Chapter 1

Introduction: Historical Background

1.1 Background

It is generally claimed by several scholars and jurists that Islamic Banking had played an important role in the development of economic system of several Muslim countries in the world. The concept of Islamic banking whose genesis is the West Asian countries rapidly spread to other region of the world particularly in the East Asia and South Asia. The system of Islamic banking is essentially based on the very concept of Islamic jurisprudence (Shari'ah) and the guidance from divine law. The idea of Islamic Banking is developed by the Quran’s forbidden of usury, this mean all activities of Interest (Riba) are banned and speculative transactions and uncertain financial instruments are prohibited.¹

In fact Muslims do not need a reason before they deny the transaction involving interest because this is the divine’s command. The human explanation is not a requirement for a divine, they must to accept a covenant, as they believe that the human reasoning have its own limitations. No human mind can imagine beyond a divine order. Therefore, it is a matter of faith (Iman), thus it can be said that the one answer why Muslims inspired to look for an alternative for conventional bank.²

The operations and activities of Islamic Banking are founded on Islamic law (Shari’ah). This means that all operations and transactions of the Islamic banks involving either deposit or financing must be preceded by Shari’ah principles. Such principles also cover other banking transactions system like money order transaction, letter of credit and foreign exchange, letter of guarantee etc. The main factor that distinguished Islamic bank

from conventional bank is that all transactions are based without involving element of interest (Riba).³

To emphasize, it must be considered that Islamic banks and conventional banks are profitable organizations. Their purpose is to gain profit but Islamic banks are not allowed to concern with interest or to relate any trade or business prohibited by Islamic rules also.⁴

This is due to the fact that Islam prohibits the payment and receipt of Riba. A Financial Institution cannot be considered as an Islamic bank institution if its operations are concerned with Riba. Beside this, the important objective of the establishment of Islamic bank is to provide the needs of Muslims in banking system. The business administration of the banks is defined on the concepts of justice and fairness in the interest of the whole society; the banks are also established on rulings set in Quran and Hadith.⁵

The management of Islamic Bank must not involve with loans, except for benevolent loan (Qardh Hasan). Islamic bank presents the principles of Musharakah (partnership) and Mudarabah (Profit Sharing), which make the investments of Islamic bank dependent on the usefulness of the project in which the money is invested. The main principles of Islamic Banking are forbidden of Interest in all transactions and the prohibition of monopoly and hoarding.⁶

Islam prohibits all activities concerned with interest. It, however, does not mean that capital is cost-less in Islamic system. Islam does not allow the factor to make predetermined claim on the productive surplus in the form of interest but Islam recognizes capital as a factor of production.⁷ Islam prohibits interest but encourages investment and provides a stimulus to

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⁵Sudin Haron and Wan Nurfiza Wan Azmi No.3, P.44.
⁶Mei Pheng Lee and Ivan Jeron Detta, No.4, P.1.
⁷Khiyar Abdallah Khiyar, No.1, P.24.
invest for the idle funds. This stimulus gets momentum that Islam allows profit in which profit as well as loss is shared, it means that the risk is shared.\(^8\)

In economy, there is a need to transfer of funds from savers to entrepreneurs. The function is provided through the process of financial intermediation in the financial market, where banks are the most important operators. Islamic bank, like other banks, the main business is to transfer capital from saver and supply this capital to entrepreneur. While conventional banks use the rate of Interest for both obtaining fund from saver and supplying these funds to entrepreneur, Islamic banks use these functions for various financial modes compatible with Shari’ah (Islamic laws).

The role of bank is indeed highly useful and socially desirable, but interest is banned in Islam. Therefore, Islamic economies have to find alternative ways of various banking function. Islamic jurists and scholars have created several alternative ways of banking activities. The concept of Islamic bank was developed through milestone of Islamic history since the ancient time of Islam in the life of Prophet Muhammad (PBUH) until now, days of modern Islamic Banking era.\(^9\)

1.1.1 History and Development of Islamic Banking

In Islamic history, the emergence and development of an Islamic Banking system is important point of a new path for Islamic world which liberated itself from the power of domination of Western thought, value and institution and revival of their social and economic life in accordance with the principle of Islamic jurisprudence and would be consistent with religious and cultural ethos.\(^10\)


Muslim societies never legitimized interest throughout the thirteen centuries of its early history to domination by imperialist power. The Islamic scholars and jurists provided alternative ways to economic activities and carried on domestic and international trade without the institution of interest.\textsuperscript{11}

From the early stage in Islamic history, Muslims were able to create a transfer system without interest for mobilizing funds to entrepreneur. The system worked quite effectively for Islamic civilizations and centuries thereafter. However, since the center of economic activities were dominated by Western financial institutions, the focus revived yet again to conventional banking system and deal with interest again.

When conventional bank emerged after the industrial revolution, Muslims desired to stay clear of interest. A majority of Muslim jurists and scholars expressed their serious concern with this model and they called for the development of alternatives to provide the financial intermediation function in Muslim society.\textsuperscript{12} However, the valuable theoretical work was done in the early nineteenth century. At that time most of the Muslim nations were under colonial rules, when Muslim countries gained their independence after World War II, the experiments in interest-free institution started on modest scale and gradually expanded in scope.\textsuperscript{13} Although Islamic bank became reality in 1960s, but this does not mean that banking activities did not emerge in early Islamic history such as receipt of deposit, loan insurance; money exchange, and bill of exchange, were in existence since the early years of Islam. Before the existence of Islam, Makkah was the center of trade and was used as a transit point by trader passing through the city from the north and south border. Thus, all the financial activities such as deposit, loan, and money exchange developed rapidly even after Islam became a center in Makkah and Madinah.

\textsuperscript{11}Khiyar Abdallah Khiyar, No.1, P.79.
\textsuperscript{12}Munawar Iqbal and Philip Molyneux, \textit{Thirty years of Islamic Banking History Performance and prospects} (London: palgrave Macmillan publishing, 2003), P.36.
\textsuperscript{13}Philip Molyneux and Munawar Iqbal, No.9, P.147.
From the historical point of view Islamic Banking can be divided into three eras. The first era began from the early years of Islam in Makkah until the period of Caliph Ar-Rashideen (companions of prophet). The second era spreads from the era of Caliphates until the fall of Uthmaniyah Empire. This is followed by the third era, which is the era of modern Islamic Banking.¹

1.1.2 Early Era of Islamic Banking

Islam was born in Makkah when Prophet Muhammad (PBUH) first received divine covenant of Islam in the year 610 AD at mount Hira, and Islam was preached openly in the year 613 AD at mount Sara. Makkah was considered to be one of the most important places in Arabia. The Makkah communities had grown beyond the limitations of clan and tribe to afford the complexity of political and economic ties. Makkah was the city of trade and its business activities continued even after Islam became rooted here. During this time businesses and trades were involved in loans with interest charges. Although in the early year of Islam the Prophet Muhammad (PBUH) and his companions introduced Islam to Arabs, this is evident to indicate that the development of Islamic Banking system started from the time of Prophet Muhammad (PBUH).¹⁵

Riba-ridden lending was generally eliminated from the Muslim society of the Prophet's (PBUH) era. Other forms of financing (Mudarabah, Benevolent lending, Sale on credit, and Bai al-Salam) dominated the financing practices of that period.

