

Consumers' Acceptance on Islamic Home Financing: Empirical Evidence on *Bai Bithaman Ajil* (BBA) in Malaysia

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Abstract

Bai Bithaman Ajil (BBA) is the most predominant mode of home financing in Malaysia since the introduction of Islamic banking in 1983. BBA is a deferred installment sale where bank capitalizes its profit up front in the sale of property. The concept is similar to debt financing which is often resulted in high cost. BBA as practiced in Malaysia is seen not to be in compliant with the *Shariah* principle as the bank does not take the risk of ownership and liability on the property. Given the controversial features of BBA, it is anticipated that there is high level of dissatisfaction among the present and potential BBA customers including Muslim and the Non-Muslim. Based on a survey of 300 owners and potential house owners, there is high level of dissatisfaction among the customers as evidenced by their low intention to use BBA. Muslim customers in general are concerned about the features of BBA notably its compliance with *Shariah* as well as its inability to fulfill the broad objective of justice, equality and societal well being. The Non-Muslim customers however seem to have greater beliefs in BBA and its ability to fulfill socially desirable objectives. The discontent feelings signal the urgent need by the bankers to come up with alternatives of Islamic home financing product. *Musharakah Mutanaqisah* or the Diminishing Partnership concept has been proposed to replace BBA for its esteemed features.

Key words: Islamic home financing, Bai Bithaman Ajil, consumers' acceptance, Diminishing Partnership, empirical evidence.

1.0 Background of study

The Islamic Banking and Finance growth in Malaysia is very encouraging. The central bank of Malaysia or Bank Negara Malaysia (BNM) has set a target of 20% of all deposits and financing in the banking industry to be under Islamic Banking by 2010. As of June 2006, the assets of Islamic banking in Malaysia were RM 143 billion or 12% of the total assets of the banking industry. Islamic banking deposit amounted to RM 107.5 billion while its share of financing was RM 81.5 billion (representing 12.8 % of the total banking deposits and 13.3 % of the total financing respectively as at 30th June 2006).¹ The assets of Islamic banking continue to develop at a double digit growth of 18% in the recent five years. The Islamic *sukuk* market has now exceeded RM120 billion and represents the largest Islamic bond market in the world.²

The predominant concept for Islamic home financing currently in Malaysia is *Bai Bithaman Ajil* (BBA). It has been practiced by almost all financial institutions in this country since it was implemented by Bank Islam Malaysia Berhad (BIMB) in 1983. The BBA is a deferred installment sale whereby bank capitalizes its profit up front in the sale of the property to the customer who in turn is required to pay a fixed sum until the tenure ends. It is similar to debt financing, which results in high cost and poses a burden to one's family obligation. The BBA practiced in Malaysia is seen not to be in compliance with the *Shariah* principle as the bank does not take the risk of ownership and liability on the property Rosly (2005) Sanusi (2006) and thus not acceptable by international scholars.

In addition, BBA is dependent on market interest rate as its bench mark. This causes problem in product pricing and marketing for Islamic home financing as when the market interest rate is low, the amount financed will be more expensive than the conventional loan. Thus, customers may withdraw from Islamic banks and transfer its facility to conventional loan. Consequently, when the market interest rate is higher than BBA profit rate, Islamic banks suffer losses as it cannot increase the profit rate in BBA due to its fixed selling price.

Siddiqi (1983); Ahmad (1984); Siddiqui (2001); Rosly and Bakar(2003) and others argue that a financial system built dominantly around debt based modes of financing cannot be superior than the existing interest-based system on the basis of equity, efficiency, stability and growth. This is because these modes of financing are actually similar to the conventional banking modes and thus cannot remove the injustices of the interest based system. Profit making is not the sole objective of Islamic banks as it also has to incorporate social responsibility into their objectives (Ahmad 2000). Ahmad's view is supported by many other scholars Chapra (1985); Siddiqi (1983, 1985); Ahmad (1984); Siddiqui (2001); Haron (1995, 2000); Rosly and Bakar (2003); Haron and Hashim (2003) and Naqvi (2003). They opined that Islamic banks must also take care of the society and promote Islamic norms and values as well. This reasoning is in line with the philosophy

¹ Utusan Malaysia, 20 Oktober 2007

² www. mifc.com

of Islam as way of life (*Al-Din*)³ and hence Islamic banks should not limit their scope to financial activities only.

Customers are apparently not happy with the current implementation of BBA home financing as many of its features mirror that of conventional mortgage financing. BBA is essentially structured as a long term debt obligation whereby the price is fixed based on the market interest rate. This makes the overall cost of financing higher compared to the conventional financing which is able to vary its price based on changes in the market interest rate. As such the product poses a financial burden to individual and affects one's family budget. Similarly when it comes to early redemption or in the event of default, the BBA contract always carries a higher financing balance compared to the conventional loan of similar annual percentage rate (APR). The recent *Affin Bank vs. Zulkifli*⁴ is a landmark case. When work in progress to construct a house is abandoned by the developer or due to calamity, the customer still has to pay monthly installment even though the property cease to exist. For the bankers, the BBA mode of financing brings in liquidity management problems. This is because its cost of funds, particularly the deposit rate is based on floating rate while its income is predominantly based on fixed long term rate causing fund mismatch in the duration.

