

## **Analytical Study of Dual banking and Earlier Efforts towards Islamization of Bank of Khyber in the light of Shariah**

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### **ABSTRACT:**

The proposal of interest-free banking is very old because Islam restricted the interest base transaction at very beginning after the revelation of prohibition of Interest, noble Quran called it as Riba. This prohibition is of sever nature relatively, Allah says; O you who have believed, fear Allah and give up what remains [due to you] of interest, if you should be believers. And if you do not, then be informed of a war [against you] from Allah and His Messenger.

The suggestion for the establishment of such financial institutions that run according to shariah has been put in queue for about centuries. To get rid from the dominancy of conventional banking system, forced the religious scholar to take initiative in this regard and started interest free banking. It was not easy to switch entirely from conventional banking system to Islamic one as for different technical issues, leads the existent banks to start dual banking system.

Bank of Khyber is the first Bank of Khyber Pakhtunkhwa operating as dual banking, i.e. Conventional as well as Interest free banking. This study focuses on analysis of dual banking system of bank of KHYBER in order to know the extent of conformity with shariah standards along with highlighting the earlier efforts of it towards Islamization.

**Key Words:** Dual banking, Shari‘ah: Islamic code of life, Riba: Interest

### **Interest Free Banking at Glance:**

Early efforts regarding Modern Islamic Banking System started from about 19th century and ongoing through to the current date. This division highlights the progress of Islamic banking system or it may call Interest Free banking system in three most prominent countries, one is Pakistan and other two are Sudan and Egypt. The major reason behind these countries is very clear and the Islamic banking in Egypt, lead the way and take initiative by local saving bank, Mit Ghamr, which was recognized in 1963, is considered the signpost in the progress of contemporary Islamic banking for the reason that it has showed that shariah set of laws are enough to meet up the financial requirements of Muslim of in the present day. The remaining two countries selection is because of the base that these two have initiated to entirely convert their banking system to Sharia stream lines. Moreover, one of the fact about Malaysia, it is believed that this is the mostly populated country accepted the challenge to hold the Islamic banking system.

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Beginning of Islamic banking system, to a great amount, is credited to the wave of restructuring believes and thoughts of the Islamic resurgence movements. Muslims scholars and reformers re-energized and encouraged the thoughts of reapplication of Shariah's teachings and principles to the entire phases of living and that adherence to shariah ideology is essential for Islam and its believers and this was the time of early twentieth century. Amr Mohamed El tiby states;

One of the main issues that concerned Muslim scholars was how to eliminate riba from their lives and how they could make their financial dealings compliant with their shari'ah. Rashid Rida (1865-1935) was a Syrian scholar and jurist who joined Jamal Al Din Al Afghani (1838-1897) and Mohammad Abdul (1849-1905) in their newspaper Al-Urwa al-Wuthqa and the later-launched Al Manas weekly newspaper in Cairo, where they published articles that discussed the legitimacy of interest. This period has also witnessed thinkers such as Hassan Al Banna (1906-1949), the founder of the Muslim Brotherhood (the foremost of Egypt's resurgent Islamic organization), Sayed Qutb (1906-1966), one of the most figures in modern Sunni Islamic revivalism and thinker of the Muslim Brotherhood in Egypt, and Syed Abdul Ala Mawdudi its party Jamaat-e-Islam and major Islamic thinker and revivalist leader. Their ideas and writing on how to reestablish the Islamic shari'ah into all aspects of Muslims lives have helped in enhancing awareness of the importance of establishing the Islamic financial system in Muslims minds.<sup>1</sup>

The proposal of interest-free banking or Islamic banking is very old because Islam restricted the interest-based transaction as *Riba* is Haram and the suggestion for the establishment of such financial institution that runs according to shariah has been for about sixty to eighty years old. The first effort to launch shariah-based financial institute or bank which finished fruitlessly and ineffectively was in Malaysia in the mid-1940s. The plan was to spend pilgrim's savings in various sectors like real estate in accordance with shariah teachings. In the rural areas of Pakistan, the subsequent testing has also been conducted by few religious scholars with intention to get rid of interest but unfortunately this testing was also failed in 1950. One other positive step taken by Malaysian government in 1962 with intention to support and help out the people who want to perform the Haj and established the institute named Pilgrim's Management Fund. The most victorious and innovative experiment was the foundation of a small financial institution in a very small town in Egypt in 1963, Mir Ghamr Local Saving Bank, considered the signpost for development of the contemporary interest-free banking system. Afterward, the next Islamic financial institution was Nasir Social Bank which was in 1973. In fact, it is not fine clear that it was working with direction of Islamic Teachings or not but it was considered that this was second Islamic institution.<sup>2</sup>