While discussing the Mudarabah, the fuqaha (Jurists) usually refer to the Mudarabah venture the Prophet Muhammad (PBUH) had with Khadijah (K.A) which started more than fifteen years before the beginning of the revelation. They also mention the common practice of Mudarabah in the Makkah society. It should be noted that Mudarabah implies that the net

¹Sudin Haron and Wan Nurfiza Wan Azmi, No.3, P.47.
¹⁵Sudin Haron and Bala Sharmugam, Islamic Banking System concept and application (Kuala Lumpur: Pelanikut publication), p.1.
profit of trade is shared between the owner (Rab al-mal) and the worker (Mudarib) after it is actually realized at the end of the transaction.

Prophet Muhammad (PBUH) had advocated lending and sale on credit. Ibn E Masud narrates that Prophet Muhammad (PBUH) said: "Whoever gives two loans will have a reward (equivalent to the reward) of one of them (be it given charity).” reported by Ibn Majah. V.2 p.812.

Abdullah Ibn-e-Rabiah said: "The Prophet Muhammad (PBUH) bought some food on credit from a Jew and the Prophet Muhammad (PBUH) gave him (the Jew) his mail (armor iron cloth) as a security.” Al Bukhari, v3 pp.15 and 231.

Bai al-Salam was made lawful by the Prophet Muhammad (PBUH). As Arabs depended on seasonal trade and agriculture for their livelihood, the practice of Bai al-Salam sale with forward delivery must have been common in their life. Al-Bukhari reports from Al-Bara Bin Azib. “When the Prophet Muhammad (PBUH) came (to Almedinah) we used to Salam sell forward against cash payment until the season”. Al Bukhari, V4, p.269.

Both before and after the arrival of Islam in Makkah, deposits were made for safekeeping. The person entrusted to keep the deposit would pledge to return the amount deposited. Prophet Muhammad (PBUH) was one person renowned for his honesty and trusted by the people. He remained custodian of other people’s deposits until his migration from Makkah to Madinah. Before his departure, the Prophet Muhammad (PBUH) appointed Saiyidina Ali to return all the deposit to their rightful owners.¹⁷

In the absence of state deposit taking institution, public money and valuables, they were kept by trustworthy individual such as Prophet Muhammad (PBUH). Another trustworthy individual who provided deposit facilities to the public in the early years of

¹⁷Sudin Haron and Wan Nurfiza Wan Azmi, No.3, P.48.
Islam was Al Zubair bin Al Awwam. He refused money from depositor if it was in the form of deposit or trust (Wadiah). Instead, he preferred it to be in the form of a loan (Qard). Al Zubair’s action was a wise one; it covered two objectives. First, by treating the deposit as a loan, he had the right to use it. Secondly, if the deposit was not used, it would actually be a loss to its owner. On the other hand, as a loan, the deposit was safe, because it represented as a secure guarantee to the owners since the borrower was liable to return the deposit to the depositors.  

Beside the prohibition of interest, and deposit under the principle of loan or Qard, activities related to remittance and the bill of exchange had also existed in the early years of Islam. For example Ibnu Al-Abbas received the “Warik” (a type of currency that originated from silver and melted down to become Dirham, which is 3.0 gram coin of pure silver) and sent an acknowledgment of Kufa (a city of Iraq). Similarly, Abdullah bin Zubair received cash in Makkah and wrote to his brother in Iraq who repaid the depositor when they arrived in Iraq. Meanwhile, Sayf al-Dawalah al-Hamdani was the first person in Islamic Banking history to use cheques.

Besides this, the practice of exchange of items and money also existed during the early year of Islam. The Prophet Muhammad (PBUH) on many occasions had to resolve problems pertaining to money exchange. This is evident from on Hadith narrated by Abu al-Minhal:

“I asked al-Bara bin Azib and Zaid bin Arqam about practicing money exchange. They replied, ‘We are traders in the time of Allah’s Apostle (PBUH) and I asked Allah’s Apostle (PBUH) about money exchange. He replied, ‘If it is from hand to hand, there is harm in it; otherwise it is not permissible.'”

(Sahih Al bukhari, vol.3 p.157).

This is a part of numerous Hadiths to indicate that the practice exchange money existed at that time.
The Islamic financial institution which originated during the time of the Prophet Muhammad (PBUH) was called “Baitul ma'1” (the exchequer or public treasury of an Islamic state). Prophet Muhammad (PBUH) used Mosque (masjid) as the treasury and Hazrat Umar the second caliph also recognized establishment of Baitul mal. The revenue for Baitul mal came from primary and secondary sources.

1. Primary sources were Zakat (wealth tax), Kharaj (land tax), Jazia (poll tax), Custom duties, Tolls and Sadaqah (donations).

2. Secondary sources included property with no known owner, property of apostates and estate of deceased person without legitimate heirs.

The fund of Baitul mal to expend into two categories of expenditure

1. The expenses of state responsibilities such as the expense for the army and salaries for state officials.

2. To provide activities for the public benefits such as constructions of roads and water supplies.21

The Baitul mal can be divided into three types.

1. Baitul mal al-khas: This was the “royal treasury” with its own sources of income and item of expenditure. It would cover the personal expense of the Caliph, his palaces, harem and pensions of the members of the royal family, palace guards and gifts from the Caliphs to foreign princes.

2. Baitul mal: Was a sort of a state bank for the Empire. The Islamic Empire was highly centralized, both at the provincial and the central level, administration of Baitul mal was always in the hands of one person. At the provincial level, the supreme head of the Baitul-mal was the governor of the province. The central Baitul

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21 Sudin Haron and Bala Shanmugam, No.15, p.3.
mal was situated at the capital of the Empire so that it could be under the direct control of the Caliph.

3. Baitul mal al-Muslimin: The treasury of all the Muslims. In fact, it was not for the Muslims alone; its functions comprised the welfare of all the citizens of the Islamic Empire regardless of their caste, colour or creed. The Baitul-mal was situated at the chief masjid and was administered by the Chief Qadi at the provincial level.

The practices in early Islam can be compared with banking practices in present day as following.

**Bank as Depository**

This is clear, that the kind of deposit in the pre Islamic period was a kind of safe keeping; a depositor pledge to return the same thing as had been deposited with him such as a great companion of Prophet Muhammad (PBUH), Az-Zubair bin al-Awwam, who refused to take money on deposit, he preferred to take it as loan. Abdullah bin Az-Zubair narrates his father as saying that when a man brought money to be deposited with him, Zubair would say: “No, it is a loan; because I am afraid it may be lost”. Thus the total money as computed by his son Abdullah amounted to twenty two hundred thousand Dirhams (2,200,000 Dirhams), a large sum according to the standards of that time.

