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Abstract

An interest-free economy plays a prominent role in the country's development. Pakistan being an Islamic country should make efforts to flourish Islamic finance in order to get the benefits of this justified and equitable Islamic economic system. The basis of interest-free finance is avoiding interest (usury) which is against the teachings of the Quran and Sunnah. The present research is qualitative in nature, data is extracted from audited financial statements of the respective Islamic banks and websites. The global annual growth rate of interest-free finance is 10% and the same growth is exhibited by Islamic banks. Islamic banks are contributing to charity to achieve SDG goals under CSR. In Pakistan, the people believe Islamic banking is not un-Islamic. Islamic finance's challenges were also mentioned. The biggest challenges include a lack of qualified people, different schools of thought, no Islamic banking laws, no client awareness, and few Islamic products.

Keywords: Islamic Banking, Murahaba, Islamic Finance, Sustainable Development Goals

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An interest-free economy plays a prominent role in the country's development. Pakistan being an Islamic country should make efforts to flourish Islamic finance in order to get the benefits of this justified and equitable Islamic economic system. The basis of interest-free finance is avoiding interest (usury) which is against the teachings of the Quran and Sunnah. The present research is qualitative in nature, data is extracted from audited financial statements of the respective Islamic banks and websites. The global annual growth rate of interest-free finance is 10% and the same growth is exhibited by Islamic banks. Islamic banks are contributing to charity to achieve SDG goals under CSR. In Pakistan, the people believe Islamic banking is not un-Islamic. Islamic finance's challenges were also mentioned. The biggest challenges include a lack of qualified people, different schools of thought, no Islamic banking laws, no client awareness, and few Islamic products.

Keywords: [Islamic Banking](#), [Murahaba](#), [Islamic Finance](#), [Sustainable Development Goals](#)

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Introduction

Background of the study

Islamic financial industry is attracting people from every walk of life, be it Muslim or non-Muslim, due to its less risky nature (Uslu & PinarKarahana 2016). The mushroom growth of interest-free finance across the globe is because of its compliance with Shariah which

is based on morality, justice, and equality (Ahmad & Chowdury 2020). This system, interest-free finance, has the capacity to satisfy the needs of people irrespective of their religion and can guarantee peace, unity, and harmony (Hatta et al. 2017). Moreover, it can be proved as a leading factor in achieving the goals of Sustainable Development Goals (SDGs) in Pakistan due to its competency in addressing many of



these goals. Interest-free finance is exactly the opposite of conventional finance which is based on Riba and this is perhaps the leading and prominent reason for differentiating between Islamic and conventional finance.

Islamic finance was introduced in Pakistan several decades ago but it has not yet reaped the benefits of interest-free finance. Consumers of Islamic finance in Pakistan believe that interest-free finance is not altogether interest-free rather it is a deception to attract customers (Butt et al. [2018](#)). This mindset creates hurdles for grooming interest-free finance in Pakistan. To overcome this hurdle, an understanding of the users regarding the compliance of interest-free finance with Islamic law should be planned and imparted. Moreover, there is also a lack of the government's efforts to promote Islamic banking in Pakistan due to which it is not yet fully accepted by the customers (Zafar & Sulaiman, [2020](#)). As an Islamic country, Pakistan should take steps towards the adoption of interest-free finance to get the inherent fruit of this nascent industry. Furthermore, there is a negative relationship between economic growth and interest rates (Anaripour, [2011](#)). The study would also focus on the legal framework, administrative, legal, and financial issues in Pakistan in regard to Islamic financing and the measures taken by the federal and provincial governments to curb the illegal practice of usury.

Research Questions

1. Are interest-free finance activities experiencing growth in Pakistan?
2. Does this kind of financial system contribute to achieving the goals of Sustainable Development Goals (SDGs)?
3. Does interest-free finance Shariah-compliant Islamic in nature in Pakistan?
4. What are the major hurdles in the implementation of interest-free finance in Pakistan?