The use of BBA is not limited to the Muslim customers as some Non-Muslim customers do engage in BBA to finance their home buying. Given the weaknesses associated with BBA, it is of interest to see if the views are shared by both Muslim and Non-Muslim customers. The knowledge of such information would have a direct impact onto the alternative financing mode that could be used to overcome the inherent weaknesses in BBA. With those objectives in mind, this paper attempts to analyze the perception of Muslim and Non-Muslim customers with regard to certain features of BBA notably those that are rather controversial in nature.

2.0 Islamic world view and the *Shariah*

Islamic law (*Shariah*) of commercial transaction is fundamentally rooted on the premise of total eradication of *riba* (usury) and *gharar* (uncertainty). It balances the moral and materials need of society to achieve socio-economic justice. Al Ghazali (1937) noted that the very objective of *Shariah is to promote the welfare of the people which lies in safeguarding the faith, life, intellect, posterity and property*⁵. He also refers to these five basics as *maslaha* (welfare). Among these 'life' came first as the other objectives are meaningful only if one survives so as to function. This includes "bodily health, survival

³ The literal meaning for "Din" is religion. A part from worshipping Allah one's obligation under 'Din' is looking after the needs of the family, society and the nature. These responsibilities are all essential for human survival and they become part of *ibadah* and 'Din'. The true *ibadah* for Muslim in all transaction is to subscribe to economic activities in line with the Quran (al- An' am, 6: 162)

⁴ The High Court in December 2005, reduced the defaulted amount of RM 394,172.06 on BBA home financing due to Zulkifli to RM 558,909,21 from RM 958,997.94 (Selling Price) inclusive of unearned profit originally claimed by Affin Bank noting that the consequences of defaulting on Islamic financing was for more burdensome on the customer than a conventional loan.

⁵ Al-Ghazali, Muhammad (1937), *Al-Maktab Al-Tijariyah Al-Kubra*, vol 1, pp 139-40, Al-Mustafa Cairo

and availability of minimum of clothing, housing and other supplies”. The primary goal of Islamic economics is equal distribution. Islam views that inequity is created by mass exploitation of resources to obtain maximum profit. Principles of Islamic commercial transaction are nurtured to check exploitation, inequities and the creation of economic imbalances in society by means of various concepts and principles to eradicate unjust enrichment.

Central to the concept of Islam is justice. All transactions whether it is judicial, political or private etc. are subject to this concept. The Quran, (Al-Hijr: 85) states that:

“We created not the heavens, the earth and all between them, but just ends. And the Hour is surely coming (when this will be manifest). So overlook (any human faults) with gracious forgiveness”

This concept has been emphasized in various places in the Qur’an⁶. Islamic culture demands that Muslims abide by the messages of the Qur’an, follow the Sunnah of the Prophet (*pbuh*) and accept the rulings of recognized scholars of the past. A Muslim is imposed with greater duty and responsibility and must abide by this culture to achieve *fallah* (success). Justice in Islam is part of Allah’s attribute and to stand firm for it is to be a witness to Allah.⁷

Islamic economic principles share risk and rewards in wealth creation via equity rather than debt. It promotes entrepreneurship and creativity in the economic cycle. In the Islamic economic model, each individual is involved in the economic activity. This differs from modern capitalism where profit maximization is the primary motive and the bank is broadly contented with earning interest on the loan regardless of the social and financial considerations of the business. In addition, the orientation of modern capitalism does not consider religion and social norm as its integral part of acquiring wealth. As such, it does not have any restriction in the way wealth is obtained. The different approaches in world view between Islam and modern capitalism is reflected in the practice of Islamic banking and finance where the salient feature is the prohibition of *riba*⁸ and *gharar* (uncertainty).

2.1 Shariah Perspective of Islamic Banking and Finance

The concept of financing in Islam differs from that of conventional financing. Loan is the main mode under conventional financing which uses interest as a time factor for borrowed money. The Quranic injunction prohibits financial activities that has interest element and/or has no genuine nexus to trading activities under the *Shariah* law. This implies that money in itself has no intrinsic value and can only serve as a medium of exchange. Hence money cannot be traded as a commodity in Islam. This differs from the

⁶ See Qur’an :(al-Maidah:8); (an-Nisaa:58;105;107;135); (Ad-Dukan: 38-39);(Al-Baqarah:213); (Ash-Shura:15); (Sad:26); (Al-Hadid:25).

⁷ See Qur’an: (an-Nissa:135 and al-Maidah: 8)

⁸ See para 2.1 for meaning of *riba*

conventional financing where money is treated as a commodity and loans are lent out with interest as its pricing mechanism. Trading “money for money” is tantamount to *riba* which is strictly prohibited in Islam. *Riba* literally means an increase, addition, expansion or growth⁹ In *Shariah*, *riba* technically refers to the ‘premium’ that must be paid by the borrower to the lender with the principal amount as a condition for the loan or for an extension in its maturity.¹⁰ Hence there is a time dimension to *riba*.

There are two types of *riba* in Islam. One is known as *Riba Al Nasiah* and the other is *Riba Al Fadl*. *Riba Al Nasiah* occurs in a loan transaction whereby interest is charged for postponement, deferment or as result of waiting. It refers to the time that is allowed for the borrower to repay the loan in return for the ‘addition’ or the ‘premium’. *Riba Al Fadl* occurs when the increase mentioned is irrespective of the postponement and not off set by something in return. It usually occurs in a buying and selling transaction where there is no equivalent counter value. This is to prevent dishonesty and unjust exchanges in business transactions by the seller.