**Bank as Investor**

It can clearly be seen that the famous trips made by Makkan traders to Syria with huge caravans full of goods for trade that polled from different people to participate in the profit and share the risk (profit-and-loss-sharing) or on interest basis. In the time of Hazrat Umar, Abdullah and Ubad ul Allah, the sons of Hazrat Umar, while passing through Iraq, Abu Musa al Ashari gives the share to their mother from the public treasury of the Muslims to sons of Umar, which they use this money invested in trade, gave the amount to their

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22 Muhammad Abdul Mannan, No.8, p.176.
mother and kept with them, the profit made thereof. Firstly Umar was not satisfied of this for his son, and then he accepted and allowed for this money should be treated like a loan, it can be used it and obliged to restore if it had lost.

Bank as a Public Treasury / Central Bank

In about 15 A.H. (636 A.D.), Hazrat Umar was given five hundred thousand Dirhams by the Governor of Bahrain Abu Hurirah. Umar called the consultative assembly, informed them and asked them what was to be done with it. Walid bin Hisham said that he had seen in Syria that the treasury and the office of accountancy were mentioned separately. Hazrat Umar approved the suggestion and laid down the foundation of public treasury. Hazrat Umar is the first leader in Islam who established an organized system of Baitul-mal or Public Treasury which undoubtedly functioned as a central bank for the new Islamic state.

Bank as a Creditor

From the days of the Umayyad, the Baitul-mal also played the role of an agricultural credit as well as commercial bank. The Governor of Iraq under Abdul Malik and Walid, it lent two million Dirhams to peasants. The historians say that no details are available about the terms and conditions of this loan and opine that no interest was charged on this.

Bank as a Money Changer

In money dealings, the different kinds and weights of currencies provided the need for exchange and barter of money. The money exchanger was called as “Sarraf” and in the time of Abbasid Empire the Sarraf used to collect gold and silver bullion from the people and in exchange give them coins equivalent to the value of the bullion, thus profiting themselves by the difference between the face and intrinsic value of gold and silver coins. Since there

22Numani, Shibli, Al-Farooq: The Life of Omar (New Delhi), pp 260-261
23Imamudin, S.M., No.23, p.182.
were different currencies, the money exchange activity took place for long time to satisfy the needs of the people. Present day this job is done by modern banks.\textsuperscript{27}

The Islamic Banking concept appeared by a few activities in the early years of Islam, it is not successfully to expand and become a complete banking system. After that period the dark ages which swept the European Continent between the fifth to the tenth century, also had significant impact upon Muslims countries. The revival of commercial and economic activities in European countries commencing from the twelfth century saw the emergence of the conventional banking system. This new system expanded rapidly not only in Europe but other parts of the world.\textsuperscript{28}

1.1.3 Islamic Banking in the Middle Era

The middle era of Islam began with the end of the reign of Caliph Uthman in the year 661 AC. What followed was the reign of Caliph Umayyah (661-750) with Damsyik as the centre, followed by the reign of Caliph Abbasiyah (755-1255) which was centered in Baghdad, the reign of Caliph Umayyah in Spain (756-1031) and the period of Uthmaniyah Empire (1350-1918).

The fall of the Roman Empire and the occurrence of the Dark Ages which swept Europe had a significant adverse impact on the economic activities of Muslim countries. The revival of the economies of the European countries and the resurrection of the conventional banking system were affected that the conventional banking system expanded beyond the European continent to the Muslim countries, although Islamic Banking failed to expand during this era.

The development took place in terms of Fatwa (legal opinions) by Muslim Jurists involving issue of Muamalat, particularly those pertaining Riba. This was the era of many renowned jurists or ulama such as Imam al-Azam Abu Hanifah (60H/698-150H/767), Imam

\textsuperscript{27}Homaud, Sami Hassan, No.22, p.21
\textsuperscript{28}Sudin Haron and Bala Shanmugam, No.15, p.4.
Malik ibn Anas (93/712-179 H/795), Imam Ahmad Ibn Hanbal (164/778-241 H/855) and al-Shafii (150 H/767-204 H/820), who were the founders of Four Mazhab (the school of thought).

The views of these Ulama, particularly on subject of Muamalat, have become the reference point for Ulama in the Modern era of Islamic Banking in giving their opinions and judgments related to Islamic Banking activities in accordance with Shari'ah principles.\(^\text{29}\) It can be said that the Islamic bank system in the Middle Era were to prepare alternatives and paved the ways to establish completely Islamic Banking system into the next era.

1.1.4 Islamic Banking in the Modern Era

In the Modern era, it seems that the history of Islamic Banking could conveniently be divided into two parts, first, when it still remained an idea; second, when it became a reality.\(^\text{30}\) The contemporary Islamic bank movement created the persistent efforts made by Islamic scholars and institutions to find Shari'ah compliant means and measures to eliminate interest from economic and financial dealing particularly in the Muslim world.\(^\text{31}\)

The late 19th and early 20th century is clearly known as the beginning of the era of Islamic resurgence. Some of prominent scholars responsible for this resurgence are as follow: Jamal al-Din al-Afghani (1838-1987), Muhammad Abduh (1849-1905), Rachid Rida (1865-1935), Muhammad Iqbal (1875-1938), Hassan al-Banna (1906-1949), Syid Qutb (1906-1966), Abul Ala Mawdudi (1903-1979) etc. Their thoughts became stimulation for Muslims to perform Shari'ah compliant and developed the practice to eliminate interest in their social and economic ties.\(^\text{32}\)

\(^{29}\) Sudin Haron and Wan Nurflza Wan Azmi, No.3, P.50.
\(^{32}\) Mei Pheng Lee and Ivan Jeron Detta, No.4, P.5.
Although fatwa or opinions by Muslim jurists stated that the prohibition of interest dealing by conventional banks no effort was made until the early 20th century by either Muslim government or private parties to establish Islamic banks. The development of Islamic Banking is a recent phenomenon although the idea to establish Islamic bank goes back to as early as 1940s. However, the conditions then were not enough for actual establishment of an Islamic bank as not much thought had been given to technical details and actual operation of an Islamic Bank.

In the mid 1940s in Malaysia, the first attempt to establish an interest-free bank started. A plan to invest prospective pilgrim saving in real estate and plantation in accordance with Shari’ah was, however, unsuccessful. In late 1950s a pilgrimage fund was established for the purpose of helping those who want to accumulate their saving for making a pilgrimage trip to Makkah. The fund became a full-fledged interest-free investment bank in 1962. The first experimental local Islamic bank was established an interest-free banking in the late 1950s in rural area of Pakistan that charged no interest on its lending. A small experiment was undertaken by a small number of pious landowners who were prepared to deposit funds without interest rewards. The credit was advanced to other poorer landowners for agricultural improvements. No interest was charged for the credit, but a small fixed administrative fee was levied to cover the operating costs of the bank. But just as the Pakistan venture was being ended a new experiment was being tried in Egypt.