Objectives of the Study

The following research objectives will be achieved in this study:

1. To analyze the growth of Islamic finance in Pakistan?
2. To investigate the contribution of Islamic industry in achieving the goals of Sustainable Development Goals (SDGs).
3. To know whether Islamic finance is Islamic in nature and Shariah-compliant in Pakistan or not?
4. To dig out major hurdles in the implementation of interest-free finance in Pakistan.

Problem Statement

Although there are numerous studies available regarding Islamic banking concerning Pakistan, there is not any particular study on interest-free finance. An effort is being made to study interest-free finance in Pakistan to tap the underlying growth of this embryonic industry.

Literature Review

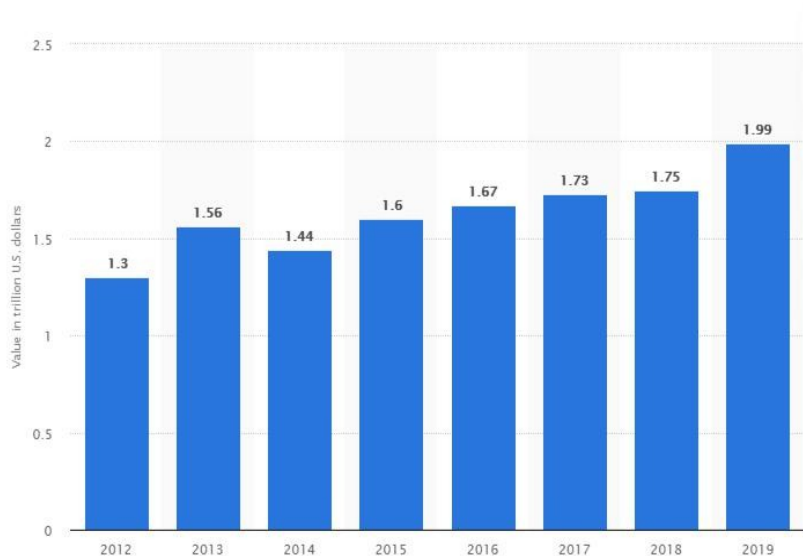
Global Practices of Interest-Free Finance

Islamic banking system offering interest-free finance was first started in Dubai in 1975 followed by non-Muslim countries. It is a popular source of finance for both Muslims and non-Muslims. Islamic financial practices have seen rapid growth since their inception. Islamic banking practices are now available in more than 75 countries having more than 300 Islamic financial institutions across the globe (Mohammad et al., [2015](#)). Considering the recognition of Islamic banking across the globe, it is now seen in the world that conventional banks have opened Islamic window operations to cater to the demands of the customers and to have a competitive advantage.

The global annual growth rate of Islamic financial assets is 10% and it is expected that by 2023 the total Islamic financial assets will reach 3.8 trillion US dollars (Ahmad & Chowdury [2020](#)).

Figure 1

Global Islamic Banking Assets from 2012 to 2019



Source: (www.statista.com, 2021)

Table 1

Islamic Financial Assets according to different publishers

Source	Year	Quoted Figure
The Banker, The 500 Islamic Financial Institutions	2009	Assets \$780 billion
The Banker, The 500 Islamic Financial Institutions	2010	Assets \$956 billion
Depositors Insurance Fund	2011	Assets \$1 trillion
University Sains Islami Malaysia.	2011	Assets \$1.3 trillion
Ernest & Young Islamic Competitiveness Report	2013	Assets \$1.8 trillion
The Global University of Islamic Finance (INCEIF)	2014	Assets \$1.7 trillion
Organization of Islamic Cooperation (COMCEC)	2014	Assets \$1.984 trillion
The Islamic Financial Board (IFSB).	2015	Assets \$1.331 trillion
Al Iqtisadia -Saudi Economic Publication	2016	Assets \$2 trillion
S&P Finance Outlook 2018	2016	Assets \$2 trillion
Arabian Business.	2018	Assets \$2.4 trillion

