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ISLAMIC BANKING: A RAPIDLY GROWING INDUSTRY IN PAKISTAN

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ABSTRACT

Pakistan is a Muslim country but its financial and banking system is working on conventional basis since its independence in 1947. Several attempts have been made in 1950s and 1980s to convert this system into Islamic, but failed due to several political and administrative reasons. Finally, Supreme Court of Pakistan and Federal *Sharia'h* Court ordered Federal Government in 1992 to convert whole banking system into Islamic. Meezan Bank was established in 2002 as first full-fledged Islamic bank in the country. After this, several Islamic banks along with Islamic banking divisions and Islamic banking windows of conventional banks were established. The objective of this study is to investigate the reasons of rapid growth of Islamic Banking Industry in Pakistan. For this purpose, statistical data was obtained from Islamic Banking Bulletin, State Bank of Pakistan which shows that by the end of December 2017, there are 5 full-fledged Islamic banks working in the country with a branch network of 1,275 branches. Similarly, 16 conventional banks are also offering Islamic banking services through their 1,178 branches which are offering only Islamic Banking services. Many banks have also established 128 sub-branches and 1,277 windows, offering Islamic banking services. Therefore, total Islamic banking branch network in Pakistan is 2,581. Financially, Islamic banking industry is growing rapidly by having total assets of Pak Rupees 2,272 Billion and total deposits of Pak Rupees 1,885 Billion. Within a short period of 15 years, Islamic banking industry has achieved a growth rate of 15 to 20 percent and captured 12.4% share in total assets and 14.5% share in total deposits of overall banking industry of the country (SBP). In the light of the facts, it can be concluded that at present, Islamic banking industry is achieving extraordinary and rapid growth and it has potential to grow further in Pakistan.
KEYWORDS: Islamic banking industry, growth, Pakistan

1. INTRODUCTION

Banking plays vital role in the economy of any country. Since Pakistan is a developing country, the importance of banking system is being recognized as a key factor of economic development. Conventional banking system has been established in the country right from its independence in 1947 which means that this system has very deep roots in the economy. During last 71 years, conventional banking system got tremendous strength and today, 46 conventional banks and financial institutions are providing banking services in the country. These include 5 public sector banks, 2 specialized banks, 16 private sector banks, 5 foreign banks, 8 development finance institutions (DFIs) and 10 microfinance banks. These banks and financial institutions are providing services from consumer financing at individual level to project financing at macro level. This study is an attempt to investigate the growth and development of Islamic banking industry in Pakistan from the time period of December 2013 to December 2017 (4 Years). For this purpose, financial and relevant data was collected from reliable sources including State Bank of Pakistan (SBP) for the specified time period. This data is evaluated on the basis of real time growth and development of Islamic banking industry in Pakistan.

1.1 Islamic Banking industry in Pakistan

Article 38(f) of the Constitution of Pakistan says *"interest shall be eliminated from country as early as possible"*. In the light of this article, Islamic banking system in Pakistan has been officially started in 1980, when State Bank of Pakistan has made certain changes in the rules and regulations of banking ordinance in the light of the guidelines provided by Islamic Ideology Council. According to these rules and regulations, all conventional banks introduced profit and loss based accounts from July 1985. This system could not succeed because a majority of the Muslim bank consumers did not accept it as Islamic way of banking. Supreme Court of Pakistan and Sharia'h Court have given their decisions in 1992 to convert whole banking system into Islamic. After 10 years of these decisions, very first full-fledged Islamic bank was established in the country in 2002. Till then, there are 5 full-fledged Islamic banks working in the country, providing Islamic banking products and services. Similarly, there are 16 other conventional banks which have also been started Islamic banking through their dedicated Islamic banking branches or Islamic banking windows. Since its establishment, Islamic banking is flourishing and expanding its network throughout the country. Majority of Muslim banking consumers are switching from conventional banking to Islamic banking with the satisfaction that Islamic banks are providing *Sharia'h* compliant banking products.

Table 1: Industry Progress and market share (Pak Rupees in Billions)

	Industry Progress			Growth			Share in Industry		
	Dec-13	**Dec-15**	**Dec-17**	**Dec-13**	**Dec-15**	**Dec-17**	**Dec-13**	**Dec-15**	**Dec-17**
Total Assets	1014	1610	2272	21.2%	27.9%	22.6%	9.6%	11.4%	12.4%
Deposits	868	1375	1885	22.8%	28.5%	19.8%	10.4%	13.2%	14.5%
Total Islamic Banking Institutions	19	22	21	_	_	_	_	_	_
Total No. of Branches	1304	2075	2581	_	_	_	_	_	_