In 1963, the establishment of Mit Ghamr Saving Bank at one of the rural regions in Egypt inspired the dawn of the modern era of the Islamic Banking history and paved the way.
for the establishment of other Islamic banks. This bank provided basic banking services such as deposit account, loan account, equity participation, direct investment and social services.\textsuperscript{39}

A pioneering experiment of the principles of Islamic Banking in practice was conducted in Mit Ghamr from 1963-1967. The experiment combined the idea of German saving bank with the principles of rural banking.\textsuperscript{40} The bank had started in a modest way with one room and staff of twenty five persons. The rural people in that region were religious and pious would not put their saving into any bank because interest is prohibition in Islam. Under these circumstances, the emphasis was given to educate the people about the use of Islamic Banking.\textsuperscript{41}

The Mit Ghamr Islamic Saving Bank (MGISB) was started by Dr. Ahmed El-Naggar who later became Secretary General of the International Association of Islamic Banks. Although El-Naggar, was primarily an academic himself, he managed the bank and carefully selected the bank’s staff from enthusiast Muslims, who had some banking experiences with commercial institutions.\textsuperscript{42} According to its founder and manager, El-Naggar, the role of this bank was three fold: First, to act as an efficient intermediary between the supply and demand of capital; Secondly, to act as an educational centre for economic efficiency, saving education and banking habit; and thirdly, To set a dynamic factor in mobilizing the idle capital for investment, thus, reducing and the problems of capital formation.\textsuperscript{43} The bank appeared to be very successful due to increasing community support. Within a short time, its business developed into nine branches, managing funds to the value of 1.8 million Egyptian pounds deposited by more than 250,000 depositors.\textsuperscript{44}

\textsuperscript{39}Sudin Haron and Wan Nurfiza Wan Azmi, No.3, P.52.
\textsuperscript{40}T. Wholers-Scharf, \textit{Arab and Islamic Banks: New Business Partner for Developing Countries} (Paris: OECD, 1983), pp.79-80.
\textsuperscript{42}Rodney Wilson, \textit{Banking and Finance in The Arab Middle East} (New york: St Martin’s Press, 1983), p.76.
\textsuperscript{43}Abdelkader Chachi, No.38, p.16.
\textsuperscript{44}M.Mansoor Khan, M. Ishag Bhatti, No.31, p.39.
Table 1.1: Development of Savings Accounts in the Mit Ghamr Saving Bank

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of savers</th>
<th>Amount (LE)</th>
<th>Average (LE)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1963/64</td>
<td>17,560</td>
<td>40,944</td>
<td>2.33</td>
</tr>
<tr>
<td>1964/65</td>
<td>30,404</td>
<td>191,235</td>
<td>6.30</td>
</tr>
<tr>
<td>1965/66</td>
<td>151,998</td>
<td>879,570</td>
<td>5.79</td>
</tr>
<tr>
<td>1966/67</td>
<td>251,152</td>
<td>1,828,375</td>
<td>7.28</td>
</tr>
</tbody>
</table>


The number of depositors increased tremendously from 17,650 depositors in its first year of operation (1963-1964) to 251,152 depositors at the end of the 1966/1967 financial year. Similarly, the amount of deposit increased from 40,944 (Egyptian pounds) at the end of its first year of operation to 1,828,375 at the end of the 1966/1967 final year.45

The bank’s operations were based on Shari’ah included five areas: Deposit Accounts, Loan Accounts, Equity Participation, Direct Investment, and Social Services.

1. **Deposit Accounts** were divided as saving accounts, which did not give any financial rewards but were meant to develop the habit of saving among small savers such as students and in investment accounts, which were run on the basis of profit and loss sharing.

2. **Loan Accounts** were classified into two main types: Non-investment loans and Investment loans. Non-investment loans, which were purposed for personal financial problems. Investment loans were provided for investment purposes on the profit and loss sharing and were paid back on installments.

3. **Equity Participation** the bank participated as join owner, holding a title deed to the enterprise and sharing the profit with the entrepreneur in proportion to the amount of capital invested.

4. **Direct Investment** started at the end of second year to initiate enterprises on its own.

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45 Sudin Haron and Wan Nurfitza Wan Azmi, No. 3, P.53.
5. **Social Services** were represented mainly through the establishment of special Zakat fund which paid voluntarily by individuals to be used for the purpose of helping others socially and economically.\(^{46}\)

It is to be noted that due to political unrest in Egypt, its operation suffered a setback. At that time, the Mit Ghamr Bank and its branches were put under the direct control of the state administration and consequently lost their operational autonomy. In the second half of 1967 the operations of the bank were undertaken by the National Bank of Egypt and Central Bank. Operational policies were changed and the basis of interest-free banking was abandoned. Until 1971, when Sadat came to the power, that the experiment of the Mit Ghamr Saving Bank was revived with the creation of the Nasser Social Bank (NSB).\(^{47}\) Nasser Social Bank was the first Islamic bank to provide social services for low income groups, and it was the first in urban setting, and the first time that a government in Muslim country had shown an interest incorporating an interest-free institution.\(^{48}\)

The late Saudi Arabian King Faisal bin Abdul Aziz al-Saud was one of the noteworthy individuals who played an important role and made a major contribution to the development of Islamic Economics and Islamic Banking. His Majesty initiated the establishment of the Organization of Islamic Conferences (OIC) and urged Muslim countries to develop their own Islamic Banking.\(^{49}\)

The most significant development in the history of Islamic Banking was set up with the establishment of the Islamic Development Bank (IDB) in 1975, which was established by the Organization of Islamic Countries (OIC). It was primarily an inter-governmental bank purposed at the providing funds for development projects in member countries and provided fee-based financial services and profit-sharing financial assistance to member countries.\(^{50}\)

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\(^{47}\) Ahmed Al-Naggar, *Banks without Interest* (Jeddah: King Abdul Aziz University Press, 1976), in Arabic
\(^{48}\) Khiyar Abdallah Khiyar, No1, P.82.
\(^{49}\) Sudin Haron and Wan Nurflza Wan Azmi, No.3, P.54.
\(^{50}\) Munawar Iqbal and Philip Molyneux, No.12, p.37.
After the IDB was establishment, it was followed by the Dubai Islamic Bank in 1975 which was the first private interest-free bank and in 1977 three more Islamic banks were incorporated, namely Faisal Islamic Bank of Egypt, Faisal Islamic Bank of Sudan, and Kuwait Finance House. Islamic Banks set up in the 1970-1980s are as shown in following table.\(^{51}\)

