

The Role of Car Financing In Shaping Islamic Banking Landscape

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Abstract

The history of Islamic banking in Pakistan parallels the global rise of Islamic banking. An essential part of State Bank of Pakistan (SBP) strategic vision has continued to be advancing Islamic finance as a competitive and robust part of the financial system through supportive legal, regulatory, and supervisory frameworks. Under Islamic banking, there are many products which are Shariah compliant such as current accounts, saving accounts, auto finance, fixed deposits etc. Car Ijarah - a car financing mode which stipulates that the Bank would buy the automobile and rent it to the consumer for an agreed-upon time—usually between one and five years—after the contract is signed, the car will either be given to the customer or sold for a reasonable amount at the end of the Ijarah period. This study defines how Islamic banking product Car Ijarah affects the growth, profitability and promotion of Islamic banking division of one of the reputed private banks of Pakistan Bank Al Habib Limited. Special customers of Islamic Banking who are well aware of Car Ijarah were selected as a sample to fill an online survey questionnaire along with the Head of auto finance Department to collect required data. Also, the data is gathered from previous research journals and annual reports of different Islamic banks. The results from the analysis confirmed that the product of Car Ijarah has proven to be an innovative and effective product and it positively effects growth of Islamic banking.

Keywords: Islamic banking, car financing, Ijarah.

Introduction

Islamic banking is a kind of banking that is in line with the law essence, ethics, and moral framework of Islamic Shariah. Interest-free banking is a specific term that refers to a variety of financial products or services that do not charge interest. Islamic banking, which is in practice, was founded on the idea of avoiding both immoral and unsocial behaviours, as well as interest-based transactions, which are forbidden by Islamic Shariah. Islamic banking, in a viable manner, is the conversion of traditional financing into transactions involving actual services and physical assets. The Islamic banking system's approach helps create a system that contributes to wealth creation.

The term "Islamic Finance" describes the delivery of financial services in conformity with Shari'ah, the Islamic law, principles, and regulations. Riba (interest), gharar (extreme ambiguity), maysir (gambling), short sales, and financing of activities that Shari'ah deems damaging to society are all prohibited from receipt and payment under Shari'ah. One of the products that bank customers favour the most is Ijarah. The Banking Companies Ordinance of 1962, which made it feasible to establish several Islamic forms of financing, like leasing and hire-purchase, also created provisions for the development of IF goods and customer service. From this vantage point, Ijarah financing in Pakistan has a great potential with unstoppable expansion since it was the commencement of Islamic Finance and IB products. To give anything on rent or to provide something in exchange for rent is known in Islamic law as ijarah.

This research has focused the Islamic Banking Division of Bank AL Habib Limited, and how the following bank is offering its Car financing specifically Ijarah Financing, thus, sustaining the sales and profitability; and how it is affecting Islamic banking of Bank AL Habib. In 2004, Bank AL Habib Limited formed a separate Islamic Banking Division after accomplishing the licence to conduct Islamic banking activities (BAHL-IBD). The first specialised Islamic banking branch of Bank Al Habib was established and operations began in 2005.

AL Habib Islamic Apni Car is the auto finance product offered by Bank Al Habib that is compliant with Islamic banking. It is a vehicle financing option that enables you to complete an Ijarah transaction in accordance with Shariah. The facility offers a quick and simple way to own an automobile, with reasonable options to fit your convenience. The vehicle is jointly owned by the Bank and the customer under the terms of the facility. The bank leases out its portion of the ownership to the consumer after acquiring ownership and control of the vehicle. The consumer agrees to periodically acquire the bank's portion of ownership, which is split into units.

The aim of this study is to evaluate the level of perception and satisfaction of customers who use car Ijarah transactions provided by Islamic banks in Pakistan. Moreover, this is a successful attempt to study Ijarah financing to evaluate customers' perceptions of IBs in general and car Ijarah specifically in Pakistan.

The data is collected for study from the annual reports and income statements of five different Islamic banks operating in Pakistan. Also, secondary data is collected through conducting survey of pool of customers as well as the CEO of Islamic car financing department. This research extends efforts in collecting the data of use of Ijarah car

financing, establishing robust empirical models to capture the relationship between ijarah and growth of Islamic banking.

Literature Review

1. Islamic Banking:

According to Islamic Shariah, an Islamic banking system is one that is controlled by rules that are consistent with Islam's spirit, philosophy, and sense of values. The phrase "interest-free" refers only to those financial transactions or instruments that do not incur interest. Islamic banking, the more generic phrase, is predicated on avoiding immoral and unsocial behaviours in addition to interest-based transactions that are forbidden by Islamic Shariah. (Alandejani, 2022) Islamic banking, in a practical sense, is the conversion of traditional financial loans into exchanges based on actual goods and services. Economic success is facilitated by the Islamic banking system as a model for a system. (Amin et al., 2011)

The Islamic Shariah serves as the foundation for Islamic banking's ideology. Islamic banking is prohibited from engaging in transactions containing interest or riba per Islamic law (an increase stipulated or sought over the principal of a loan or debt). Additionally, they are prohibited from engaging in any transactions whose subject matter is void (haram in the eyes of Islam). Islamic banks place a strong emphasis on making money through investments that adhere to Shariah. According to Islamic Shariah, capital gains are correlated with performance. Using contracts from different Islamic means of financing, Islamic banking operations, which operate within the bounds of Shariah, are

predicated on sharing the risk that may develop via trade and investing activities.(Naseem, 2014)