All trade-related documents under the *Shariah* must have the element of employment of capital, labor and risk, failing which it may be construed as a ‘*riba*’ transaction and treated as forbidden (*haram*). The fixing of profit or definite returns in terms of percentage as opposed to sharing of profits in *Shariah* banking activities are more akin to *riba* than trade. Thus it must be emphasized that the basic and most important characteristic of *Islamic financing is that it does not deal with fixed interest or pre-determined profits. It is based on a profit and loss sharing contract. In crux, it follows an equity based financing mode*¹¹

Another principle that should be observed in Islamic sale transaction is that the seller must have possession of the goods and takes liability of it before it is sold to the buyer. Prophet Muhammad S.A.W (*pbuh*) mentioned that *profits belong to him who bears responsibility*¹². Rosly (2005) further illustrates this point in his Islamic normative theory of profit. According to Rosly there should be *iwad* or counter value in a trading transaction. Three elements that should exist in *iwad* are risk (*ghorm*), liability (*dhaman*) and effort (*kasb*). *Iwad* is the basic trait or the *condition sine quo non* of a halal or lawful sale (*Al-Bay*), because a sale is necessarily an exchange of value against an equitable return and compensation for the goods or services exchanged¹³. According to Ibn Al-‘Arabi (d.543H/1148), every increase which is without an *iwad* or equal counter value, is *riba*. *Iwad* is the necessary requirement to be fulfilled in trading (*Al-Bay*) as it brings

⁹ See the word *riba* in al-Zubaydi’s *Taj al- ‘Aras* (Cairo: Al-Marba’ah al-Khairiyyah, 1306, vol. 10, pp 142-3)

¹⁰ Ibn Manzur specifies that “what is prohibited is the extra amount, benefit or advantage received on any loan”.

¹¹ As stated by Y.A. Dr Haji Hamid Sultan bin Abu Backer, Judicial Commissioner in his judgment of *Ya’kup bin One and Rosni bt. Fauzi vs. Malayan Banking Berhad* pp 38 (OS-24-173-2006-H)

¹² Hassan, A.A (1997), “*Sales and Contract in Early Islamic Commercial Law*” pp 30

¹³ Rosly (2005), pp.40.

along a sense of equity and justice into a business that rendered it superior to an interest-bearing system (Rosly 2005).

2.2 Hypotheses development

In developing the hypotheses for this study, we review the relevant literatures and issues related to the research areas.

Debt concept

In the debt contract, the borrower is obligated to pay the lender the entire sum due for the amount financed. In addition, he/she will be penalized if there is a default in repayment of monthly installment. The concept of buying and selling e.g. *Murabahah* and BBA contracts in Islam is similar to debt. The difference is that there must be an underlying asset for an Islamic transaction otherwise it would mean trading “money for money” which is tantamount to *riba*. Although the *Shariah* allows the debt concept, in practice, the financing arrangement is similar to conventional financing except that profit replaces interest rates. Thus, it would be important to see if customers perceive the debt concept used in BBA financing as different from that of the conventional home financing. In addition, the study is to examine if such perception differs between Muslim and Non-Muslim customers or potential customers. Our *priori* throughout the study is to assume that the Muslim customers would be in better position to understand the features of BBA than the Non-Muslim customers. As such we would expect that the perception on each of the features of BBA to vary between Muslim and Non-Muslim customers. For simplicity, we are using the words customers and potential or future customers interchangeably. Thus our first hypothesis is:-

H1: There is a difference in perception between Muslim and Non-Muslim customers with regard to ‘The debt concept used in BBA home financing is similar to that in conventional home financing’.

Method of computing pricing and interest rate

Conventional housing loan is based on market interest which is forbidden in Islam. A customer purchased a house for RM 250, 0000 and paid RM 25,000 (10% of purchase price) to the developer as down payment. Bank lends RM 225,000 to customer (borrower) for 20 years at interest rate of 10% per annum. Customer pays bank RM 2,171.30.¹⁴ as monthly installments for 240 months. Bank unearned interest for the 20 years period is computed as RM 296,112. The unearned interest is not capitalized in the total financing amount. Monthly interest is only recognized at end of each month based

¹⁴ Computed using the standard formula for present value of annuities, i.e. $PV = \frac{Pmt}{i} \left[1 - \frac{1}{(1+i)^n} \right]$

which gives $Pmt = \frac{i(1+i)^n PV}{(1+i)^n - 1}$.

on the outstanding balance. Conventional interest rate may vary during the 20 years according to economic conditions and as such will affect the total amount borrowed by the customer and duration for the loan.

There are four pillars of contracts required by the *Shariah* in a BBA home financing facility, namely the buyer (customer), seller (bank), good (house), price (profit rate) and *aqad* (agreement). Using the same financing amount as above to purchase the house for RM 250,000 the bank provides financing for the balance of RM 225,000 for 20 years at profit rate of 10% per annum. Using the present value of annuities formula, the monthly installment is also computed as RM 2,171.30¹⁵ payable for 240 months and the selling price to the customer amounted to RM 521,112. The difference between RM 521,112 and the original financing of RM 225,000 i.e. RM296,112 is the total profit earned by the Islamic bank in this transaction. The total profit is capitalized upfront in the BBA financing model, unlike under the conventional loan, where the interest due is unearned until the elapse of time.