Table 1.2: Islamic Banks Set Up in the 1970s and 1980s

<table>
<thead>
<tr>
<th>Name</th>
<th>Country</th>
<th>Date of Establishment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nasser Social Bank</td>
<td>Egypt</td>
<td>1972</td>
</tr>
<tr>
<td>Islamic Development Bank</td>
<td>Saudi Arabia</td>
<td>1975</td>
</tr>
<tr>
<td>Dubai Islamic Bank</td>
<td>United Arab Emirate</td>
<td>1975</td>
</tr>
<tr>
<td>Faisal Islamic Bank of Egypt</td>
<td>Egypt</td>
<td>1977</td>
</tr>
<tr>
<td>Faisal Islamic Bank of Sudan</td>
<td>Sudan</td>
<td>1977</td>
</tr>
<tr>
<td>Kuwait Finance House</td>
<td>Kuwait</td>
<td>1977</td>
</tr>
<tr>
<td>Islamic Banking System</td>
<td>Luxembourg</td>
<td>1978</td>
</tr>
<tr>
<td>Jordan Islamic Bank</td>
<td>Jordan</td>
<td>1978</td>
</tr>
<tr>
<td>Bahrain Islamic Bank</td>
<td>Bahrain</td>
<td>1979</td>
</tr>
<tr>
<td>Dar al-Mal al-Islami</td>
<td>Egypt</td>
<td>1981</td>
</tr>
<tr>
<td>Bahrain Islamic Inv.Company</td>
<td>Bahrain</td>
<td>1981</td>
</tr>
<tr>
<td>Islamic International Bank for Investment &amp; Development</td>
<td>Egypt</td>
<td>1981</td>
</tr>
<tr>
<td>Islamic Investment House</td>
<td>Jordan</td>
<td>1981</td>
</tr>
<tr>
<td>Al-Baraka Investment and Development company</td>
<td>Saudi Arabia</td>
<td>1982</td>
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<tr>
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<td>West Sudan Islamic Bank</td>
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<td>Al Rajhi Company for Currency Exchange&amp; Commerce</td>
<td>Saudi Arabia</td>
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<td>Al-Ameen Islamic &amp; Financial Investment Corp. India Ltd.</td>
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\(^{51}\) Sudin Haron and Wan Nur Fiza Wan Azmi, No.3, P.55.
Another organization as an impetus for the establishment and promotion of Islamic Banking is "The International Association of Islamic Banks". This organization was established on 20th August 1977 by the OIC in Jeddah, Saudi Arabia. Currently there are 35 Islamic banks which have subscribed as full members.\(^{52}\)

Dr. Ahmad Mohamed Ali, President of the Islamic Development Bank has divided the development of Islamic Banks into many phases. The first phase which set up in the 1950s as the starting point, during this period Islamic scholars began giving their views on concepts of Islamic Banking to replace conventional banking systems. The 1960s saw the emergence of early institution of Islamic banks as Mit Ghamr Saving Bank in Egypt in 1963 and Lembaga Tabung Haji in Malaysia in 1966. The period of the 1980s was the most significant phase in terms of the Development of Islamic Banking system. During this decade, many banks were established and new products emerged. Conventional banks also showed interest in providing Islamic Banking service through the window concept. The 1990s witnessed the development of Islamic Banking in the American capital market, where the Dow Jones Islamic Index was launched.\(^{53}\)

This modern era was the most significant period in the history of development of Islamic bank industry. During this period, it matured in a viable alternative model of financial intermediation. It achieved respect and credibility both theoretical development and practical experiences. On the one hand, several financial products compatible with the Shari'ah were developed and, on other hand, Islamic Banks showed good results while using these products.\(^{54}\)

\(^{52}\)Sudin Haron and Bala Shanmugam, No.15, p.11.
\(^{53}\)Sudin Haron and Wan Nurulzah Wan Azmi, No.3, P.58.
\(^{54}\)Munawar Iqbal and Philip Molyneux, No.12, p.37.
One of the most important contributions made by this bank to Islamic banking history was that it proved to the Muslim community that there was an alternative to the conventional banking system.55

1.2 Objectives of the Study: The principle objectives of the study are as under:

1. To study the historical background and the development of Islamic Banking which were attempted during the last fifty years or so.

2. To understand the issues involving in Islamic financial instruments in Islamic banking which were essentially adopted to eliminate interest in accordance with Al-Quran, Al-Hadith and Islamic Jurisprudence in Islamic banking.

3. To analyze the progress, development and structure of Islamic Banking of Saudi Arabia as well as the evolution of Islamic Banking since the creation of the Kingdom.

55Sudin Haron and Bala Shanmugam, No.15, p.6.
4. To examine the evolution and development of Islamic Banking of Thailand as well as planning to administer the organizations and opportunities to expand in future.

5. To critically study and analyze both the structure and planning between Islamic Banking of Saudi Arabia and Thailand particularly relating to operating systems between them.

1.3 Hypotheses

1. Islamic Banking operates in accordance with the rules of Shari’ah (Principle of Islamic Jurisprudence) although in each country, it has distinguished operational system.

2. Islamic Banking utilizes various Islamic Financing Instruments; its potential to encourage the economic growth of a country without based on interest.

3. Islamic Banking can take place in Non-Muslim countries also.

4. Islamic Banking of Thailand has opportunities to achieve and to expand the branches all around the country.

5. Islamic Banking system of Thailand is quite different from Islamic Banking system of Saudi Arabia by comparison.

1.4 Methodology (Sources of data) and Scope:

It is a historical -cum- analytical study which is essentially based on secondary sources of data and information which is collected from different sources and publications. Various yearly and monthly official and semi-official publications providing information on the feature program and development of Islamic banking of Saudi Arabia and Thailand have been consulted to examine the objectives of the study. Several statistical tools relevant for the study have been employed to analyze the different issues and testing of hypothesis.

Broadly speaking the sources can be classified under two heads:
1. National source:

Saudi Arabia: This particularly includes government publications namely Saudi Arabian Monetary Agencies (SAMA), Ministry of finance and National Economy, Banking and Financial Service of Saudi Arabia, Saudi Arabia Investment Bank etc.

Thailand: It consists of different publications of Central Bank of Thailand, Islamic Bank of Thailand, Ministry of Finance, The Stock Exchange of Thailand, and Officer of the Securities and Exchange Commission etc.

2. International Sources:

It comprises of Islamic Development Bank (IDB), Islamic Research and Training Institution (IRTI), Islamic Banking and Finance Institution of Malaysia (IBFIM), Dar Al-Mal Al-Islam Trust etc.

1.5 Significance and Limitations of the Study

The scope and significance of the study is limited. The proposed study would focus on both the operational system between Saudi Arabia and Thailand and its important role as a crucial contributor to drive alternative ways for Muslims to provide Islamic financial instruments between both the countries, which assisted the Muslims to eliminate interest from their financial dealings in accordance with Shari'ah. Furthermore, the study specially emphasizes on the different structure of the growth and development between two countries because it has been identified as significant information for this study.

1.6 Literature Review

1. Review of Theory

1.1 Quranic Verses Related to Islamic Banking Practices

The methodology of the Shari’ah in dealing with 'ibadat (devotional acts) and 'mu a malat (transactions) is somewhat different in character. A thorough study of the Quran and
the Sunnah on this subject reveals that 'ibadat have been dealt with in detail, while mu a
malat have been discussed in general terms. The wisdom appears to be that ibadat are held to
be universal truths that are unaffected by time and space. They are not subject to
modification or change by means of ijithad or otherwise. The muamalat are matters
pertaining to individuals interacting amongst themselves. The variety of this interaction is
neither foreseeable nor capable of being complied with by a regime of fixed rules. They are
also changeable in different era of time within various geographical entities. (Dr.
Muhammad Tahir Mansuri, 2010, p.3.)

Shari'ah ordains that a creditor's demand for any increase on capital over or above
the principal in lieu of time, as a condition for extending credit, is Riba or interest, and
strictly prohibited. The prohibition of interest is absolute; it does not matter whether the
stipulate increase on capital is high or low simple or compound, taken for personal or
private, productive or consumption purpose. The rulings on the prohibition of interest are
mentioned in holy Quran and also well-proven from the Prophet Mohammad (PBUH)'s
traditions. (M. Mansoor Khan and M. Ishaq Bhatti 2008, p.20.)

