

A Review of Islamic Commercial and Social Finance in Pakistan



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Presentation Outline



- Islamic Banking in Pakistan
- Islamic Capital Markets in Pakistan
- Islamic Mutual Funds
- Islamic Microfinance in Pakistan
- Role of Redistributive Institutions: Zakat and Waqf
- Conclusion

Islamic Banking in Pakistan



- Section 38(f), 1973 constitution said: **Riba should be eliminated.**
- Council of Islamic Ideology in 1980 clearly defined Riba:

The term Riba encompasses interest in all its manifestations irrespective of whether it relates to loans for consumption purposes or for productive purposes, whether the loans are of a personal nature or of a commercial type, whether the borrower is a government, a private individual or a concern, and whether the rate of interest is low or high.

- Historic Judgment on Interest in 1991 by the Supreme Court of Pakistan settled the debate in academics and in legal sphere.

Islamic Banking in Pakistan



- The first phase of Islamic banking in Pakistan during the 1980s under the patronage of ex-President Mr. Zia-ul-Haq was not highly successful.
- However, with increased participation of Shari'ah scholars in the policy making, product design, audit and supervision, the second phase of Islamic banking since 2002 has seen impressive and consistent growth.
- Now, Islamic banking in Pakistan is an established industry with **11.7%** and **13.3%** market share in total banking assets and deposits respectively as at December 31, 2016.

Islamic Banking in Pakistan



- The market share of Islamic banking assets has grown from a meagre 0.5% in 2002 to **11.7%** in 2016.
- By year-end 2016, the total Islamic banking assets in Pakistan stood at **Rs. 1.85 trillion** (\$17.65 billion) while total Islamic banking deposits stood at **Rs. 1.57 trillion** (\$15 billion).
- With increased participation of conventional banks in Islamic banking industry, the branch network has swelled to **2,322 branches** by year-end 2016.

Islamic Banking in Pakistan



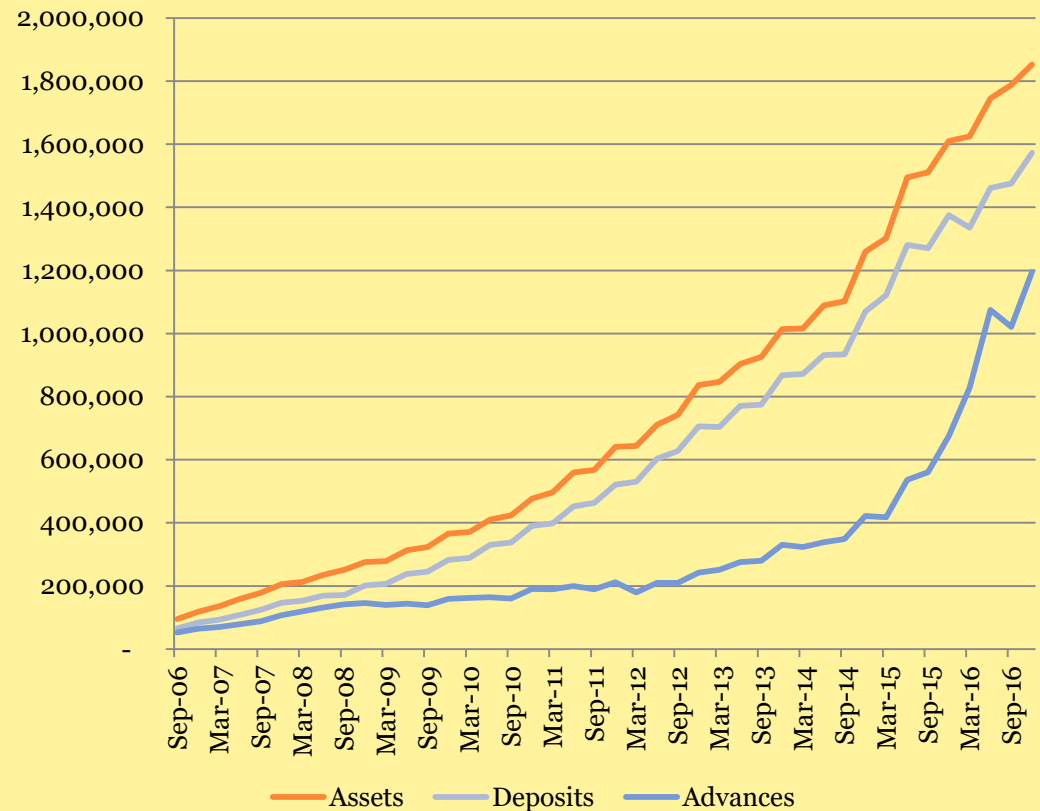
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Islamic Banking in Pakistan