Table 1 shows the industry progress and market share by Islamic banking industry in Pakistan. During the time period from December 2013 to December 2015, assets of the Islamic banking industry increased from Pak Rupees 1,014 billion to Pak Rupees 1,610 billion which is a remarkable increase in a short time period of 2 years. Further, it increased from Pak Rupees 1,610 billion in December 2015 to Pak Rupees 2,272 billion in December 2017 with an extraordinary growth rate of 22.6%. Deposits of the Islamic banking industry also increased remarkably from Pak Rupees 868 billion in December 2013 to Pak Rupees 1,375 billion in December 2015 and to Pak Rupees 1,885 billion in December 2017. In terms of market share, assets of Islamic banking industry increased from 9.6% in December 2013 to 11.4% in December 2015 and to 12.4% in December 2017. On the other hand, market share of Islamic banking industry's deposits in overall banking industry increased from 10.4% in December 2013 to 13.2% in December 2015 and to 14.5% in December 2017. These results show the confidence and trust of the consumers of Islamic banking industry in Pakistan.

Table 2: Province Wise Branch Network

	Dec-13		Dec-15		Dec-17	
Province	**Total**	**% Share**	**Total**	**% Share**	**Total**	**% Share**
Punjab	569	43.6%	987	47.6%	1234	47.8%
Sindh	438	33.6%	642	30.9%	750	29.1%
Khyber Pakhtoonkhawa	147	11.3%	219	10.6%	296	11.5%
Baluchistan	55	4.2%	80	3.9%	106	4.1%
Gilgit Baltistan	5	0.4%	8	0.4%	12	0.5%
FATA	4	0.3%	7	0.3%	9	0.3%
Federal Capital	71	5.4%	104	5.0%	134	5.2%
AJK	15	1.2%	28	1.3%	40	1.5%
Total	**1,304**	**100%**	**2,075**	**100%**	**2,581**	**100%**

Islamic banks are gradually increasing their branch network to provide better services to the consumers. There were 19 Islamic banking institutions in December 2013 which increased to 22 in December 2015 and then decreased to 21 in December 2017 due to the reason that Burj Bank Limited was merged into Al-Baraka Bank (Pakistan) Limited. Similarly, total branch network of Islamic banks was 1,034 in December 2013 which increased to 2,075 in December 2015 and 2,581 in December 2017 which is a remarkable increase in overall branch network. Table 2 shows the province wise branch network in the country. As Punjab is the largest populated province of Pakistan, it has the largest branch network of Islamic banks. Sindh, being the second populated province has the second largest branch network. However, with more than 76.9 percent concentration of Islamic banking branch network in two provinces (Punjab and Sindh) and 53 percent concentration in 5 big cities (Karachi, Lahore, Quetta, Peshawar and Islamabad), smaller provinces in conjunction with second and third tier cities still remain under served.

Table 3: Investments (Pak Rupees in Billions)

	Dec-13	**Dec-15**	**Dec-17**
Federal government securities	266.7	307.4	-
Fully paid up ordinary shares	4.3	12.0	-
TFCs, Debentures & Bonds	34.0	56.7	-
Other investments	90.9	62.5	-
(Surplus) /deficit on revaluation	(2.7)	(6.7)	-
Net Investments	**393.2**	**431.9**	**534.0**

Table 3 shows the investments by Islamic banks in Pakistan which increased from Pak Rupees 393.2 billion in December 2013 to 431.9 billion in December 2015. This increase was due to huge increase in “Federal government securities” and increase in “fully paid up ordinary shares, Term Finance Certificates (TFCs), debentures & bonds and other investments”. It further increased from Pak Rupees 431.9 billion in December 2015 to Pak Rupees 534.0 billion in December 2017 due to the increase in “Federal government securities, fully paid up ordinary shares, TFCs, debentures & bonds and other investments”. This increase was due to the continued growth and development of Islamic banking industry in Pakistan.

Table 4: Financing Mix (Pak Rupees in Billions)

Financing	**Dec-13**		**Dec-15**		**Dec-17**	
	Amount	**%**	**Amount**	**%**	**Amount**	**%**
Murabahah	134.2	40.6	158.1	24.5	159.0	13.2
Ijarah	25.4	7.7	42.5	6.6	77.0	6.4
Musharakah	22.0	6.7	90.1	14.0	266.0	22.0
Mudarabah	0.5	0.2	0.6	0.1	0.0	0.0
Diminishing Musharakah (DM)	101.8	30.8	204.5	31.7	371.0	30.7
Salam	13.3	4.0	34.1	5.3	34.0	2.8
Istisna	18.5	5.6	55.4	8.6	99.0	8.2
Qarz/Qarz-e-Hasna	0.0	0.0	0.0	0.0	0.0	0.0
Others	14.5	4.4	60.0	9.3	202.0	16.7
Total	**330.2**	**100.0**	**645.3**	**100.0**	**1,207.0**	**100.0**