The word Riba or its variant has been used in numerous versus of Al-Quran. There is,
however, a complete consensus among Muslim jurists that only in the following eight verses
of Quran; this word has been used in its economic sense:

"And from the Riba-based giving (investment), you think as if your wealth
is increasing at the cost of others (borrowers), but in the sight of Allah (from
overall perspective), it is not increasing. On the other hand, when you give
something in charity to please Allah, then your wealth is increasing (in the
sight of Allah)". (Al-Room 30:39)

"Due to the tyranny of those who entered the Jewish religion we have
banned them from good things that had been lawful to them; and due to their
dissuasion from the religion of God and taking usury which is banned to
them and by reason of eating the monies of people though illicitness we
have prepared for the renegade atheist among them painful suffering". (Surat
An Nisa, Verse 159-160)

The Quran states:
"Believers! Do not consume Riba, doubling and redoubling and fear God so that you may prosper" (Aal-e-Imran 3:130)

"People who indulge in Riba shall be raised like those who have been driven to madness by the touch of Devil. That is because they say that a Riba-based transaction is just like trading, while God has permitted trade and prohibited Riba. Hence those who have received the admonition from their Lord and have desisted accordingly may have what has already passed, their case being entrusted to God; but those who revert to Riba-based dealings, shall be the inhabitants of the hell-fire and abide therein forever. (You must know that) God deprives Riba from all blessings and blesses charity; He loves not any ungrateful sinners’. (Al-Baqarah 2:275-6)

"Oh you (who claim to be) believers! Fear God and give up Riba that remains outstanding if you are true believers. Watch out! If you do not obey this commandment, then God declares war against you from Himself and from His Prophet. But, if you give up your outstanding Riba, then you can claim your principals. Neither should you inflict harm (due to Riba) to others, nor others should do harm to you’. (Al-Baqarah 2:278-79)

"God has made buying and selling lawful, and Riba unlawful” (2:274).

"Those who eat Riba (usury) will not stand except like the standing of a person beaten by shaitan (Satan) leading him to insanity. That is because they say: Trade is only like Riba (usury). Whereas, Allah has permitted trading and forbidden Riba (usury). Whosoever receives an admonition from his lord and stops eating Riba (usury) shall not be punished for the past; his case is for Allah (to Judge); but whoever returns to Riba, such are the dwellers of the fire they will abide therein”. (Al-Baqarah (2) verses 275-276 and 278-279)

"Those who traded misguidance for the right way; their trade suffered as loss and thus they strayed from the right path”. ( Surat Al-Baqara, Verse 16)

1.2 Riba in Hadith:

On the subject of Riba, there are numerous of hadith but it can be divided for purpose, under the following four titles:

1. Ahadith that reinforce the concept of Quranic Riba

1.1 The Prophet Muhammad (PBUH) said: "There is no Riba except in loaning.” (Nasnee 4504)

1.2 The Prophet Muhammad (PBUH) said: "Verily Riba is in loaning.” (Muslim 2991)
1. The Prophet Muhammad (PBUH) said: "There is no Riba in hand to hand (spot) transactions." (Muslim)

2. Ahadith that refer to Riba in barter trade

   2.1 Abu Sa'eed Khudri said that once companion Bilal (RA) brought to the Prophet Muhammad (PBUH) some good quality dates. The Prophet Muhammad (PBUH) inquired as to where he got those dates. Bilal (RA) replied that he had some low quality dates, which he had exchanged in 2:1 ratio for high quality ones in order to present the latter to the Prophet Muhammad (PBUH). Upon hearing this, the Prophet Muhammad (PBUH) said "Oh no! Oh no! That is Riba. That is exactly Riba. Do not do it again. If you want to do such an exchange, first sell your dates (for money or another commodity) and then buy other ones." (Bakhari 2145)

   2.2 The Prophet Muhammad (PBUH) said: "While exchanging gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates and salt for salt, exchange like for like (in equal measure) and exchange at spot. Whosoever paid more than what he received or demanded more than what he gave, verily he dealt in Riba. Both the payee and the receiver are equal in violating the Law of God." (Muslim 2971)

   2.3 Two traders asked the Prophet Muhammad (PBUH) about their mutual barter trade. He said: "If it is at spot, it is all right. But, if it involves loaning then it is not permissible." (See Shafi 1996 p.90)

   2.4 The Prophet Muhammad (PBUH) said to companion Jabir b. Abdullah: "In a credit transaction, it is not permissible to take two animals for one. However, if it is a hand to hand (spot) transaction, such an exchange is acceptable." (Tirmizee)

3. Ahadith that refer to implicit Riba

   3.1 The Prophet Muhammad (PBUH) said: "When one of you grants a loan and the borrower offer him a dish, he should not accept it; and if the borrower offers him a Ride on an animal, he should not Ride, unless the two of them have been previously accustomed to exchanging such favors mutually." (Ibn-e-Majah 2423)

   3.2 The Prophet Muhammad (PBUH) said: "A loan from which some benefits accrue to the creditor is one of the many different forms of Riba." (Al-Bayhaqi)

4. Ahadith that talk about the general concept of Riba.

   4.1 The Prophet cursed all those who take Riba, who give Riba, who write a Riba contract and the two witnesses to a Riba contract. He further said: "They are all alike (in guilt)." (Muslim 2995)
4.2 The Prophet Muhammad (PBUH) said: "On the night of my ascendance to the Heavens, I came upon people whose tummies were as big as houses that were filled with snakes visible from outside. He asked Angel Gabriel as to who they were. Gabriel replied that they were the people who received Riba (in their lives)." (Ibn-e-Majah)

4.3 The Prophet Muhammad (PBUH) said: "Riba has 70 segments, the least serious being equivalent to the sin of a man who commits adultery with his own mother." (Ibn-e-Majah 2265)

4.4 The Prophet Muhammad (PBUH) said: "Deceiving of an uninformed entrant into a city market is Riba." (Kanz al-Ummal) The Prophet said: "The person who serves as an agent to bid up prices in open auctions is a cursed taker of Riba." (Kanz al-Ummal)

4.5 The Prophet Muhammad (PBUH) said: "In any society, when Riba becomes common, it causes hunger and poverty in it. And in any society, when bribery becomes common, it makes it depressed (as compared to other nations)." (See Shafii 1998 p.79)

2. Review of Related Studies

Banks provide financial inter-mediation, consultancy and agency services that are diversified with the passage of time. Services are different from goods because they are intangible as they cannot be seen, touched or felt; perishable as we are unable to store them; inseparable because they are attached with a service provider; and insubstantial due to heterogeneity (Parasu Raman et al. 1985; Hoffman and Bateson, 2002).

Hanson (2000) suggested that service quality shows the organization's ability to meet customers' desires and needs. So organization must improve their services to meet the customers' wants and requirements. It is found that customers' perception of service quality is very important for managers to compete in the market (Hoffman and Bateson, 2002).