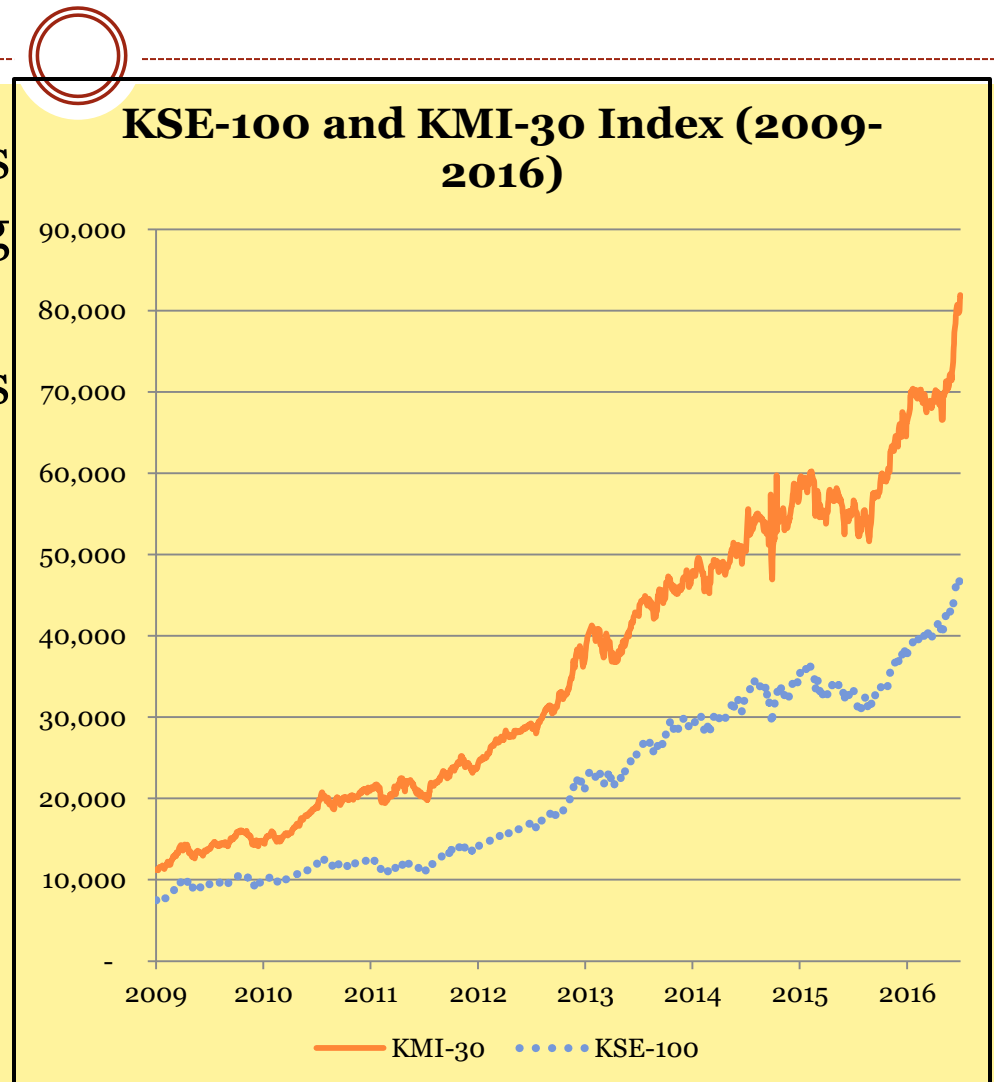
- CAGR for total assets has remained at 31.68% during 2006-16.
- CAGR for total advances has remained at 33.78% during 2006-16.
- CAGR for total deposits has remained at 34.08% during 2006-16.

**Islamic Banking Assets, Advances and Deposits
(2006-2016)**



Islamic Capital Market in Pakistan

- CAGR for KMI-30 index has remained at 29.01% during 2009-2016.
- Growth in individual years had been recorded at:
 - 2010 38.66%
 - 2011 5.59%
 - 2012 44.63%
 - 2013 45.68%
 - 2014 19.57%
 - 2015 9.60%
 - 2016 47.10%



Sukuk Market in Pakistan



- Sukuk investments are a Shari'ah compliant alternative to corporate and treasury bonds.
- Government of Pakistan had issued Ijarah Sukuk on numerous occasions in past.
- Public sector companies had also issued Sukuk in past. Sovereign Ijarah Sukuk allows the government to mobilize funds.
- Sukuk holders are also able to earn Shari'ah compliant income.
- It also facilitates Islamic banks to manage their liquidity.