Source: (Publication of Institute of Islamic Banking and Insurance)

The above figure 01 and Table 01 show that assets of Islamic finance are increasing over time. Figure 01 depicts the constant growth of Islamic finance across the globe and this growth is expected in the future as we consider the interest of customers in this new field of finance. Table 01 shows the amount of Islamic financial assets across the globe according to the research conducted by various authentic publishers/researchers. It shows the growth of Islamic financial assets from 780 billion US dollars to 2.4 trillion US dollars in 2018 which is a considerable success growth of Islamic finance. The past decade

shows an enormous growth in the activities of Islamic finance.

Figure 02 shows the modes of Islamic finance across the globe. The literature on Islamic finance expresses that Musharaka, Mudaraba, Murahaba, and Ijara are the popular modes of Islamic finance. There are many other modes of Islamic finance as well which are offered by Islamic financial institutions like Bai Salam, Istisna, etc, but Murabaha is the most practiced mode of Islamic finance. According to Thomas Reuters (2018), shown in figure 02, Murabaha is 70% of total Islamic finance in the world followed by Ijara, Musharaka, and Mudarabah.

Different Modes of Islamic Finance

There are various modes of Islamic finance available in the world but as Figure 02 shows popular among them are four i.e. Murabaha, Ijarah, Musharaka, and Mudarabah. These four types of Islamic finance are being discussed.

Murabaha

This is the most common and used mode of Islamic finance across the globe. In this mode of Islamic finance, clients approach the Islamic bank for the purchase of an asset. As the clients do not have a sufficient amount to purchase the asset on their own, therefore, they seek the help of Islamic banks. Islamic financial institutions make two types of contracts with the customers. First, the Islamic bank will buy the required asset on behalf of the clients as specified by the clients. Second, clients are bound to purchase that asset from the respective bank on a cost-plus-profit basis.

Ijarah

In this mode of Islamic finance, an asset that is not consumed due to use is being rented to the customer against the agreed payment. The rent that is charged from the customer by the bank is calculated in such a way that it covers both the cost and profit of the asset. The ownership of the asset rests with the bank. If some mishap occurs to the asset like an earthquake, then the bank will bear the loss.

Musharaka

Musharaka means shirkat which indicates partnership. Under Musharaka, Islamic banks provide funds that are mixed with the funds of the business enterprises. Different kinds of projects and ventures are carried out by the partners under this type of Islamic finance. Profit is shared under the pre-agreed ratio; however, the loss is shared according to the funds provided by all stakeholders. This mode of Islamic finance is considered a real participatory type of finance and is widely used by Islamic financial institutions and welcomed by customers due to its true nature of being Islamic.

Mudaraba

In this type of Islamic finance, one party brings funds to the business operation while the second party brings its skills, efforts, and management to the business venture. The party that provides funds is called Rab-ul-mal while the other party is called Mudarib. The profit from the business operation is shared under the pre-agreed ratio while in case of loss; it is borne by the fund provider.

Activities of Interest-Free Finance in Pakistan

Pakistan is among those countries that first started the activities of interest-free finance. This new industry in Pakistan emerged almost four decades ago and became an integral part of our financial system. Being a Muslim country, this new arena of Islamic finance attracted people and full-fledged Islamic banks offering activities based on Shariah emerged. Islamic banking industry saw rapid growth due to which conventional banks also started the activities of Islamic banking by the opening of Islamic windows. At present, a total of 21 Islamic financial institutions are offering Shariah-compliant activities in Pakistan, of which five are full-fledged Islamic banks while the rest are the subsidiaries of conventional banks (SBP, 2021). Moreover, there is a network of 2589 branches of Islamic institutions in Pakistan while 1283 are Islamic windows of conventional banks offering Islamic banking services. Currently, the Islamic banking industry possesses 13.5% of the banking share in Pakistan (SBP, 2021).