Then the 3rd step which was a landmark in the setting up of Islamic financial system is the establishment of the Islamic development bank, Jeddah in 1973. This Islamic development bank was set-up by the OIC comprising of all the Muslim countries and it has a wide membership of the Muslim countries and mostly finances them. But

fortunately, as early as in 1973 when Islamic development bank was established, it was decided that this Islamic bank was to be run according to Islamic principles. So therefore, right from the very beginning, this Islamic development bank is working under the Islamic modes of financing. Although this Islamic development bank has no permanent Sharia board, but it has been consulting different Muslim scholars at different stages and with the great efforts of the different Islamic expert and Muslim scholars the documents of this Islamic Bank are up to optimum extent according to the Sharia's Principles. This era also observed the foundation of a number of Islamic banks in the Arab countries, for example, by team of businessmen from a number of countries, the interest free bank, known as United Arab Emirates, established and that was believed the first Islamic private bank in the world in 1975. Similarly, the other bank named, Dubai Islamic bank in Dubai was established. After two years, Faisal Islamic banks were established as private banks in two different countries that is in Egypt and Sudan in the years 1977. Government of Kuwait in the same year in 1977, established an Islamic financial institution, named the Kuwait finance house.

The next episode which has duration of about twenty-five years, from seventies of twentieth century to the start of twenty first century, stepped up as a result of quick boost in black gold i-e oil worth that carried massive capital and prosperity towards the areas of Middle East and become core reason for the broaden the volume and frequency of Islamic banks in the world of different Islamic and non-Islamic countries. In this phase, more than hundred Islamic banks were established and working across the world. In adding up, other than Islamic banks started to present and recommend the shariah based different type of services and products via specific subdivision currently became identified are Shariah or Islamic Counters. In this duration, few countries converted the entire banking system to Islamic one like Sudan and the other country is Iran. These two countries have converted the financial system in less time to Islamic or shariah based system but unluckily, Pakistan due to some of the external and internal factors did not persist. The process of conversion here in our country is very slow, that initiate with beginning of Pakistan existence i-e in 1947 and then it became formal in round about 1970 and was in broad spectrum in decade of late eighties and till date the struggle is continue and most of the positive steps were taken by the State Bank of Pakistan.

The next phase seems which has duration of about five to six years, lengthened from 2003 until the mid of 2009. This period is prominent among all pervious phases for its two distinct features; one of these is the universal recognition of shariah based compliance financial resolution by the dictatorial establishment in United States and Western Europe, and predominantly by FSA i.e. Financial Services Authority and this is the only finance regulators in the Europe. The other one is the emergent attention and contribution of the global finance giants in Western World in general and specifically in Europe, United States and Japan in the Islamic finance dealing. These include a number of banks like Citibank, Credit Swiss and UBS i-e Union Bank of Switzerland. Similarly, in Japan, Islamic Finance got informed and several Japanese

banks have also got entry in Shariah based financial transactions or Islamic Dealings. During this period, Financial Services Authority authorized three completely Shariah based financial institution and the Islamic Banks established by the investors from Middle East in order to meet the needs and to fulfill the emergent demands for shariah compliance financial solutions in the United Kingdom. The name of the three banks approved by the cited above authority i.e. FSA, in 2007, the Bank of London, in 2004 the Islamic Bank of Britain and the other one is the Bank of European Islamic Investment, in 2006. The tendency towards Islamic financial institutions and Banks go sky-high in the last quarter of the year, 2009, where regulators, overseer and bankers throughout the Universe, assessing the grounds, basis and results of worldwide economically downfall and crunch observing all the financial markets. Many regulators as well as bankers assessing the reality that only one sector, Interest free financial Institutions remains safe and the slightest harmed due to these crises facing the entire world because of its such nature totally based on assets or it may say asset-based nature.