Table 4 shows the financing mix by Islamic banks in Pakistan. Gross financing of the Islamic banking industry has been increased from Pak Rupees 330.2 billion in December 2013 to Pak Rupees 645.3 billion in December 2015 due to the increase in Murabahah, Musharakah and Diminishing Musharakah. Similarly, financing further increased from Pak Rupees 645.3 billion in December 2015 to Pak Rupees 1,207.0 billion in December 2017 which is an extraordinary increase. The reason for this is the increase in Murabahah, Ijarah, Musharakah, Salam, Istisna and huge increase in Diminishing Musharakah and others. Analysis of financing mix reveals that all financing heads including Murabahah, Ijarah, Musharakah, Diminishing Musharakah, Salam, Istisna and other forms of financing have been increased during this time period which shows the acceptability of Islamic banking products by the consumers in Pakistan.

Table 5: Client Wise Financing Portfolio (Share Percent)

	Dec-13	Dec-15	Dec-17
Corporate Sector	71.8%	74.4%	70.6%
SMEs	5.1%	3.1%	3.3%
Agriculture	0.1%	0.6%	0.5%
Consumer Finance	11.6%	10.0%	9.9%
Commodity Financing	9.6%	8.6%	13.9%
Staff Financing	1.6%	1.3%	-
Others	0.2%	2.0%	1.8%
Total	**100.0%**	**100.0%**	**100.0%**

Table 5 shows the percent share of client wise financing portfolio in the country. In line with the general trend, client category wise financing of Islamic Banking Industry remained concentrated in corporate sector, having a share of 71.8% in December 2013, 74.4% in December 2015 and 70.6% in December 2017. Financing in agriculture and others have constant growth in financing during the time period from December 2013 to December 2017 except minor decrease in some sectors. However, financing in commodity financing has mixed trend of increase and decrease during this time period. Whereas, financing in consumer finance and staff financing continuously decreased from December 2013 to December 2017.

Table 6: Financing Concentration - percent share

	Dec-13	Dec-15	Dec-17
Chemical and Pharmaceuticals	6.3%	7.7%	1.2%
Agribusiness	3.6%	5.8%	9.3%
Textile	19.1%	18.0%	13.0%
Cement	0.9%	1.8%	1.9%
Sugar	3.9%	3.4%	4.4%
Shoes and leather garments	0.9%	0.7%	0.4%
Automobile and transportation equipment	1.7%	1.5%	0.8%
Financial	0.7%	0.7%	0.8%
Insurance	0.0%	0.0%	0.0%
Electronics and electrical appliances	1.7%	1.9%	1.3%
Production and transmission of energy	8.9%	9.4%	16.4%
Individuals	13.3%	10.9%	11.0%
Others	38.9%	38.1%	36.5%
Total	**100.0%**	**100.0%**	**100.0%**

Table 6 shows the sector wise distribution of financing by Islamic banking industry in the country. Results reveal that the industry continued its concentration in the textile sector which is in line with that of overall banking industry. However, financing in this sector declined from 19.1% in December 2013 to 18.0% in December 2015 and to 13.0% in December 2017 but it captured the major portion of overall financing. Other sectors including chemical and pharmaceuticals, agribusiness, cement, sugar, automobile and transportation equipment, electronics and electrical appliances, production and transmission of energy and others have shown mixed trend of increase and decrease during the time period from December 2013 to December 2017. Sectors including shoes and leather garments and individuals showed continuous decrease in financing from Islamic banks during this time period. Whereas, financing in financial sector stood constant from December 2013 to December 2015 and then increased in December 2017. Islamic banking industry did not participated in insurance sector during this time period.

Table 7: Performance Indicators

	Dec-13	Dec-15	Dec-17
Assets Quality Ratio			
NPFs to Financing	5.7%	4.9%	3.0%
Net NPFs to Net Financing	1.5%	0.2%	0.5%
Provisions to NPFs	74.4%	95.6%	82.5%

Table 7 indicates that among asset quality indicators, NPFs to financing ratio decreased from 5.7% in December 2013 to 4.9% in December 2015 and to 3.0% in December 2017 which is a healthy trend in Islamic banking industry. However, provisions made by Islamic banking industry have increased from 74.4% in December 2013 to 95.6% in December 2015 but then decreased to 82.5% in December 2017 due to better financial performance by Islamic banks. All above mentioned performance indicators of Islamic banking industry are however still lower than overall industry ratios indicative of relatively better asset quality of Islamic banking industry.