The growth of Islamic banks which are under consideration in this particular study. The activities of interest-free finance of Dubai Islamic Bank in Pakistan are admirable as the figure shows considerable growth in its activities. Moreover, despite COVID-19, Bank Islami and Albaraka Bank have not shown negative growth rather they are somewhat stable or improving which is a positive sign for the Islamic banking industry in Pakistan. Conclusively, we can say that the operations of the Islamic banking industry in Pakistan are flourishing.

Table 2

The growth rate of interest-free finance in Pakistan (Growth rate of Interest-free finance (Rs. In Million)

Bank	2020	2019	2018	2017	2016	Growth(2020-19)	Growth (2019-18)	Growth(2018-17)	Growth(2017-16)
Bank Islami	137930	137018	120864	120627	78677	0.67%	11.70%	0.19%	34.77%

Bank	2020	2019	2018	2017	2016	Growth(2020-19)	Growth (2019-18)	Growth(2018-17)	Growth(2017-16)
Meezan Bank	493391	506512	522263	428833	319616	-2.65%	-3.10%	17.88%	25.40%
Albarak bank	97356	81290	79771	76446	71090	16.50%	1.86%	4.16%	7%
Dubai Islamic bank	205089	180793	155463	121480	95713	12%	14%	21.80%	21.20%

Source : (Audited Financial Statements of the banks)

Role of Interest-Free Finance in Achieving Sustainable Development Goals (SDGs)

Islamic finance plays a prominent role in achieving Sustainable development goals as it is based on equality, justice, and morality. Interest-free finance is based on Shariah which helps in reducing the social and economic evils that are based on Sustainable Development Goals. Sustainable Development Goals are broadly categorized into three categories: economic, social, and environmental protection. Islamic finance helps in achieving mainly the first two categories of the Sustainable Development Goals i.e. economic and social aspects of the goals (Sadiq and Mushtaq 2015). The majority of the Sustainable Development Goals will be achieved by following Shariah as it assists in developing a society that provides equal economic and social opportunities to people. Thus, Islamic finance is a great help in meeting Sustainable Development Goals, especially in Pakistan as it is an Islamic country and could easily implement and follow the modes of Islamic finance.

Pertinent features of interest-free finance that help in achieving Sustainable Development Goals

The private sector plays a prominent role in achieving Sustainable Development Goals as it provides goods and services side by side with the government. In Pakistan, Islamic banks offer valuable services to businesses and thus assist the government in meeting the goals of the United Nations i.e. 2030. Islamic banks in Pakistan work on Sustainable Development Goals through their Corporate Social Responsibility. It is an important aspect of any company as it impacts positively our society which in turn favorably impacts the general masses (Irfan, 2021). There are a good number of NGOs (Non-governmental organizations), INGOs (International non-governmental organizations), and other social welfare trusts working together with Islamic banks in Pakistan thus helping the government in achieving SDGs. Moreover, CSR is among the significant tenets of Islam as it

arouses ethics and taqwa which guide Muslims in every walk of life consisting of economic and financial avenues (Jahja, 2022).

Islamic banks have been contributing to philanthropic projects and schemes under the banner of Corporate Social Responsibility (CSR). Meezan Bank is the leading one in this regard by working in association with 64 NGOs, welfare trusts, foundations, and other charitable associations. Moreover, there are 40 NGOs and welfare trusts in connection with Albaraka Bank offering different services to the community. Additionally, Bank Islami, which has been providing valuable services to the people for long, has 25 NGOs on the list in the year 2020. In the preceding years, Bank Islami had a quite good number of trusts but in the year 2020, it had fewer NGOs and it might be due to the reason of COVID-19.