There is tremendous elevated rate of 28.6 percent observed of assets growth of world high rated five hundred Islamic financial institutions. The volume is of about more than US\$ 1.2 trillion of existent Islamic financial institutions. The Islamic Banking sector of Pakistan raised by seven percent in the middle of current year, i.e. 2013. According to the official statement of the Central Bank of Pakistan i.e. State Bank of Pakistan, the growth rate abridged technically because of a huge deposit invested in the Islamic division. Presently, the deposit base position at Rs. 771 Billion, while the asset section improved to Rs. 903 Billion for the period of 2016<sup>3</sup>. As a whole the Islamic Banking shares rises to 9.9 percent in Pakistan. On the other hand, profit stage has float down to Rs. 4.3 Billion as measure up to Rs. 5.9 Billion in the previous year. Islamic Banking, strongly endorsed by the Central Bank, has displayed stronger performance as compared to the conventional banking sector. Its asset 'quality' is sounder than conventional institutions, and the rising share in Pakistan's market is evidence of an aggressive outlook for its future.<sup>4</sup>

### **Historical Background of Bank of Khyber:**

The first official bank of the province Khyber Pakhtunkhwa called as Bank of Khyber came into being in 1991, after developing consensus & for the purpose a Resolution passed in the Assembly of Khyber Pakhtunkhwa.<sup>5</sup> The basic and core aim for the creation of this financial institutions is to create the more chances to engage the people and reduce the unemployment along with intens-ion to enhance the opportunities of earning in this area, to strengthen the provi-nce and to grant financial assistance to those citizens of this area, who are busy in the different nature of businesses i-e small, medium and large level business. The other factor is that almost all the Head offices of all nationalized comer-cial bank are situated in provinces other than Khyber Pakhtunkhwa, which considers as one of the basic and core hurdle and barrier to get the any sort of finance or loan to meet the short term as well as long

term financial needs from these banks in time as there is necessity to take a officially proper sanction from their Head Offices for the purpose of any sensitive activity like getting loans or any other type of advances for regular customers or to put together any financial dealings with other financial institutions or their sub-branches. For that reason, there was a dire need felt that there should be a particular bank having a Head Office situating in this province in order to release, not only the above-mentioned tensions and hurdles but also help out the time delay, communication breach or inefficiency and easy, timely provision of required documents for the purpose of advance loans or any other transaction.

In the beginning, this bank, the bank of Khyber had agency association with Allied Bank Limited and Muslim Commercial Bank for different types of activities like collecting and clearing check from other banks, but with the passage of time the situation and circumstances were changed and with hardworking of the team and its top management to accomplish the goals and objectives, more specifically by the elegance and kindness of Almighty Allah and the high efforts of its executives and staff, it grows tremendously and shaped a scheduled bank in 1994. This status of a bank as scheduled bank permitted at opening branches within and outside the province, also get the channel and proper membership of the clearing house and involved in all other trade finance or like relevant transactions directly.

The bank of Khyber started its functions concerned with State Bank of Pakistan and hired its own clearing officer for clearing purposes and to attempt other affairs with State Bank of Pakistan. At the moment, this said bank, Bank of Khyber initiate its activities as an agent for other financial institutions and then slow and steady expands its business nature and started working as full fledged bank. At starts this bank awarded as the first approved and certified merchant to play in the businesses of foreign exchange coupled with services of trade. The Bank of Khyber also offered its facilities and expertise to the other branches as well, that has involvement in foreign trade that is, had import/export business. The Banks established its own network of its branches in different cities of the country and almost there is a branch in all big cities like Islamabad, Rawalpindi, Karachi Lahore and Muzaffarabad etc.<sup>6</sup>

The bank of Khyber is playing a prominent role for enhancing the living standard of the people and making them able to stand on their own feet. For the purpose, the bank is struggling to create different product's formats by offering different sort of financing like public loans along with offering special loans to private institutes, having huge intentions to increase the employment and for the enhancement of earning power of the individuals but likewise for the prosperity and progress of Khyber Pakhtunkhwa. Those who acquire finance from the bank became able to initiate their own setup or business by this manner, job opportunities create and the unemployment surface declines to more extent in most of the fields and distinct areas, particularly for the publics of this region, that may contribute a lot in declining the level of poverty and problem of scarcity which is one of the basic issue and problem of the region. In addition, with the existing Finance & Demand Finance facilities,