Table 1: Comparison between Conventional Loan and BBA

	Conventional Loan	BBA Financing
Annual Percentage Rate (APR)	10% per annum	10% per annum
Financing amount	RM 225,000	RM 225,000
Monthly payment	RM 2,171.30	RM 2,171.30
Total payment in 20 years	RM 521,112	RM 521,112
Total interest/ Profit to bank	RM 296,112	RM 296,112
Balance after 10 years	RM 164,305	RM 260,556

Table 1 compares the differences between conventional home loan and BBA home financing. As can be seen, the balances of financing before the expiry of the 20 years duration of financing differ. It is noted that BBA balance after 10 years (i.e. after 120 payments) is the total of the remaining 120 payments, i.e. RM260,556 (RM 2,171.30 x 120 months) whereas under conventional loan, this amount represents the total installments (principal and interest) paid for the loan over the 20-years period i.e. RM 164,304.70. The Islamic bank, however, may give some rebate for the early repayment, but the amount of rebate is determined at the discretion of the bank. *Shariah* prohibits the rebate to be stated as part of the contract as the selling price had already been fixed and stating the rebate is tantamount to double pricing which is not allowed in Islam.

¹⁵ Computed using the standard formula for present value of annuities (based on time value of money)

as computation for conventional housing loan, i.e. $PV = \frac{Pmt}{i} \left[1 - \frac{1}{(1+i)^n} \right]$ which

gives $Pmt = \frac{i(1+i)^n PV}{(1+i)^n - 1}$.

Therefore, even after ten years of repayment, the balance of RM 260,556 under the BBA mode can exceed the original financing amount of RM225,000.

It is noted that under BBA home financing, customers are charged profit instead of interest, but regrettably, the profit rate is dependent on the market interest rate due to arbitrage activities¹⁶. Therefore, while the BBA is practiced as *Shariah* compliant in some countries, it is, nonetheless, converging to the conventional mode where the computational formulas are similar to the conventional and where the profit rate tracks the market interest rates. The current difference between the fixed-rate BBA and the conventional mode is that once the profit rate is fixed in the BBA, say at 7% per annum, it will remain the same for the entire duration of financing. This, in fact, causes problems for the financiers as it is difficult to estimate accurately the cost of funds and profit rate over long periods like 20 years, due to the volatility of economic conditions. The situation encourages customers to refinance their home from BBA home financing to conventional home financing during low interest periods and vice versa.

Another reason that makes BBA Home financing costly is due to the price of houses which are subjected to changes in the economic conditions. When the price of house increases, financier accommodates house buyer by extending the tenure of financing to lower monthly installment e.g. from 20 years to 30 years to make it affordable to the customer to purchase the house. High selling price causes difficulties for a low income earner to settle the outstanding balance causing it to spill over to the second generation. Indeed, second generation home financing had already existed in Japan and Hong Kong housing loan market where tenure had exceeded 40 years¹⁷. The foregoing discussion has highlighted some of BBA features that have contributed to dissatisfaction or controversies among the consumers. As such it would be appropriate to examine the perception of customers on these issues which bring about the next three hypotheses:

H2: There is a difference in perception between Muslim and Non-Muslim customers with regard to ‘The method of computing profit in BBA home financing is similar to conventional home financing’

H3: There is a difference in perception between Muslim and Non-Muslim customers with regard to ‘The pricing of BBA home financing is similar to conventional home financing except that profit rate replaces interest rates’.

H4: There is a difference in perception between Muslim and Non-Muslim customers with regard to ‘The pricing of BBA home financing is high because it is pegged on market interest rate ‘

¹⁶ Which Sheikh Nizam Yaquby and Muhammad Taqi Usmani, in a 1998 fatwa, approved so long such interest-based benchmarks do not attach the contract on a variable rate.

¹⁷ Baharum, Mohd Ali (2005). *Bagaimana Mengurangkan Beban Hutang Rumah Anda?* Kuala Lumpur: BIRR Sdn. Bud. pp 134

Shariah compliant

The current practice of home financing in Malaysia does not genuinely fall under the concept of BBA as bank does not take actual possession of the house. It falls under the contentious sale of *Bai Inah* as the bank buys the house directly from the customer and resells the same property to him/her with added profit without incurring any risk and value addition.¹⁸ In the legal documents for the BBA financing transaction, Rosly et al (2003) observed that under the Property Purchase Agreement (PPA) and Property Sales Agreement (PSA) there is no actual transfer of goods between customer (buyer) and bank (seller). A bank merely provides financing of the house to the customer and does not take actual possession of the goods (Sanusi 2006). Rosly (2005) further opined that there is no risk taking in the current BBA home financing and hence, does not merit the Qur'anic concept of *Al-Bay*. Like wise the bank does not take any liability (*dhaman*) which should exist in a trading transaction in which the bank provides guarantees on the goods sold. Since BBA does not fulfill the requirement, it is deemed to be non-*Shariah* compliant by many Islamic finance scholars. The next hypothesis is developed to investigate if customers are aware of such issues relating to BBA.

H5: There is a difference in perception between Muslim and Non-Muslim customers with regard to 'BBA home financing is not *Shariah* compliant because there is no real purchase of property and the bank does not take ownership risk'.

Justice, riba and the promotion of societal well being.