Compliance of Interest-Finance with SHARIAH

There is no concept of Riba in Islamic finance and activities of Islamic banking should comply with Shariah. All those operations which are in contrast to the guidelines of the Quran and Sunnah are strictly prohibited. Pakistan being an Islamic country promotes the environment of interest-free finance to reap the fruits of the judicial economic system i.e. Islamic finance. The 1973 constitution of Pakistan advocates the elimination of Riba and supports the enactment of the Quran and Sunnah. According to Article 38 (f) of Pakistan's constitution, the government should try to eliminate Riba as soon as possible. Moreover, the same constitution in Article 227(1) states that all laws, rules, and regulations in Pakistan should conform to the Quran and Sunnah. In conformity with the constitution and Shariah, The Eradication of Riba Act (2015/2019) has been passed to eradicate Riba in Pakistan (Mumtaz, 2021). Having these Articles/Acts in mind, Islamic banks in Pakistan are required to have a Shariah Supervisory Board to ensure the compliance of operations and activities of Islamic banks with the injunctions of the Quran and Sunnah.

Difference Between the Theory and Practice of Interest-Free Finance in Pakistan

Though it is very fortunate for Pakistan that *Muharaka*, a participatory form of finance, constitutes 50% of total Islamic financing, there is almost 40% of financing offered by Islamic banks in Pakistan which is not exactly fulfilling the requirements of the Shariah. Theoretically, the products of Islamic banks are according to the guidelines of the Quran and Sunnah. It is because the Shariah Board in every Islamic bank in Pakistan is responsible for compliance of the Islamic products with Shariah. However, in practice, around 40% of the Islamic financing in Pakistan is believed to be a weak source of financing by religious scholars. This percentage goes to 70-80% for the rest of the world as *Murabaha* is the popular source of Islamic finance in the world. The use of KIBOR in finding values for Islamic products and offering the non-participatory form of financing by Islamic banks in Pakistan are big questions on the compliance of Shariah. Thus, it can be said that what is there, in theory, is not in practice in Pakistan. The operations of Islamic banking in Pakistan are quite impressive in the world but it needs further improvements to get the benefits of Islamic finance.

Hurdles in interest-free finance in Pakistan

The Islamic banking sector has shown rapid growth in the world. However, with this augmented development in Pakistan, there are several issues and hurdles in the way of Islamic finance which could retard the growth of interest-free finance. Some of the basic and known hurdles of Islamic finance in Pakistan are being discussed.

Various Schools of Thought

There are several religious schools of thought in Pakistan and all of them have dissenting views regarding various issues of Islam. They deny the verdicts of one another and thus divide the public on trivial matters. There are three major sects of Islam in Pakistan and all of them are following their course of action. There is no single authority in Pakistan that constitutes a body to issue a verdict to be followed by everybody. The more pressing issue in this regard is the illiteracy of Pakistan (Saqib et al., 2016).

Regulations of Islamic Banking

Regulations of the banking sector are issued and controlled internationally through BASEL. It requires

the banking sector to follow certain rules related to capital and risk Management (Drumond, 2009). These rules and regulations are made specifically to address the issues of conventional finance. There is no such forum for Islamic banking to be followed. Islamic banks in Pakistan are also following these regulations and thus it makes no difference between conventional finance and Islamic finance. BASEL regulations incorporate the concept of interest and Islamic finance has no room for it (Tursoy, 2018).

Lack of Customers Awareness

There are several Islamic financial products offered by Islamic banks in Pakistan but customers are unaware of the utilities of those products and hence they are left with one choice of conventional products (Awan, 2014). Though Pakistan is a Muslim-majority country, the adoption level of Islamic finance is very low. There are numerous factors that contribute to the unawareness of the public like illiteracy of the masses, no interest in the banking sector and blindly following religious scholars. The majority of the orthodox religious scholars consider the operations of the banking sector as un-Islamic and the same sentiment has been transferred to the general masses. As people cannot understand the features of Islamic financial products which retards the growth and adoption of these products.