Table 8: Break up of Deposits (Pak Rupees in Billions)

	Dec-13	Dec-15	Dec-17
Deposits	**867.7**	**1,375.0**	**1885.0**
Customers	**798.6**	**1,284.0**	**1763.0**
Fixed Deposits	261.2	345.0	373.0
Saving Deposits	314.4	534.0	733.0
Current accounts - Remunerative	2.3	6.0	9.0
Current accounts - Non-remunerative	217.1	393.0	632.0
Others	3.5	6.0	16.0
Financial Institutions	**69.1**	**91.0**	**122.0**
Remunerative Deposits	68.5	90.0	121.0
Non-remunerative Deposits	0.6	1.0	1.0

Table 8 shows an increase in Islamic banking industry's deposits from Pak Rupees 867.7 billion in December 2013 to Pak Rupees 1,375.0 billion in December 2015. It further increased from Pak Rupees 1,375.0 billion in December 2015 to Pak Rupees 1,885.0 billion in December 2017 which is a remarkable increase in Islamic banking industry in Pakistan. Likewise, share of Islamic banking industry's deposits in overall banking industry increased from 10.4% in December 2013 to 13.2% in December 2015. It further increased from 13.2% in December 2015 to 14.5% in December 2017 which is a remarkable growth of this industry. This increase in deposits was mainly due to the increase in customers' deposits during this time period. On the other hand, financial institutions' deposits with IBIs also increased from Pak Rupees 69.1 billion in December 2013 to Pak Rupees 91.0 billion in December 2015. It further increased to Pak Rupees 122.0 billion in December 2017 which shows the credibility of Islamic banking industry towards other financial institutions in the country. Further analysis of customers' deposits shows that fixed deposits and savings deposits registered positive growth which shows the level of trust by the customers of Islamic banking industry during the specified time period.

Table 9: Earning & Profitability

	Dec-13	Dec-15	Dec-17
Net Income to Total Assets (ROA)	0.9%	0.9%	1.1%
Return on Equity (ROE)	12.0%	13.3%	17.1%
Operating Expense to Gross Income	69.7%	70.0%	69.8%
Personnel Expense to Operating Expense	37.6%	40.3%	-

Table 9 shows the profitability of the Islamic banking industry which has recorded at Pak Rupees 9.4 billion (profit before tax) at the end of December 2013, Pak Rupees 12.3 billion (profit before tax) at the end of December 2015 and Pak Rupees 23.0 billion (profit before tax) in December 2017. It shows the remarkable performance of Islamic banking industry in Pakistan. Among indicators of earnings and profitability, return on assets (ROA) remained same from 0.9% in December 2013 to 0.9% in December 2015 but it increased to 1.1% in December 2017 which shows the strength in profitability. Similarly, return on equity (ROE) increased from 12.0% in December 2013 to 13.3% in December 2015 and then increased to 17.1% in December 2017 mainly due to the increase in non-performing financing of the Islamic banking industry. In line with general trend, Operating Expense to Gross Income and Personal Expenses to Operating Expenses of Islamic banking industry remained higher than that of overall banking industry.

2. CONCLUSION

Islamic banking industry in Pakistan is in its initial stage as it started in 2002. During last 15 years, Islamic banking industry showed extraordinary financial performance due to the reason that a vast majority of Muslim banking consumers shifted towards Islamic banks to avoid from *Riba*. The overall growth rate of this industry is 15 to 20 percent in the country (SBP). Right from the beginning, Islamic banking industry faced some problems from their giant competitors (conventional banks) and secondly, the unawareness of Islamic modes of financing by the consumers in large. Gradually, Islamic banking industry overcome these problems and made their own way to progress. Now, by having only 5 full-fledged Islamic banks, this industry is flourishing rapidly in the country. In the result, all conventional banks are also converting their banking towards Islamic slowly and gradually. Therefore, 16 conventional banks also started Islamic banking by establishing separate Islamic banking branches or by providing Islamic banking windows. This shows the success of this banking system in Pakistan. Similarly, the future of Islamic banking industry is very bright in this country. However, for this, Islamic banks have to struggle very hard, first to educate the consumers about the effectiveness of Islamic modes of financing and secondly, by introducing new and innovative Islamic banking products. Similarly, they have to increase their branch network as well so that a common consumer should have the access to Islamic banking services without any difficulty. As Government of Pakistan is also very determined to convert conventional banking system into Islamic, it is a golden opportunity for this industry to grow as much as possible in this country.

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GLOSSARY

SBP	State Bank of Pakistan
FATA	Federally Administered Tribal Areas
AJK	Azad Jammu & Kashmir
TFC	Term Finance Certificate
SME	Small and Medium Enterprises
NPF	Non-Performing Financing
NPA	Non-Performing Assets
FCY	Foreign Currency
IBI	Islamic Banking Institutions
ROA	Return on Assets
ROE	Return on Equity
Forex	Foreign Exchange
DFI	Development Finance Institutions

Currency conversion: (1 US$ = 140 Pak Rupees), as on 4 March 2019.