In the BBA home financing arrangement, the customers have engaged in a 'debt contract' with the bank at the onset. Thus in a situation when the house financed is uncompleted, customers still have to pay the monthly installments although no "good" had been delivered to the customer yet. Hence it can be seen that in the current BBA home financing, the customer is forced to face the financial burden of paying for the house even before it is completed. By ignoring the concept of *iwad*, the BBA contract is not seen as conforming to the objective of *Shariah*, (*Maqasid al-Shari'ah*) that removes hardship (*raf' al-haraj*) and prevents harm (*daf' al-darar*) in the economic sphere, thereby leaving the welfare of people unprotected – a possible crime when the transaction is done under an Islamic label¹⁹. As can also be seen, the injustice created taints the transaction as *riba* following the view of Abu Bakar Ibn Al-Arabi, "every excess in return for which no reward is paid is *riba*".²⁰ This general view includes both material and immaterial gains. It also implies gains from exploiting situation. Customers of BBA may not be technically sound with the concepts that BBA may have not complied. Nonetheless, they could still

¹⁸ Rosly and Che Seman (2003), Juristic Viewpoints on Bai' Al-Inah in Malaysia: A Survey, *IJUM Journal of Economics and Management* 11, no 1 (2003): 87-111

¹⁹ See Farid, B et.al.

²⁰ Quoted by Afzal-Ur-Rahman, *Economics Doctrines of Islam Vol IV (Banking and Insurance)*, Islamic Publications Ltd, 2nd edition, 1990.

evaluate if such an arrangement under the BBA has brought feelings of justice, equality and eventually well being of the society. This leads to the next three hypotheses:

H6: There is a difference in perception between Muslim and Non-Muslim customers with regard to ‘BBA home financing product is based on justice and equality’.

H7: There is a difference in perception between Muslim and Non-Muslim customers with regard to ‘BBA home financing does not reflect the true spirit of Islam in promoting the well being of the society’.

H8: There is a difference in perception between Muslim and Non-Muslim customers with regard to ‘Usury (*riba*) does not exist in BBA home financing’.

In the light of the above literature review, it can be seen that the prevailing BBA model does not seem to meet the objectives of *Shariah (Maqasid Shariah)* due to its high pricing and is burdensome to customers. It falls under the contentious sale of *Bai Inah* as bank buys the house directly from customer and resells the same property to him/her with added profit. Furthermore there is no counter value (*iwad*), as the bank does not take any market risk and liability and merely creates a debt for the customer to pay. BBA financing is expensive due to fixed profit rate over long term tenure, uncertainty in amount of rebate, not flexible and causes mismatch of funds and liquidity problems. Hence there is a need to re look into the existing practice of BBA home financing and also explore other financing models that allow for greater flexibility than BBA to address issues that have been mentioned above. While exploring the alternative financing models, it is worth to examine if the shortcomings of BBA are also agreeable or perceived by customers. The acid test for BBA acceptance would be indicated by this last hypothesis:

H9: There is a difference in perception between Muslim and Non-Muslim customers with regard to ‘If I apply for home financing, I would seriously consider taking BBA home financing’.

3.0 Research Methodology

Sample, Procedure, and Instruments

Data for this study was collected by means of a self administered survey conducted on 300 post graduate students from three public universities in Klang valley namely the International Islamic University Malaysia (IIUM n=140) Universiti Teknologi MARA (UiTM n=90) and Universiti Putra Malaysia n=70). Post graduate students from these universities were chosen using a purposive sampling technique to represent the existing and potential house owners in this country as there is no official population frame to represent all present and potential house buyers. Post graduate students were also chosen due to their maturity, working experience and thus are able to make decision needed for this study. Since this study is about home financing, post graduate students are potential buyers with good purchasing power. According to Singhapakdi et al. (1996), students are considered a valid sample for exploratory study and when items in the questionnaires are pertinent to the respondents who answer. The instrument developed has benefited from

comments received from three *Shariah* scholars and five lecturers to ensure that the concepts and questions used are clear and relevant for Islamic financing and a pilot study on 30 post graduate students.

4.0 Findings

4.1 Profile of respondents

A total of 320 respondents participated in the survey, however only 300 questionnaires i.e. 94% were useable. The remaining 20 questionnaires that were not fully completed were excluded from the analysis. The respondents' distribution by universities indicated that 47% were from the International Islamic University (IIUM), 30% from Universiti Teknologi MARA (UiTM) and 23 % from Universiti Putra Malaysia (UPM). The distribution by program study comprised post graduate students pursuing business, finance and economics at Masters level 88% and PhD level 12%. As for home financing status, 41 % had already owned a house whilst 59 % had not owned a house at the time of the study. About 94% of those who did not own a house indicated that they intend to buy a house within the next 20 years. Thus in total 290 respondents or 97% of the respondents had either owned a house or planned to buy one. Table 2 provides the profile of the respondents.

Table 2: Profile of Respondents

	Frequency	Percentage (%)
Gender		
Male	164	54.7
Female	136	45.3
Marital status		
Single	158	52.7
Married	137	45.7
Divorced	5	1.6
Age		
Below 20	-	-
20-30	166	55.3
31-40	98	32.7
41 and above	36	12
Race		
Malay	183	61
Chinese	45	15
Indian	7	2.3
Others	65	21.7
Religion		
Islam	250	83.3
Buddha	41	13.7
Hindu	4	1.3
Christian	5	1.7

Qualification		
Diploma	3	1
Degree	251	83.7
Master	46	15.3
Working currently		
Yes	188	62.7
No	112	37.3
Working experience		
< 1 year	63	21
1- 5 years	87	29
6-10 years	74	24.7
11-20 years	69	23
> 20 years	7	2.3
Monthly Income		
< 3000	134	44.7
3001-5000	96	32
5001-10,000	53	17.7
10,001-20,000	13	4.3
>20,000	4	1.3
Job designation		
Officer	86	28.7
Manager	48	16
Senior Manager and above	17	5.7
Lecturers	39	13
Others	110	36.6