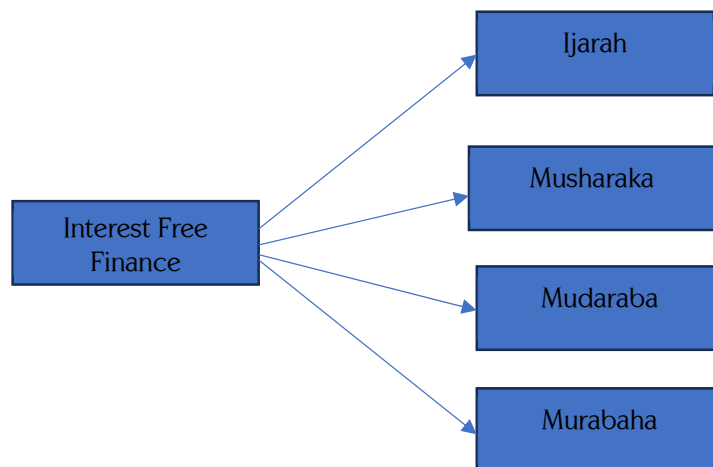
Limited Modes of Financing

Despite being shown rapid growth by Islamic finance in the world, it is still far behind conventional finance. One of the reasons for limited Islamic financial products is the late emergence of the Islamic banking industry. The operations of commercial banking were started in 1407 in Italy under the name of Banco di San Giorgio (Mohammed et al., 2019). On the other hand, Islamic banking started its operation in 1980. This shows that conventional banking has been in the market for a long due to which functions are more developed than Islamic banking.

Theoretical Framework

Concepts with their respective definitions, together with citations from the appropriate academic literature, constitute a theoretical framework. In light of the above discussion, the following theoretical framework of the study has been formulated.

Figure 2



Hypotheses

In light of the above theoretical framework, the following set of hypotheses has been developed.

1. Interest-free finance has a significant effect on Ijarah
2. Interest-free finance has a significant effect on Musharaka
3. Interest-free finance has a significant effect on Mudaraba
4. Interest-free finance has a significant effect on Murabaha

Research Methodology

The current research study has used a deductive approach in which on the basis of theory the data was gathered and analyzed. The research strategy is the course of action through which the data has been collected. In this study survey method was used to collect data. The data was secondary in nature and research articles, annual reports, and State Bank Reports were analyzed. The data analyzed were interpreted and the results of the studies were discussed. In this study historical documents, research papers, annual reports, etc. were downloaded and critically analyzed in the light of the above-mentioned research questions and research objectives.

Source of Data

The data sources of the current study were mainly comprised of relevant published documents, including government-published reports, blind peer-review articles, and government documents on the

subject matter. Moreover, various sources including audited financial statements of the respective banks, newspapers financial websites, etc. Moreover, the sample banks in this particular study were Meezan Bank, Bank Islami, Albarak Bank, and Dubai Islamic Bank. Five years of data were taken starting from 2016 to 2020. The data collected were analyzed through using descriptive statistics such as graphs and charts.

Results and Data Analysis

Findings of the study

The study revealed that the global growth rate of interest-free finance is around 10% and almost the same growth was seen in the case of Pakistan. Though in the year 2020, the growth rate of Islamic finance in Pakistan was a bit low, it was due to the fact of COVID-19. The majority of the studied banks have shown a positive growth rate of interest-free finance despite having negative effects of COVID-19 on the economy. Moreover, the pertinent mode of Islamic finance in the world is Murabaha which constitutes almost 70% of Islamic finance. Furthermore, Islamic banks in Pakistan are contributing to the charity and are working in collaboration with different NGOs/INGOs thus helping the government to achieve the goals of SDGs. There are several NGOs attached to Islamic banks and they are sponsoring them under the banner of Corporate Social Responsibility (CSR). The majority of the goals of SDGs are covered by Islamic banks in Pakistan.