Halal Stocks in Pakistan: Screening Criteria



- **Core Business:** Must be Halal.
- **Interest Based Leverage:** Must be less than 37% of total assets.
- **Interest Based Investments:** Must be less than 37% of total assets.
- **Non-Compliant Income:** Must be less than 5% of gross revenue.
- **Illiquid Assets:** Must exceed 25% of total assets.
- **Minimum Market Price:** Must be greater than net liquid assets per share.

Islamic Mutual Funds in Pakistan



Number of Funds

Fund Category	Islamic Funds	Conventional Funds
Equity Funds	16	24
Income Funds	15	28
Money Market	3	23
Aggressive Income	3	8
Asset allocation	8	14
Balanced	2	6
Capital Protected	2	3
Fund of Funds	31	9
Index Tracker	1	2
Commodities Funds	1	2

Market Share

Category	Conventional	Islamic
Aggressive Fixed Income	81.41%	18.59%
Asset Allocation	50.06%	49.94%
Balanced	48.21%	51.79%
Capital Protected	61.85%	38.15%
Commodities	53.34%	46.66%
Equity	65.88%	34.12%
Fund of Funds	6.84%	93.16%
Fund of Funds - CPPI	16.44%	83.56%
Income	76.75%	23.25%
Index Tracker	33.91%	66.09%
Money Market	89.35%	10.65%
Total	66.60%	33.40%

Islamic Mutual Funds in Pakistan



Assets under Management in Islamic Funds (in million Rs.)

Category	2011	2012	2013	2014	2015	2016
Equity	7,027	8,104	15,349	23,363	51,167	67,215
Income	20,888	29,944	36,414	36,783	21,028	29,692
Fund of Funds	-	-	699	927	3,269	23,679
Asset Allocation	1,264	1,120	870	1,116	4,784	10,818
Fund of Funds - CPPI	-	-	-	11,533	20,671	9,168
Money Market	6,353	7,762	7,088	5,189	13,483	5,920
Balanced	2,289	2,334	2,538	6,955	3,493	4,822
Aggressive Income	725	688	1,178	2,253	2,157	3,209
Capital Protected	724	443	1,304	2,972	3,015	1,771
Index Tracker	-	289	901	1,176	1,159	881
Commodities	-	-	-	-	-	321
Total	39,270	50,684	66,341	92,267	124,226	157,496

Islamic Microfinance in Pakistan



Overall Microfinance Outreach

- Islamic microfinance share in 2016:

- Active borrowers 15%.
- Loan portfolio 7%.

- Some operators include:

- Akhuwat
- Wasil Foundation
- Kashf Foundation
- Naymet Trust
- Muslim Aid Pakistan
- Islamic Relief Pakistan
- Kawish Welfare Trust
- Esaar Foundation.

Key Indicators - Province wise	Sindh	Punjab	Balochistan	KPK
Offices – Fixed	651	2,284	17	107
Offices – Mobile	26	14	2	-
Active Borrowers	904,892	3,449,902	5,577	97,239
Potential Microfinance Market	2,400,000	12,600,000	500,000	500,000
Penetration Rate (%)	37.7%	27.4%	1.1%	1.9%