Table 2 summarises the basic statistics on gender, marital status, age, race, religion, qualification, current position, working experience and monthly income of respondents. Gender of respondents comprises 54.7% male and 45.3 % females. As for marital status, 52.7% of the respondents were single followed by 45.7% married and 1.6% divorced. Majority of the respondents aged between 20-50 years. This is in line with the findings of previous studies on customers' perception i.e. Erol and El-Badour (1989) and Metawa and Almosawi (1998). According to the latter study, "investigating the perception and behaviour of customers and depositors within this age group is likely to have far-reaching influence on the Islamic banking policies" Thus, with this sample, the study would provide useful insights on how these prospective group of respondents perceive the BBA home financing product. The above result also reported that the majority of the respondents were Malay 61 %, followed by Chinese 15%, Indian 2.3% and Others 21.7%. These racial composition reflected their religious background whereby majority of the respondents (83.3%) were Muslims, 13.7% Buddhist, 1.7% Christians and 1.3% Hindu.

In terms of education, the majority of the respondents (83.7 %) were degree holders and 15.3% were master level. The composition of higher education reflected the respondents' maturity needed to understand various concepts and operations mentioned in the questionnaires. This is further supported by their working experiences whereby 50 % of the respondents had minimum of 6 years and 29% a minimum of 1 year. Majority (44.7%) of the respondents were in the RM 3,000 and below group income group. A total of 32% surveyed respondents earned between RM 3,001- RM 5000 per month. Combined together, the respondents in those two income groups represent approximately 77% of the total sample. Thus, most of the respondents can be classified as middle-class income earners.

4.2 Descriptive Statistics

Table 3: Respondents' Perception of BBA Features and Operations

Level of measurement / Percentage		Disagree (%)	Neutral (%)	Agree (%)	Mean	Std Dev.
1	The debt concept used in BBA home financing is similar to that in conventional home financing	36.3	16	47.7	3.17	1.22
2	The method of computing profit in BBA home financing is similar to conventional home financing.	34	15.7	50.3	3.26	1.20
3	The pricing for BBA home financing is similar to conventional home financing except that profit rates replace interest rates	19.7	18.3	62	3.58	1.11
4	The pricing of BBA home financing is high because it is pegged on market interest rate	20.4	19	60.6	3.54	1.11
5	BBA home financing is not <i>Shariah</i> compliant because there is no real purchase of property and bank does not take ownership risk	13.3	22.7	64	3.69	1.05
6	BBA home financing product is based on justice and equality	46.6	34	19.4	2.57	1.05
7	BBA home financing does not reflect the true spirit of Islam in promoting the well being of society	15.3	27.3	57.4	3.65	1.15
8	Usury (<i>riba</i>) does not exist in BBA home financing	42.7	29	28.3	2.74	1.25
9	If I apply for home financing, I would seriously consider taking BBA home financing	44.7	35	20.3	2.58	1.17

Note: The original scoring is based on 5 point Likert scale 1 = strongly disagree, 5 = strongly agree.

For the purpose of reporting, response for 1 and 2 and 4 and 5 are combined and termed as disagree and agree respectively.

Table 3 displays the frequencies of respondents' perception of BBA features and operations. In response to the statement "The debt concept used in BBA home financing is similar to conventional home financing", there was mixed responses from respondents in this statement with 47.7% agreed, 16 % neutral and 36.3 % disagree. A high mean of 3.17 was recorded with standard deviation 1.22 In general the *Shariah* permits the debt concept such as *Murabahah* and *Bai-Bithaman Ajil* being practiced under the sale contract. However bank should strictly abide to the rule under a sale contract whereby it

should take ownership and risk of the goods as mentioned in the literature. Otherwise it will violate the legal maxim and *Shariah* principle.

In statement 2, respondents' evaluation was 50.3% agreed, 15.7% neutral and 34% did not agree as a response to the statement "The method of computing profit in BBA home financing is similar to conventional home financing". Mean was 3.26 and standard deviation 1.20. The overall perceptions by respondents on the statement indicated that the same method was used to compute BBA and conventional home financing i.e. using the standard formula for present value of annuities based on time value of money²¹ thus yielding the same financing amount.

Statement 3 further evaluates respondents' responses on the similarity of Islamic profit rate with interest by asking the question, "The pricing of BBA home financing is similar to conventional home financing except that profit rates replace interest rates". A high mean of 3.58 was recorded with standard deviation of 1.11. Majority (62%) of the respondents agreed with statement, 18.3% neutral and 19.7% did not agree. To understand the majority decision, we refer to the earlier discussion on the formula used to calculate conventional home financing and BBA home financing. As can be seen, the same standard formula for present value of annuities was used for both computations. The only different was profit rate replaces interest rate. Thus the majority decision on the similarity can be explained.

Statement 4 about "The pricing of BBA home financing is high because it is pegged on market interest rate". The mean was high at 3.54 with standard deviation of 1.11. Again we noticed that 60.6 % of the respondents agreed with this statement, 19% neutral and 20.4% disagreed. The scores were similar to statement 3. We believed that respondents were aware that the reason why BBA home financing was high was because of its benchmark to market interest rate. Due to this dependency, BBA home financing cannot be more superior to conventional home financing as it is dependent on market interest rates Siddiqi (1983); Ahmad (1984); Siddiqui (2001); Rosly and Bakar (2003). Thus there is a need to find an alternative bench mark for Islamic home financing.