there is also establishment of specific controlling department refer to Micro Finance Department or Department of Micro Finance has been announced and purpose of it to back up the all sort of such businesses, which are on a minute and small level like corner shops, home level schemes related to women, example stitch-ing and beauty parlors centers or other small projects. The State Bank of Pakistan has permitted the scheduled banks to open Islamic windows or to open new branches based on whole sole Islamic Banking System having a pure shariah board in the country. For the said purpose, the bank of Khyber established an Islamic Banking Division in order to provide, not only necessary guidance to the customer but deal with them in accordance with shariah standards set by the shariah board in order to provide the interest free product or transaction. Current position of the said banks is that it has parallel banking i.e. conventional banking and Islamic banking.

### **Core Objectives:**

The KPK first official bank, Bank of Khyber is one of the profitmaking organizations and its major objective is maximization of profit. The means for accomplishment of profit maximization are the following layouts:

1. Profit Maximization by enhancing the level of deposits.
2. Profit Maximization by charging interest. Normally the interest charged from the people in the shape of increment after periodic repayment on loans financed to the individuals and other organizations for the said purpose.

The details are as under:-

### **Increase in Deposits:**

It is fact that there is a lot of competition in banking sector and almost all banks whether it is private, nationalized Pakistani or foreign bank, make an effort to raise its deposits by adopting several tools and means in order to facilitate their customers. Deposits are the lifeblood of banks as if there more deposits there will more tendencies for the bank to extend better sum of loan and hence accomplish higher profit. The Bank of Khyber is also humanizing its services and facilities to catch the attention of clients with upper magnitude of sums.

There are two most important features, services and courtesy those make the big difference and play a vital role in customer satisfaction and real factors involved in increasing the volume of deposits. For this reason, most of banks focused on it regarding achieving the high volume of deposits. Comprehensive-ly, the bank prefers to increase the deposits ultimately increase the profitability of the Bank.

### **Financing or Postponement of Loans:**

The growth or the level of profit of any bank fundamentally up to more level depends on the finance acquired by the individuals for different purposes like for consumer use or business purposes etc. and other sort of people to whom credit is given that is credit praiseworthiness of the borrowers. This approach has worked relatively well for Bank of Khyber. Money in the form of Deposits are taken from the account holders and spend in different sort of sectors and small and large projects for the welfare purpose.

Bank of Khyber prefers to award loans to financially reliable and sound parties, after getting the collators. Bank of Khyber has a tremendously well-organized subdivision. The staff is skilled, educated and proficient. They asses the case carefully before taking decision about advancing the loan. By this mean higher profit achieved through Interest charged on the loans. Some others objectives besides cited above of Bank of Khyber are as also of great importance as it has pertinent role in resolving the financial issues of the public in a very better way like, Improve customer services, Better cooperation, To assist in the country growth, To expand industrialization of the country, Quick disposal of credit, To eradicate the poverty, To produce maximum profit for the shareholders, To enhance the bank standard among competitors, To be number one player of the market and to value the customers with full emphasis on their satisfaction.

### Major Divisions:

To make Departments or division is the logical process of grouping of activities, or the process of grouping jobs in the logical arrangement through which the organizational goals or objectives can be achieved. It is also the process of division of work into various sections or department or divisions, over which a manager has authority and responsibility for performance of specified activities like Personal, training & establishment Division, Banking Operation Division, Treasury Division, Audit & Inspection Division, Credit Division, Computer Department, Micro Finance Division, Public Relations Department, International Banking Department, Islamic banking division, Marketing Department and Consumer Finance Department<sup>7</sup>

### Financial Presentation:

Bank of Khyber is one of the most profitable banks that have a consistent growth year to year. Here is the sketch that will highlight the bank's performance for their specific years.