Financial liberalization and deregulation has increased the competition among banks to attract potential customers. Every banker tries to provide superior services to keep satisfied customers. In Pakistan, emergence and growing popularity of Islamic Banking products raises competition among Islamic Banks. Islamic Banks have to face numerous challenges in the recent age. Firstly, they are competing with their peers and secondly they
have to cope with the conventional banks. Customer satisfaction is a set of feelings or outcome attached with customer's experience towards any product/service (Solomon, 1996).

Islamic banks are competing for more customers with each other besides stiff competition with conventional banks. There are several measures that were adopted by the researchers to assess the bank performance like profitability, liquidity, management performance, market share, sales volume, innovation, productivity, human resources, quality of goods and service etc. There are different qualitative and quantitative tools that are used to measure the bank performance. The measure of performance evaluation should be meaningful. It reflects management's clarity about organization's current situation and its viability to achieve its goals. It should be manageable as it can be handled easily based on simple calculations and manipulation of data. It must be measurable as it should be Comparative Study of Islamic Banking quantifiable and operational. It may be material, as it should provide material results of significant improvement (Ernst & Young, 1995).

Chapman et al. (1997) examined the influence of quality on the performance of an organization. The study measured the organizational performance using financial ratios such as earnings on share holders' funds, return on total assets and labor productivity ratio. It is found that there is a positive relationship between strategic quality indicators and financial performance parameters. It is reported that employees of domestic banks do not contribute towards profitability. But employees of foreign banks significantly contributed towards profitability (Arby, 2003).

Islamic Banks showed remarkable progress. It has captured a reasonable market share with excellent growth rate of 114% per annum. The increasing number and size of Islamic Banks is also a positive sign of development and success. There are six full-fledged Islamic Banks working in different cities of Pakistan and 13 conventional banks have started partial
Islamic banking practices by establishing a large number of branches exclusively engaged in Islamic banking practices (SBP, 2006)

Mishkin (2001) reported that banking and financial services are the integral part of services industry and its contribution is increasing with the passage of time. However, expansion of global and integrated banking sector has to face many challenges of legislation, technological and structural changes (Anguret al. 1999). The relationship between service quality and customer satisfaction is investigated by a number of researchers across the globe. It is concluded that there is strong association between dimensions of service quality and overall customer satisfaction (Anderson and Sullivan, 1993). It is found that the banking industry has a link between service quality and customer satisfaction (Avkiran, 1994). Islamic banking practices result a notable increase in the supply of loans. It is found that government intervention played an important role to manage funds besides other economic factors in the economy (Makiyan, 2003)

There are few studies available in the literature that investigated the relationship between service quality, customer satisfaction and bank performance. Banks are dominant players of financial market having multiple opportunities in the recent age. Islamic banking practices came with numerous benefits for individuals, organizations and society. It is suggested that service performance appraisal system of the organization should be improved in line with customer satisfaction in the banking sector (Kayis, Kim and Shin, 2003). Financial performance of banks and other financial institutions could be measured by using the conventional method of accounting as well as latest measures of risk and expected returns (Duncan and Elliott, 2004).

The expansion of the banking industry requires a study to assess service quality in relation to customers' satisfaction and its influence on bank performance. Islamic banks are striving to capture the maximum number of customers to compete with conventional banks
by providing a large number of products as an alternative for interest based products. In Pakistan, banks are providing a wide range of products and services and facing intensive competition to attract potential customers. It is reported that banking and financial services are the integral part of services industry and its contribution is increasing with the passage of time (Mishkin, 2001). However, expansion of global and integrated banking sector has to face many challenges of legislation, technological and structural changes (Angur et al. 1999).

Mohamed Ariff (1983), presented his views about Islamic banking in his article “Islamic banking”. He says that one of the main selling points of Islamic banking, at least in theory, is that, unlike conventional banking, it is concerned about the viability of the project and the profitability of the operation but not the size of the collateral. In many developing countries, of course, development banks are supposed to perform this function. Islamic Banks are expected to be more enterprising than their conventional counterparts. In practice, however, Islamic Banks have been concentrating on short-term trade finance which is the least risky.

Quraishi (1946) considered banking as a social service and government should support this area as supported to others. He was in favor of partnerships between banks and businessmen as an alternative because the bank could neither pay any interest to neither account holders nor charge any interest on loans advanced. Ahmad also spoke of possible partnership arrangements with the businessmen who seek capital from the banks. However, the partnership principle was left undefined, and it was not clear who would bear the loss if any. It was suggested that banks should cash bills of trade without charging interest, using the current account funds.

The principle of Mudarabah based on Shari’ah was invoked systematically by Uzair (1955). His principal contribution lay in suggesting Mudarabah as the main premise for
'interest less banking'. However, his argument that the bank should not make any capital investment with its own deposits rendered his analysis somewhat impractical.

Al-Arabi (1966) envisaged a banking system with Mudarabah as the main pivot. He was actually advancing the idea of a two-tier Mudarabah which would enable the bank to mobilize savings on a Mudarabah basis, allocating the funds so mobilized also on a Mudarabah basis.

Siddiqi thought that interest-free banking could operate successfully 'only in a country where interest is legally prohibited and any transaction based upon interest is declared a punishable offense' (1983b:13). He also thought it is important to have Islamic laws enforced before interest-free banking could operate well. This view has not gained acceptance, as demonstrated by the many Islamic Banks which operate profitably in 'hostile' environments, as noted earlier.

Chapra's scheme also contained proposals for loss-compensating reserves and loss-absorbing insurance facilities. He also spoke of non-bank financial institutions, which specialize in bringing financiers and entrepreneurs together and act as investment trusts. (Chapra 1982).

Mohsin (1982) has presented a detailed and elaborate framework of Islamic Banking in a modern setting. His model incorporates the characteristics of commercial, merchant, and development banks, blending them in novel fashion. It adds various non-banking services such as trust business, factoring, real estate, and consultancy, as though interest-free banks could not survive by banking business alone.

Uzair (1982) that the central bank should acquire an equity stake in commercial banking by holding, say, 25 per cent of the capital stock of the commercial banks. The rationale behind this proposal was that it would give the central bank access to a permanent source of income so that it could effectively act as lender of last resort.
Ahmad Kaleem and Mansor Md. Isa provide evidence in their article (Causal relationship between Islamic and conventional Banking instruments in Malaysia) that the conventional TDRs (term deposit return) cause Islamic TDRs in all categories. Their results also find significant competition between Islamic and conventional TDRs series in case of finance companies and merchant banks. Overall results conclude that Islamic Banking considers interest rates before adjusting its deposits returns.

Gatibor (2001) argued that Islamic jurists are only concerned that the element of risk should not be excluded from the financial transactions. Otherwise, it would no longer be one of business and trade, but of usury. Gatibor further argued that the profits would have accrued from one year to another according to the performance of the bank, not according to changes in interest rates.

A study made by Erol and El-Bdour (1989) indicated that Muslims patronize Islamic Banks not specifically because of the religious factor, but more because of the returns they would receive from their investments. Depositors in Islamic 33 countries also did not differentiate between the services offered by the conventional banks and the Islamic Banks. They remarked that since religion is no longer the main factor in attracting depositors, Islamic Banks should recognize that how the customers view their products and services. They should offer quality of service and products compatible with those offered by the commercial banks.