In Table 3, Statement 5 shows that the majority of the respondents (64%) agree with the statement that "BBA home financing is not *Shariah* compliant because there is no real purchase of property and the bank does not take ownership risk". While only 22.7% neutral and 13.3% disagree. Mean was high at 3.69 and standard deviation 1.05. This indicates that the majority of customers agree the bank should take ownership of the property which currently is not the practice. This infringes the *Shariah* principle as stated

²¹ Time is not recognized by *Shariah* as a basis of claiming an excess over principal when making a money loan, becomes part of the justification for a mark-up in credit sale (Khan, 1995 pp 160-63) as cited in Siddiqi, M.N. (2004), *Riba, Bank Interest and The Rationale Of Its Prohibition, Issues in Islamic Banking*, IRTI, 2004.

in the *hadith* of the Prophet (*pbup*) that “Do not sell what you do not possess” as narrated by Abu Dawud²² As bank further does not take liability on the defects of the property, it is also not in line with the Islamic normative theory of profit mentioned by Rosly (2005) due to the absence of the three elements of *iwad* (counter value) which are risk, liability and effort.

In statement 6 – “BBA home financing product is based on justice and equality”, the mean was 2.57 and standard deviation 1.05. 46.6% of the respondents disagree, 34% neutral and 19.4 % agreed. Again it indicated that majority of the respondents disagreed with the statements which mean that they are of view that there is no justice and equality in the current BBA home financing.

Statement 7 further examines respondents’ perception whether “ BBA home financing does not reflect the true spirit of Islam in promoting the well being of society”.57.4 % agreed with the statement, 27.3% neutral and 15.3% disagree. Mean was also high at 3.65 and standard deviation at 1.15. Majority of the respondents agreed with this statement. Their perception could be affected by their overall evaluation of the product whereby they observed that its operations is not in line with the objectives of the *Shariah*, (*Maqasid Al-Shariah*) that removes hardship and prevents harm in the economy leaving the welfare of the people unprotected. Unlike the equity concept, the debt concept in BBA does not allow the bank to share profit and loss with customer which forms the fundamental of Islamic economics.

In Statement 8, “Usury (*riba*) does not exist in BBA home financing” the mean was 2.74 and standard deviation on 1.25. 42.7% disagree, 29% neutral and 28.3 % agreed. Generally, it indicates that the respondents agree that *riba* exists in the current BBA. This is not a surprise as mentioned under statement 5 that bank should take ownership of the property with the three elements of *iwad* (risk, liability and effort) *or* run the risk of the transaction being construed as *riba*.

In the last Statement 9, “If I apply for home financing, I will seriously consider taking BBA home financing”, the mean was 2.58 and the standard deviation was 1.17. 44.7% disagreed, 35% neutral and 20.3% agreed. The result indicated majority of the respondents disagreed in seriously considering BBA home financing. 35 % had reservation and unwilling to commit themselves. Only 20.3% agreed with the statement. This is a surprise as although BBA home financing has been widely practice by all Islamic banks in Malaysia for the past 25 years, the product is still not fully supported by the respondents in this study. Hence there is indeed a need to probe further into the features and operations of this product.

²² in his *Sunan*, 3/78, hadith No 3503

Table 4: Differences in Perception Between Muslim and Non-Muslim (*t*-test)

No	Hypothesis There is a difference in perception between Muslim and Non-Muslim customers with regard to	Mean Difference	t	p-value	Std. Error
H1	The debt concept used in BBA home financing is similar to that in conventional home financing.	0.152	0.905	0.368	0.168
H2	The method of computing profit in BBA home financing is similar to conventional home financing.	0.332	2.088	0.040	0.159
H3	The pricing of BBA home financing is similar to conventional home financing except that profit rate replaces interest rates.	0.052	0.366	0.716	0.142
H4	The pricing of BBA home financing is high because it is pegged on market interest rate.	0.116	0.818	0.416	0.142
H5	BBA home financing is not <i>Shariah</i> compliant because there is no real purchase of property and bank does not take ownership risk.	0.324	2.478	0.015	0.131
H6	BBA home financing product is based on justice and equality.	-0.488	-3.35	0.001	0.146
H7	BBA home financing does not reflect the true spirit of Islam in promoting the well being of society.	0.376	2.707	0.008	0.139
H8	Usury (<i>riba</i>) does not exist in BBA home financing.	-0.332	-1.976	0.0520	0.168
H9	If I apply for home financing, I would seriously consider taking BBA home financing	-0.072	-0.446	0.657	0.162

Significance level: $p < 0.05$

Of the nine hypotheses, only five hypotheses i.e. (H2, H5, H6, H7 and H8) have proven that there are differences in opinion between Muslim and Non-Muslim customers with regard to the various statements about BBA features and operations (statistically significant at less than 5% i.e. < 0.05). Hypothesis 2 (H2) indicated more Muslim customers feel that there is no difference in the method of computing profit under BBA and conventional home financing. Similarly for H5 where the Muslim customers have expressed their agreement over the opinion that BBA is not *Shariah* compliant for there is no real purchase of property and no transfer of ownership risk on the part of the bank. For H6 and H8 which covers the feeling of justice, equality and *riba*, majority of Muslim

customers express their disagreement over those issues signifying dissatisfaction over the present practice. In line with the sentiment expressed for H7, Muslim customers shows their disbelief over BBA's ability to reflect the true spirit of Islam in promoting the well being of society although the statement was negatively worded. Result for H8 confirms that BBA is not free of *riba* or usury as expressed by the Muslim customers.