(Rs. Billions)

Items	2005	2006	2007	2008	2009
Income	28.2	34.2	34.5	35.3	33.7
Expenditure	29.5	33.2	32.4	34.8	32.7
Pre-tax profit/(loss)	(1.26)	.995	2.14	.52	1.03
Total assets	274.1	310.6	325.9	350.4	370.7
Deposits	235.9	254.9	273.4	294.8	316.5
Advances	85.9	105.6	109.5	122.6	140.3
Investments	108.2	109.5	102.9	91.5	80.4
Employees	1500	1800	1850	1890	1911

It shows that the financial performance is not bad because of its continuous growth in these mentioned years. One can easily observe that the growth ratio of employees is tremendously increased from year first to the end of last year as mentioned in table that is approximately 27.4 %. Similarly, the total assets increase is also appreciable that is 35.24%. Indeed, it shows that overall performance was up to the mark.<sup>8</sup>

### **Evolution & Present Performance as Islamic Banking:**

In fact, nobody can deny this statement that the socio-economic development of any emergent country depends mostly on the strength of its financial institutions. Among these institutions, the banking region is indeed, plays a fundamental and central role in the leading the country's economy for the reason that the banks involvement is much more and almost all departments of the country linked by it like it deals in the trade, industrial sector, health sector, education sector and commerce of the country etc. it is a basic organ of the whole economic development of county. Bank of Khyber upholds its rank as one of best bank of the country determined to set higher standards of attainments and accomplishments. It is the key business co-worker of the Govt: of Pakistan with special stress to promote, cheer & encourage the Pakistan's economic growth through durable, balanced and sturdy lending policies, products and services that are technologically oriented, offered through its great net-work of branches to be found country wide locally, internationally and representative offices.

The State Bank of Pakistan has permitted the opening of banks and branches, run according the Shariah principles and rules in the country<sup>9</sup>. For the said intention, a step was taken by the State Bank and an Islamic Banking Department has been established to give necessary guidance and directions to these Islamic banks and to train the concerned bank's staff. They have also directed all the banks to set up necessary steps for promotion of particular division that handle the shariah based product & services. The Bank of Khyber established an Islamic banking division in 2003. The aim and objective of this division is to implement and execute the Central bank's policy and to value the customers who want to get rid from the curse of interest and wishes to deal with the banks according to Islamic teachings and rules. As the Head office of this bank situated in province Khyber Pakhtunkhwa and the majority of population living here is of Pashtuns and general inclination of them towards religion is comparatively more and they tending towards Islamic Banking system.<sup>10</sup>

### **Future growth, performance and public acceptance:**

To be the Premier Islamic Bank providing innovative Financial Services, based on the Principles of Shariah. Translates true Islamic economic principles in to practice, with firm beliefs to establish an economic system based on the Final Revelation.<sup>11</sup>

The growth of Islamic banking sector's market share has a comparatively swift pace, that is round about seven percent in last 07 years, when judge against to other countries like Bahrain where the situation is different i-e market share measures at around about eight percent in last thirty years and Malaysia is the other example where the market share is also in the region of 12 percent after twenty five years with pure presence of Islamic financial institutions/banks there. For this reason, the government of Pakistan should provide market-based incentive and perks to this industry like lower the tax rate on dealings and transactions with these interest free Islamic Banks or other Islamic financial institutions, in order to support it.

The Islamic banking industry has consistent remarkable growth. In order to observe



the performance of Islamic banking division, it is noticed that it came into being under the bank of Khyber act in 1991 and started to deal principally like commercial banks and afterward acquired the position of scheduled bank in 1994 and listed on Karachi stock exchange. In the beginning there were few branches but with the hard working and consistent efforts of the management, the Islamic banking division established in 2003 and the expansion continued. Over the past two to three years; Bank of Khyber established five new branches those were Islamic one, 2 Islamic banking sub sub-branches and those were in running position. At the end year 2011, there were about sixty-two branches as a whole, among 62, the Islamic branches were 26. In 2012, the number increase to 77 and Islamic branches were 35 and this was a tremendous growth. As a result of their performance and consistent growth in the market, the level of its competency and goodwill going high and high and the time come that bank of Khyber considered one of the key players in the Financial Market. In 2013, the Bank completed their ten years of successful Islamic Banking Division and they were appreciated and respected. At the end of tenth year of Islamic Banking Division of Bank of Khyber the total branches reach to 100 and among them 45 branches are Islamic ones in 2013.

In addition, Islamic banking counters or windows are opened by all conventional banking branches. The economic crises in 2008 have improved the common public's faith and trust in Islamic banking as vigorous and healthy institutions and accept as truth that the sector of Islamic banking has a brilliant and bright future.<sup>12</sup>

The overwhelming majority of the community is tending towards the Islamic banking because of its shariah based transactions and that the Islamic banking sector itself is in constant and stable shape of headway and improvement. The conventional banking that is totally based on interest is mainly focused on money lending and that the actual risk of their businesses becomes obvious at "times of crises". On contrary to this, the spirit and strength of Islamic banking industry be required to give fair, positive, valuable and beneficial services to customers on sympathy and ethical roots which is the foundation of all religions including Islam.