In Malaysia, Radiah (1993) observed that there are two main types of depositors among local Muslims. The first group represents those who strictly follow the religion in life and want to stick with Islamic Banking at any cost. The second group consists of moderate Muslims. They give more priority to service quality and time value of their savings.

Metawa and Al mossawi (1997) who surveyed Islamic Banks in Bahrain founded that religious beliefs are the basic reason for depositing money, followed by the rates of return
and the bank’s location. Haron and Noraffifah (2000) observed that in 1984, the Kuwait Finance House did not distribute profits at all. Surprisingly there was no incident of any serious withdrawal of money.

Haron and Noraffifah (2000) analyzed the relationship between total Islamic deposits and rate of returns offered under Islamic and conventional banking schemes in Malaysia. They used the “Adaptive Expectation Model” and covered the period from January 1984 to December 1999 on a monthly basis. Their findings showed negative relationships between the interest rates and total interest free deposits. They observed that Islamic savings and investment accounts holders are highly influenced by the profit motive.

Gillian Rice and Essam Mahmoud indicated in their article (Integrating Quality Management, Creativity and Innovation in Islamic Banks) that an important key to the growth of customer capital in the Islamic financial industry is knowledge-based management as well as a focus on the innovation of services and customer-related processes that are less easily imitated. The lack of knowledge has also contributed to a weak relationship, in most instances, between Islamic Banks and their central banks. This is partly due to the inability of the newly appointed personnel of Islamic Banks to explain adequately the special characteristics of their transactions to central bank staff.

Knowledge, an essential basis for innovation, is created only by individuals. An organization cannot create knowledge by itself. An organization learns by the learning of its members and by ingesting new members who have knowledge, which the organization previously did not have (Simon, 1991). A problem exists in Islamic Banks because of insufficient training of their personnel (Kahf, 1999).

Samad and Hassan (1999) apply financial ratio analysis to see the performance of a Malaysian Islamic Bank over the period 1984-1997 and generally find that bankers’ lack of knowledge was the main reason for slow growth of loans under profit sharing. A bank in the
paper was found to perform better than conventional banks in terms of liquidity and risk measurement (less risky).

Haron et al. (1994) sought to establish the selection criteria used by Muslim customers in Malaysia when selecting their banks. The three most important criteria perceived by Muslims in Malaysia were the provision of a fast and efficient service, the speed of transaction, and friendly bank personnel.

Another important contribution from this study was the potentiality of individual customers in patronizing an Islamic Bank when they had knowledge of this new system. 80 per cent of Muslim and 53 percent of non-Muslim respondents indicated that they would consider establishing a relationship with an Islamic bank if they had substantial understanding of its operations.

Nasser, Jamal, and Al-Khatib (1999), surveying 206 bank customers in Jordan, added a bank’s reputation and perceived level of confidentiality to this list of selection criteria noted in the Haron et al (1994) study. Again, as in the earlier case, the researchers noted a high level of ignorance regarding specific Islamic products, with 70% of the respondents stating that religion was a very important reason for them to select an Islamic Bank.

Similarly, Gerrard and Cunningham (1997) found no difference between Muslims and non-Muslims on bank selection criteria. They do note, however, that nearly 25% of the respondents indicated that religion was the sole basis for choosing an Islamic Bank. These primary findings are in contrast to Metawa and Al mossawi (1998) who interviewed 100 Islamic Bank customers in Bahrain and found that the single most important factor for the selection of an Islamic Bank is the Shari‘ah-based principles that govern these financial institutions.

The results of Humayon A. Dar estimation shows that four factors, namely education, occupation, location and income are significant determinants of demand for Islamic financial
services. Other factors like age, gender, ethnicity and marital status are not statistically significant.

1.7 Plan of the Study

In order to achieve the objectives of study, it has been divided into several chapters, each dealing with a specific aspect. The chapter scheme is as under:

Chapter 1: Introduction: Historical Background

It introduces the topic of research in a proper perspective and focuses on a brief history of Islamic Banking, general background and related issues. It underlines the general important aspects of history and evolution of Islamic Banking system from early Islamic period to Modern Islamic Banking era. In a chronological order it also outlines the main objectives and the methodology employed to pursue and test the hypotheses stated therein. In brief this chapter provides an overview of the subject and sets the tone for further analysis and investigation.

Chapter 2: The Concept and Functioning of Islamic Banking System

The main focus of this chapter would be to deal with the Concept of Islamic Banking comprising the Definition, Theory, Model Type, Objective, Strategy Function, Business Practice, Stabilities, Efficiency, Finance Structure, Prospect, Feasibility, Challenges and Main problems of Islamic Banking as well as distinguishing features of Islamic Banks and Conventional Banks for in depth examination in the subsequent chapters.

Chapter 3: the Islamic Financial Transactions

This chapter is basically devoted to the review of various Shari’ah Compliant of Financial Instrument with conformity to principles of Islamic jurisprudence such as Mudarabah, Murabahah, Musharakah, Istisna, Takaful, Ijarah, Qarz-e-Hashanah, Bai-al-Salam, Bai-al-Muajjal etc. as well as various aspects of Islamic Shari’ah and several aspects of controversy among Modern Ulama (Jurisprudents) in the Arab World.
Chapter 4: Islamic Banking of Saudi Arabia

This chapter would examine in some depth the evolution and historical background of Islamic Banking in Saudi Arabia as well as its structure. It would also deal with the Regulatory Framework of Islamic Banking in Saudi Arabia such as The Saudi Arabian Monetary Agency, The Capital Markets Authority, factors behind the expansion of Islamic Banking etc. The evolution of Islamic financial products, the implementation of Shari’ah in the retail banking Industry, the Stock Market shall also be analyzed for a comprehensive understanding of the banking system in the country.

Chapter 5: Islamic Banking of Thailand

This chapter would mostly deal with characteristics of the Islamic Banking of Thailand. What are the objectives and purposes of the bank as well as the structure and plan process in Islamic Banking in Thailand, and it would also study the opportunities to expand the branches all around the country as well as developing plans of Islamic Banking in the near future.

Chapter 6: Islamic Banking Systems of Saudi Arabia and Thailand: A comparison

This chapter would deal with a comparison of performance between Saudi and Thailand in Islamic Banking with various details in several aspects of Islamic Banking in both countries such as geography and climate, population and language, government, currency and foreign exchange regulations, economic aspects, inception of banking, Central Bank, banking structure, commercial banks, Islamic Bank, objectives of Islamic Bank, shareholders, capitals, customers target and officer, financial instruments practiced, the similarities and differences in Islamic financial instrument, distinguishing products of Saudi Arabia, network Branches, financial performances and financial statement analysis.
Chapter 7 Summary and Conclusion

This chapter would give a concise picture of the study by summarizing the main findings of the study and drawing conclusions for policy implications in order to assess the effectiveness between Islamic Banking of Saudi Arabia and Thailand. It also deals with the relationship between the two countries for coordination and success of the banking system which is still evolving.