Overall Microfinance Sector

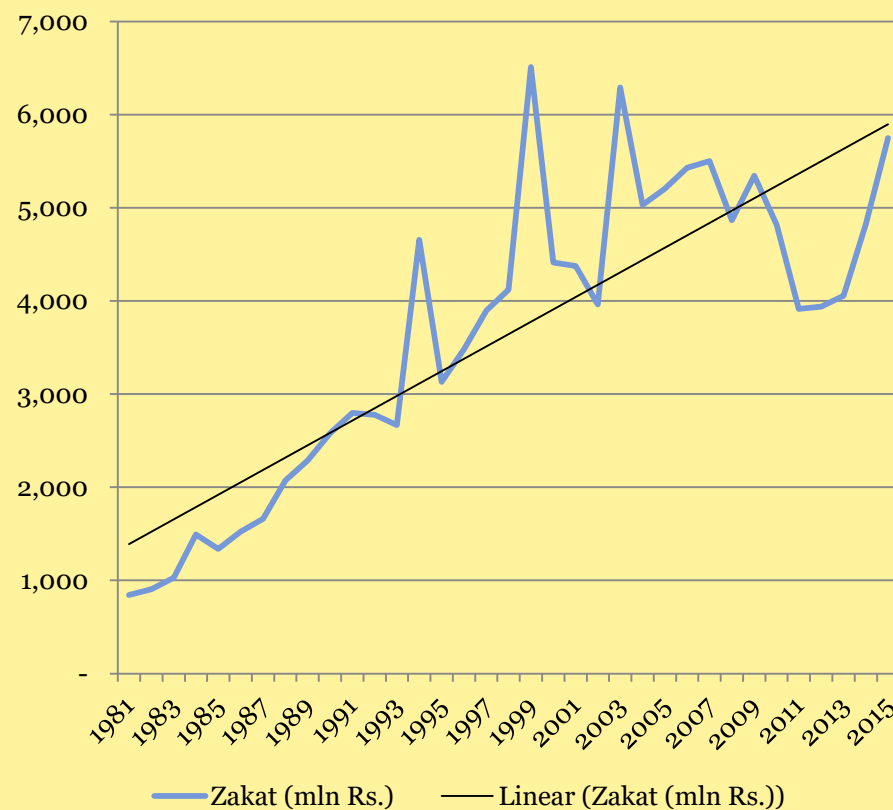
Key Indicators	2010	2011	2012	2013	2014	2015	2016
Number of Borrowers (million)	1.6	1.7	2.0	2.4	2.8	3.8	4.6
Gross Loan Portfolio (bln Rs.)	20.2	24.8	33.1	46.6	61.1	92.9	136.9
Active Women Borrowers	0.8	0.9	1.3	1.4	1.6	2.1	2.5
Branches	1,405	1,550	1,460	1,606	1,747	2,960	3,220

Role of Redistributive Institutions: Zakat

- People prefer to pay their *Zakāt* and *Sadqāt* individually.
- As per PCP, total estimated charitable giving in Pakistan is:
 - Overall Rs. 300 billion.
 - Sindh Rs 67.9 billion.
 - Punjab Rs. 103.69 billion.
- A recent estimate by Pakistan Peace Initiative (2017) contends that people in Pakistan pay around **Rs. 554 billion** in charity every year.



Zakat Collection by Government



Role of Redistributive Institutions: Waqf



- In Pakistan, *Waqf* is mostly used in establishing mosques, maintaining shrines and in some cases, Muslim graveyards.
- In Punjab, *Awqaf* Department maintains 1 hospital and 14 dispensaries. An amount of Rs. 28 million (\$270,000) per annum is spent on health care at Data Darbar Hospital, Lahore as well as in 14 Dispensaries where poor and needy patients are treated freely.
- Sindh Government owns 31 *Waqf* properties in the Sindh province.
- Corporate *Waqf* is uncommon, except for Hamdard Laboratories.
- Reason for the dormant *Waqf* sector owes to the negative effects of nationalization of public property during the 1970s.

Conclusion



- Market share of Islamic banking is 11.7% in banking assets.
- Market share of Islamic funds is 33.40% in mutual funds.
- Nonetheless, Islamic microfinance is yet to realize its true potential and promise despite high levels of poverty.
- Islamic redistributive institutions have potential, but their use and focus in policymaking is scant.
- Lack of trust between public and government has resulted in very limited mobilization of *Zakāt* funds through the official government agencies in Pakistan.
- In addition, nationalization in 1970s and non-standardization of rules has resulted in lower interest in the institution of *Waqf*.

Recommendations



- Islamic banks must facilitate easy opening of bank accounts for students, housewives, self-employed technicians, small entrepreneurs and tutors to increase their outreach among the general masses.
- Sustained growth in branchless banking is required to allow more outreach and to avoid the scale disadvantage in underprivileged areas.
- Since agriculture provides employment to more than one-third of the people in labor force, Islamic banks need to focus on this critical sector and raise their financing share to agriculture from a meagre level of 1.4% of their total financing mix.

Recommendations



- Government should give tax incentives for corporations to go towards Sukuk issuance.
- In addition, if the government will issue more domestic sovereign Sukuk, it will enable the Islamic income funds to have safer Shari'ah compliant investments in place of high-yielding interest based treasury bills.
- There is considerable need for enhancing the scale of Islamic redistributive institutions and creating synergies. There is strong basis of complementarity if these institutions are integrated with each other to provide financial as well as support services in the area of human capital development.



Thank You

Questions & Feedback

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