### **Major Products:**

The major business units of Islamic banking group of Bank of Khyber consist of treasury, consumer finance, corporate banking and commercial banking. Following are some of the services provided by it on asset side of the balance sheet through different products and these are the key services and products of Islamic banking, *Murābaḥa*, *Ijarah*, *Musharakah*, *Diminishing Musharakah*, *Mudarabah*, *Wakala*, *Istisna*, Import and Export under Islamic banking, Discounting of bills through agency rearrangement and Export refinancing. On deposit side a wide range of products offered by Islamic banking group of Bank of Khyber on deposit side. All the accounts are firmly based on shariah principles like term deposits are wholly based by principles of *Musharakah* and current accounts are based on the principles of *Al-qard*. These all are designed in such a manner through which the customers are satisfied and

having flexible features that fulfill the required needs of customers with in the shariah compliants manner. Following are some of the types of deposits accounts presently offering by the Islamic banking group of Bank of Khyber.

1. Current Accounts
2. Riba free certificates
3. Interest free PLS saving accounts
4. Riba free special deposits pool for Banks
5. Riba free special deposits pool for staff provident fund

Bank of Khyber is trying to compete with other banks in adopting all existent means and tools of Islamic banking. To observe the other sectors and overall the industry in stability and prosperity and to gain the public attentions and confidence, the bank introduced the proper check and balance system to ensure that all the activities of the concerned Islamic banking division are not against the shariah and the system is going on according and with the Islamic teachings and Principles. For the purpose mentioned above, there is a proper a Shariah Supervisor Committee or board of renowned religious scholars to examine and approve the all types of agreements, polices and all type of concerned documents of the services and products offered by the Islamic Banking Group of Bank of Khyber.

### **Dual or Parallel Banking:**

It is pertinent to mention the fact that banking with dual nature or called as parallel banking is not against the shariah rulings. There is chance of declination in profitability or somehow fluctuation in the financial performance but the practices shows that affect happens in those banks having dual banking system.<sup>13</sup> Although general perception of the layman is totally different of it because one may think that how it is possible for any financial In situations to work in conformity with Shariah standard as well as operating conventionally as transaction entirely on interest base with same infra-structure and human resources. Same Building with same staff operating distinctly is really a question mark apparently but in fact it is not like that. There is principle and law in Islamic jurisprudence that money as medium of exchange cannot be specified and nor be treated as commodity. The money enter into the bank cannot be treated as interest base if the transaction went through the staff or infra-structure of conventional banks. The transaction be called Non-Islamic when there is occurrence of violation of shariah teachings or anything against the Islamic laws of contracts.<sup>14</sup> The fact that there is no any contradiction with shariah rulings if the bank working as dual banking system abide by all rule and principles of shariah standards. The transaction become interest based or non-Islamic when violate the general laws of Islam.

### **Conclusion:**

In spite of all these which are appreciable and much more significant but there are some of the areas that are still in position to develop and progress with in the shariah umbrella. Whatever is going on regarding Islamic banking system, indeed it is positive step but to fill loop holes in this system is also one of the main responsibility

of management of Islamic Banking Group to indoctrinate the shariah based environment and culture within the organization and outside too while interacting with financial institutions where it suits and also their liability to remind the front line staff and top authority about the importance and essentiality of Shariah and its effects and impacts on the public in general and more specifically on the these financial institutions and more particularly on the performance of the said bank if these shariah principles and teachings were not implemented in a better way and practices are not observed.

Overall performances of Islamic Banks as dual banking are limited to some areas but there are few sectors like education, agriculture and personal financing etc. needs promotion and encouragement regarding shariah compliance product and services and there is dire need felt to gain the momentum. The general public is not good aware of the dual banking or Islamic products and there should be seminars and workshop about Islamic Banking system in order to enhance the general awareness and understanding about it. Similarly, those banks which are operating as dual banking or parallel banking like bank of Khyber are not against the Islamic laws if the transaction and products are being supervised by their concerned Board of Shariah scholars.

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