Conclusion and Recommendations

Conclusion

The study was carried out to learn about the different

aspects of interest-free finance in Pakistan. The study was qualitative and it consisted of four research questions. The data for the research was gathered from various sources including audited financial statements of the respective banks, newspapers financial websites, etc. Moreover, the sample banks in this particular study were Meezan Bank, Bank Islami, Albarak Bank, and Dubai Islamic Bank. Five years of data were taken starting from 2016 to 2020.

It was observed that the annual growth rate of interest-free finance is around 10% and is consistently increasing. Moreover, it was also observed that by the end of 2023, global assets of Islamic banking would reach US 3.8 trillion dollars. Additionally, the most prominent mode of international Islamic finance is Murabaha which constitutes around 70% of Islamic financial products. Secondly, the activities of interest-free finance in Pakistan were reflected. It was found that just like global Islamic banking; the growth rate of interest-free in Pakistan is also experiencing rapid growth. There wasn't any single Islamic bank that showed a negative growth rate except Meezan Bank in the year 2020. But the main reason for this negative growth was COVID-19 which hampered the economic development across the globe including Pakistan. Thirdly, the role of Islamic banking in achieving Sustainable Development Goals in Pakistan was considered.

Recommendations

The following recommendations will assist Islamic banks in Pakistan to reduce their problems and issues.

1. The use of KIBOR should not be allowed in Islamic banks. For this purpose, specific regulations for this niche finance market should be formulated to avoid the use of KIBOR. The research advises that the word Kibor be better referred to as the Pak Profit Rate (PPR) among master (SBP) and its slaves (clients).
2. Additionally, it is advised that the profit ratio under Title PPR be left unfixed, notional, and consistent with Pakistan's intended GNP development. According to the research, the GNP of Pakistan should expand at a variable pace as its parameters' values alter in real life. As a result, the planned PPR will probably fluctuate, which makes it Islamic because Hadya shouldn't really be set.
3. The study predicts that its suggested solution should be acceptable to SBP, its regulated banks, and the general public because it is true that all banks are already committed to upholding and abiding by SBP regulations, and

because masses in need of debt should have no objection to time-bound slavery that is not intended to sell or buy humans but rather to facilitate the masses.

4. iii. All the products of Islamic banks should be strictly in adherence with the injunctions of the Quran and Sunnah. In this regard, a special committee should be formed at the bank/organizational level to assess the essence of the product. In other words, the committee should assess whether the product being offered is as per the Islamic spirit or not.
5. vii. Islamic banks should properly organize training for their personnel and should equip them, especially with the injunctions of the Quran and Sunnah about finance. In this regard, Islamic Scholars and Mashaikh should also be consulted to inculcate Islamic teachings in the employees.
6. viii. Besides, organizational initiatives it is the prime responsibility of the state to ensure the smooth functioning of the Islamic interest-free banking in the country. The government should play a vital role in this regard. It should remove and eradicate the obstacles and barriers which are impeding interest-free banking in the country. It should focus on the regulatory framework, policies, and procedures and align them to Islamic values to support Islamic banking.

Managerial Implications

The current research has several implications. It provides a guiding framework for the management of the banks to develop Islamic products, instruments, and modes of finance for the customers. Moreover, the current research would help them to identify the barriers faced by interest-free banking at organizational levels and chalk out viable strategies for the smooth functioning of Islamic banking. Besides, the outcome of the study would also assist the managers to alter or modify their HR policies accordingly.

Limitations and Future Directions

The current research has several limitations like other researcher studies. For instance, the current research study is based on secondary data hence, future research studies should be based on primary data. Secondly, the current research focuses on the existing level of interest-free banking in Pakistan and the

hurdles it is facing in implementation. Hence, future researchers should conduct studies analyzing the effect of other factors such as government policies,

public perceptions, or economic landscape on the success of Islamic banking in Pakistan.

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