5.0 Discussion and Implications

The findings in this study seem to suggest a feeling of dissatisfaction notably among the Muslim customers about the features and operations of BBA. Concerned as expressed by the scholars Ahmad (2000); Chapra (1985); Siddiqi (1983, 1985); Ahmad (1984); Siddiqui (2001); Haron (1995, 2000); Rosly and Bakar (2003); Haron and Hashim (2003); Naqvi (2003) that profit making should not be the sole objective of Islamic banks and lesser priority be given to social responsibility, promotion of Islamic norms and values. These concerns are also shared by majority of the respondents in this study. Although the respondents are largely Muslim customers, nonetheless the Non-Muslim are also represented with a view of their own. Out of the nine hypotheses overlooking at the possible divergence of opinions between Muslims and Non-Muslims, five hypotheses have proven to be vital. They are method of computing profit in BBA home financing; product is non *Shariah* compliant; BBA home financing is not based on justice and equality; the financing does not reflect true spirit of Islam in promoting well being of society and the existence *riba* in its financing. The Muslim respondents are of the opinion that the method of computing profit under BBA is no different from that of the conventional home financing, while the Non-Muslim respondents do not share the same view. It is possible that the Muslim respondents with better knowledge of Islam would be inclined to hold such a view. Interestingly, similar question to Hypothesis 2 (H2) but asking about debt concept in BBA home financing i.e. Hypothesis 1 (H1) does not yield similar statistical significance.

Muslim respondents do not believe that the present practice of BBA brings in justice, equality and societal well being. Non-Muslim respondents are more likely to think that BBA satisfies the noble Islamic intention of upholding justice, equality etc to the society. This is understandable as the Non-Muslim would not have detail understanding of Islam. As a result, they are more likely to take the ideal view of BBA. The acid test for BBA acceptance is based on H9 where the respondents were asked about their intention of using BBA if they wish to buy a home. The majority of the respondents (regardless of their religious status) would not consider taking BBA as their home financing choice. Obviously this is a clear signal to the bankers that BBA has overstayed its welcome. Another alternative Islamic financing method has to be introduced to overcome the inherent problems of BBA. This alternative method should be focusing in addressing the major shortcomings of BBA features and be more *Shariah* compliant. Among the issues that need serious attention is the transfer of ownership risk and possession of the property to fulfill the *Shariah* requirement.

The concept of *Diminishing Partnership* (DP) or *Musharakah Mutanaqisah* as an alternative to BBA could be considered. It focuses on joint purchase of property between customers and banks. There are three portions to the contract. First, the customer enters into a partnership (*musharakah*) under the concept of '*Shirkat-al-Milk*' (joint ownership) agreement with the bank. Customer pays, for example, 10% as the initial share to co-own the house whilst the bank provides for the balance of 90%. Second, the bank leases its share (90%) in the house ownership to the customer under the concept of *ijarah*, i.e. by charging rent; and the customer agrees to pay the rental to the bank for using its share of the property. The periodic rental amounts will be jointly shared between the customer and the bank according to the percentage share holding at the particular time. Thirdly, the customer redeems the financier's 90% portion through the purchase of additional share until the house is fully owned by the customer. Bank takes ownership of its equity in the house and assumes responsibility of the property until the financing amount is fully settled and customer takes possession of the property.

The implementation of DP would address several issues raised by Muslims and Non Muslims in this study. This is because DP is based on equity rather than debt whereby banks and customers jointly purchase the shares in the house. Pricing should not be benchmarked against interest rate as in BBA. It should be based on the market rental rates which differ between the types and locations of the particular property. It is furthermore flexible and can be changed within a specific period agreed between the customer and the bank and not fixed as in BBA. To address the particular concern of Muslim customers, DP meets their criteria of *Shariah* compliant, justice, promotion of true spirit of Islam and non *riba* in its contract. DP also addresses the principle that should be observed in Islamic sale transaction i.e. the seller must have possession of the goods and takes liability of it before it is sold to the buyer. As for the method of computation, DP uses profit and loss sharing mechanism which differs from BBA home financing which uses time value of money in its formula. Given these differences, it is worth investigating the DP home financing mode further as an alternative to tap the dissatisfied BBA customers market.

6.0 Conclusion

Since the introduction of Islamic banking in Malaysia, BBA has enjoyed the privilege of being the most predominant concept of Islamic home financing. BBA is however, based on debt concept which results in high cost and poses a burden to one's family obligation. Besides, BBA as practiced in Malaysia is seen not to be in compliant with the *Shariah* principle as the bank does not take the risk of ownership and liability on the property (Saiful 2005) (Sanusi 2006) and thus not acceptable by international scholars. Given the controversial features of BBA home financing, there is high dissatisfaction among the present and potential customers of BBA. However, such evidence had been absent or had not been collected systematically to assess the acceptance level of BBA. This paper has filled the gap by examining the perception of Muslim and Non-Muslim customers toward BBA.

The findings suggest a high level of dissatisfaction among the customers as evidenced by their low intention to use BBA in the future home financing choice. Muslim customers in general are concerned about the features of BBA notably its compliance with *Shariah* as well as its inability to fulfill the broad objective of justice, equality and societal well being. The Non-Muslim customers however seem to have greater beliefs in BBA and its ability to fulfill socially desirable objectives. BBA has certainly overstayed its welcome and there is a dire need to find an alternative to BBA. Bankers should be looking for a viable alternative especially one that could overcome the *Shariah* compliant issues well. Diminishing Partnership is one of the newly emerging concepts that fulfill the *Shariah* requirements and is fast gaining acceptance. Bankers should be reading the strong signal sent by findings of this study and consequently prepare for another level of battle in Islamic home financing.

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