

Rizwanullah, InayatUllah, Dr. Madiha Khan, Dr. Arshad Ali, Fayaz Ali Shah,(2012) conducted critical research on Ijara as a case study n Meezan Bank Ltd.The highlighted that Ijara contract should be based on Islamic sharia rules as specified by Islam

Objective of Research and Model Frame work

The main objective of this study is to analysis of Ijara financing and it overall growth in Pakistan, but researcher has conducted her study on Ijara Investment as a case study of Meezan Bank. After the deep study of previous researches researcher has taken Two variables Share Capital and Deposits is to find out the relation between Net Ijara financing and said variables therefore following model is formed:

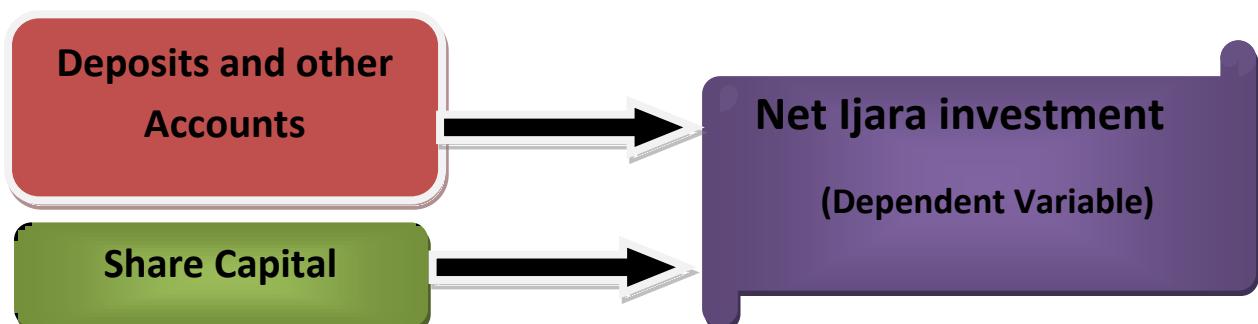


Figure 01: Research Model

Research Methodology

Researcher has used secondary data for research, which is collected from the financial statements of the Meezan Bank and total time period was covered 7 years (2007 to 2013).

Research Design:

The Descriptive Research Design is used for the study.

Sample Design:

Out of five full fledge Islamic Banks in Pakistan, Meezan is selected by the researcher as a sample case study. Sampling type was Random sampling. This study only includes the Islamic Banking sector of Pakistan; Islamic Leasing companies are excluded.

Data Analysis Methodology

Data is analyzed with different tools and methods, these methods include Regression, Correlation and ANOVA analysis.

Statements of Hypothesis

H₁₀: Deposits & Other accounts have no high impact on net investment in Ijara

H_{1A}: Deposits & Other accounts have high impact on net investment in Ijara

H₂₀: There is no relationship between Share capital and net investment in Ijara

H_{2A}: There is relationship between Share capital and net investment in Ijara

Statistical Model

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + U_i$$

Where, Y= Net investment in Ijara;

X₁= Deposits & Other accounts; X₂= Share capital

Data Analysis and Results

For the analysis of data, Regression, Correlation and ANOVA tests are applied by researcher. Regression analysis is a statistical technique used to illustrate the nature of the relationship among variables, that is, positive or negative, linear or nonlinear and Correlation

method used to find out whether a relationship between variables exists or not. The Analysis of Variance (ANOVA) test is applied to test out the model's adequacy and how model fits.

Regression Analysis

Table 01: Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|-------|-------------------|----------|-------------------|----------------------------|
| 1 | .994 ^a | .988 | .983 | .11917 |

a. Predictors: (Constant), S.capital, Deposits and other accounts

In the above mentioned table of regression analysis the value of "R" is 0.994 which shows that there is high correlation between Net investments in Ijara(dependent variable) and independent variables Share capital and Deposits and other accounts.

R square measures that how well the least square equation is, Higher the R square, the more useful the Model. R square takes on values between 0 to 1. In the above table the Value of "R square" is 0.988, it means more usefulness of Model.

Analysis of Variance (ANOVA)

Table 02: ANOVA^b

| Model | Sum of Squares | df | Mean Square | F | Sig. |
|-------|----------------|-------|-------------|-------|---------|
| 1 | Regression | 4.869 | 2 | 2.435 | 171.432 |
| | Residual | .057 | 4 | .014 | |
| | Total | 4.926 | 6 | | |

a. Predictors: (Constant), S.capital, Deposits and other accounts

b. Dependent Variable: Net investment in Ijarah

In ANOVA table if significance value is more than 5%, it means that the model is not acceptable and vice versa. As we can see in the above table the value of significance is 0.000 it means model is acceptable.

Coefficients

Table 03: Coefficients^a

| Model | Un-standardized Coefficients | | Standardized Coefficients | t | Sig. |
|-----------------------------|------------------------------|------------|---------------------------|--------|------|
| | B | Std. Error | Beta | | |
| 1 (Constant) | 24.210 | 3.967 | | 6.103 | .004 |
| Deposits and other accounts | -3.183 | .379 | -2.147 | -8.401 | .001 |
| S.capital | 3.198 | .674 | 1.213 | 4.746 | .009 |

a. Dependent Variable: Net investment in Ijarah

This table shows the significance level of each independent variable. As per the above table the significance level of Deposits & other accounts is 0.001 which is less than 0.05 which shows that it has significant impact on Net investment in Ijara so, the null Hypothesis (H_{1A}) is rejected in other words alternate Hypothesis (H_{1A}) is accepted. Constant of Deposits and other accounts shows negative sign, the reason is the great financial crisis occurred since 2008 our deposits increased but net financing in Ijara dramatically decreased every year as we can see in the following graph, and even most of the *conventional banks* stop *leasing* due to sever financial crisis.

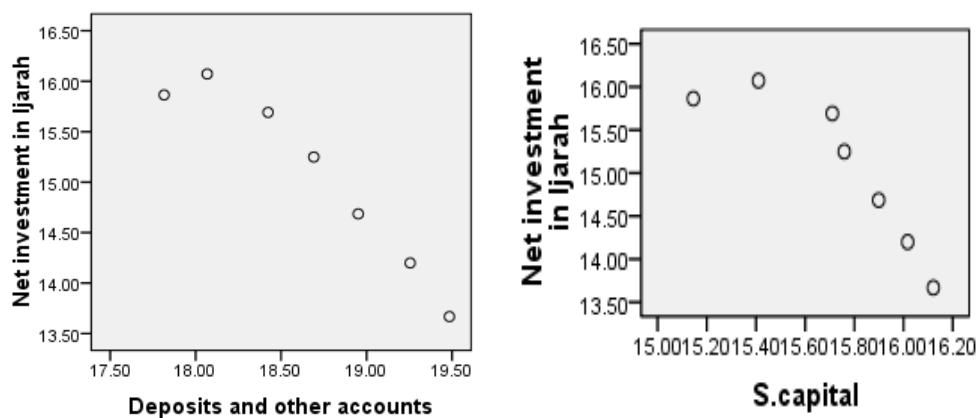


Figure 02: Graphical Representation

Same as the significance level of S.capital is 0.009 which is less than 0.05 which shows that there is a relationship between S.capital and Net investment in Ijara so, the null

Hypothesis(H_{20}) is rejected in other words alternate Hypothesis (H_{2A})is accepted.Now we can put coefficients in our model:

$$\text{Net Ijara Investment} = 24.210 + (-3.183)(\text{Deposits \& Other accounts}) + (3.198)(\text{Share Capital})$$

Correlations

Table 04: Correlations^a

| | | Net investment in Ijarah | Deposits & other accounts | S.capital |
|-----------------------------|---------------------|--------------------------|---------------------------|-----------|
| Net investment in Ijara | Pearson Correlation | 1 | -.961 ** | -.886 ** |
| | Sig. (2-tailed) | | .001 | .008 |
| | N | 7 | 7 | 7 |
| Deposits and other accounts | Pearson Correlation | -.961 ** | 1 | .978 ** |
| | Sig. (2-tailed) | .001 | | .000 |
| | N | 7 | 7 | 7 |
| S.capital | Pearson Correlation | -.886 ** | .978 ** | 1 |
| | Sig. (2-tailed) | .008 | .000 | |
| | N | 7 | 7 | 7 |

**, Correlation is significant at the 0.01 level (2-tailed).

The correlation coefficient for each pair of variables appears at the intersection of one variable's row and the other variable's column. As per the above correlation matrix, the correlation coefficients have *negative* values indicate that one variable increases then other decreases.

As I have already mentioned the reason is that the great financial crisis occurred since 2008 our deposits and Share Capital increased (see in the graph on previous) but net financing in Ijara dramatically decreased every year and even most of the conventional banks stop leasing due to sever financial crisis. As per the above matrix the significance value is less than 5%, it means model is acceptable.

Conclusion

Ijara is one of the popular modes of Islamic finance. Researcher has worked on Meezan Bank as a case study and analytical check the relationship of Net investment in Ijara

with the Share Capital and Deposits & Other accounts. As it is mentioned in the statistical result that there is a strong relationship among them and researcher has proved its both Alternate Hypothesis Ha1 and Ha2 are accepted. Overall significance value is 0.000 which is less than 5%, it means model is acceptable. As per the correlation statistics, correlation coefficients have negative values indicate that one variable increases then other decreases. As I have already mentioned the reason is that the great financial crisis occurred since 2008 our deposits and Share Capital increased but net financing in Ijara dramatically decreased every year and even most of the conventional banks stop leasing due to sever financial crisis. Correlation matrix shows the significance value is less than 5%, it means model is acceptable and our both following alternative hypothesis are accepted:

H_{1A}: Deposits & Other accounts have high impact on net investment in Ijara

H_{2A}: There is relationship between Share capital and net investment in Ijara

Recommendations

After the analytical study researcher would like to suggest the some recommendations to Islamic Banks. Firstly, in order for Islamic financial institutions to be competitive with conventional products and attractive to customers, Islamic financial products must meet the risk/ reward profiles of investors and issuers, while fulfilling the tenets of Sharia and remaining sufficiently cost-effective. Secondly, Islamic financial institutions must train their workforce to understand the doctrine of Islamic law that pertain to finance, and must instruct them to meet the terms of Sharia. Thirdly, State Banks should develop a separate Islamic Index for calculation of profit ratio instead of using KIBOR as a bench mark rate. Fourthly, for the awareness regarding Islamic financial products in the society, everybody has to play its role. For example conduct workshops, seminars and sessions. Fifthly, Sharia advisors should perform his role diligently. Sixthly, Sharia Audit report must highlight the mistakes of making transaction which are not as per the ruling of Sharia.

References

- Aisyah Abdul Rahman (2014)- “A vehicle financing comparative study between Ijara in May Bank Berhad and BaiBithamanAjil in Bank Islam Malaysia Berhad”-*Universiti Kebangsaan Malaysia, 43600 UKM Bangi, Selangor, Malaysia.*
- FahadZafar (2012)- “*Ijarah* contract: a practical dilemma.” Journal of Islamic accounting and Business Research, Vol. 3 Iss: 1, pp.67 - 69
- MehwishShams(2012)- “Comparison Between Ijara and Conventional Leasing”-NUST BUSINESS SCHOOL- <http://www.scribd.com/doc/50588928/Comparison-Between-Ijara-and-Conventional-Leasing>
- Mohammad HashimKamali-(2007), AShari‘ahAnalysis of Issues in Islamic Leasing. *J.KAU: Islamic Econ.*, Vol. 20 No. 1, pp: 3-22
- NurdianawatiIrwaniAbdullah and AsyrafWajdiDusuki(2006). “A Critical Appraisal of Al-IjarahThumma al-Bay’ (AITAB) operation: Issues and Prospects”. Paper presented at 4th International Islamic Banking and Finance Conference. Monash University of Malaysia. Kuala Lumpur, November 13th-14th2006
- Nurul, Mahfuzur, Mohamed (2014)- Issues and Prospects of Islamic Hire Purchase Financing: Malaysian Evidence-Journal of Management Research, ISSN 1941-899X, 2014, Vol. 6, No. 1
- Rizwanullah, InayatUllah, Dr. Madiha Khan, Dr. Arshad Ali, Fayaz Ali Shah,(2012) A critical review of Car Ijara in Pakistan”.(A Case Study of Car Ijarah Offered By Meezan Bank Limited Pakistan)- Electronic copy available at: <http://ssrn.com/abstract=2173876>
- Saba, Irum and AlSayyed, Nidal (2010-Malaysia) “Economic Pricing Mechanisms for Islamic Financial Instruments: Ijarah Model”- MPRA Paper No. 20685, posted 15. February 2010

Sabir, Saira,(2008) “ Prospects of Ijarah in Banking Sector of Pakistan “ Available at SSRN:

<http://ssrn.com/abstract=1308826>.

Seif I. Tag El-Din - N. IrwaniAbdullah(2007) -“ Issues of Implementing Islamic Hire Purchase in Dual Banking Systems: Malaysia’s Experience”. Thunderbird International Business Review • DOI: 10.1002/tie • March–April 2007

Wan Muhammad. Muhammad RidhwanSyadiyah Abdul Shukor(2013)-“ A vehicle financingcomparative study between ijara in MAY Bank Behrad and BaiBithamanAjil in Bank Islam Malaysia”.