Typically, Islamic banks get the majority of their operational income from providing lending and fee-based income products including both people and businesses. The sharia financing contract serves as the foundation for product development.(Naqvi & Perveen, 2014) Here are a few of these products (Zainol, 2008):

i. Mudaraba: One economic agent with capital partners with another who has the business skills, investment management expertise, skills in investment projects, and entrepreneurship in a financial transaction known as a mudaraba. In this instance, the capital owner is responsible for the losses.

ii. Murabaha: When the profit margin is determined by the cost that the seller expended, a cost-plus contract is analogous to the situation at hand. The contract must explicitly mention the cost, profit margin, and selling price. The use of this type of contract is made possible for organisations or people without adequate financial resources. The financier, who acquires the good, service, or raw material, as well as the seller of the real estate, determines the mark-up profit margin.

iii. Musharaka: A working partner may receive a larger share of the profit than a passive partner, and the loss of money is not distributed equally among participants in what is considered as a joint venture or equity partnership. The management and investment processes are combined in this contract. The bank claims a portion of the earnings that would cover the financial risk when it participates in this transaction.

iv. Ijarah: This is an example of a leasing contract in which the bank or financial institution purchases the item from a seller and leases it to the client for a specified fee that should include the profit.

v. Bai' al-mujjil: This type of payment allows the buyer to pay the seller (who may be a bank) in instalments while still including a profit margin.

vi. Sukuks: These are a type of bond that represents a right of participation in an asset.

2. Car Financing:

The variety of financial options available that enable customers to purchase a car with any arrangement other than a full-cash, one-time payment is known as auto financing (outright payment). The availability of car financing, typically provided by a bank or other financial institution, enables customers to pay the dealer or manufacturer even though they lack the necessary funds; in other words, car financing enables the customer to purchase a car by borrowing funds in order to pay the seller. Both individuals and corporations frequently use auto finance.(Ehsan et al., 2017) There are many different financial products accessible. Business contract hiring is generally well-liked by businesses since it may offer tax and cash flow advantages.

Islamic auto financing works to help customers budget their money, spread the actual cost of buying the automobile, and make sure they don't pay interest on the financial choice they've selected. In addition to following Islamic Sharia regulations on interest(the payment and receipt of which is forbidden) and speculation, drivers can benefit from auto loan offers. People who desire financing choices that adhere to Sharia law are the target market for halal vehicle financing.(Latip et al., 2017) Islamic financing basically

guarantees that individuals may spread the cost of the automobile without violating Sharia laws for those who do not have the money to buy a car outright or for those who do not want to buy a car paying cash.

Customers who can't afford to buy new cars turn to conventional and Islamic banks for vehicle finance, which includes a variety of rates and deals for buying a car. Customers can choose from a variety of financing options for cars, known as direct and indirect methods of financing and lending.(Muhamad Sori & Mohamad, 2017)

The process of obtaining halal auto financing is fairly simple and relies on the parties agreeing to a loan. On the value of the automobile the seller is selling, the buyer and seller in the transaction are in agreement. The vendor does not impose a lending rate on the purchase of the automobile as they would typically do to profit from the financing. Instead, the seller raises the cost of the automobile to cover what they would have spent on interest payments. A bank or the seller never truly charges interest.(Aqib Ali & Hussain, 2022)

3. Ijarah:

As more individuals become aware of Islamic banking products and get interested in it, Islamic leasing, also known as Ijarah finance, is one of the current rising phenomena. Numerous researches have been done throughout the globe to determine how consumers feel about Islamic banking products and Ijarah Financing.(Awan & Azhar, 2014)

Al-ijarah is the name given to the lease in Islam. Ijarah's original meaning is "wages," "replacements," or "rewards." In the meanwhile, it is replacing a thing and absorbing its advantages. In order for the renters to be able to use the rented items, the renting party

must best prepare them. ("International Journal of Islamic and Middle Eastern Finance and Management," 2008)

According to one definition, an "ijarah" is a contract between a lessor and a lessee in which the latter receives a specific service or benefit in exchange for a specific payment or rent from the former's property. (Usmani, 2002) It is a lease contract wherein the lessor rents out a specified asset to the lessee for a given length of time in exchange for a predetermined fee or rental.

The leased property's owner is referred to as the "Muajjir" (lessor). From the moment the asset was turned over to "Mustajir," the rental became payable. (Rizwanullah et al., 2012) The lessee may be penalised for paying late, but the lessor may only utilise the money recovered for charitable endeavours.

The second type of Ijarah is not related to the services of individuals, but rather to the usufructs of assets and possessions. In this context, the word "ijarah" refers to "transferring the legal right of a chosen property to a different individual in exchange for rent demanded from him." In this context, the word "Ijarah" is akin to the word "lease" in English. In this case, the owner is referred to as "Mu'jir," (Khediri et al., 2015) the lessee is referred to as "Musta'jir," and the rent due to the owner is referred to as "Ujrah."

Hence, Car Ijarah is an effective product of Islamic Banking and it is opted by large number of customers, increasing the demand and success of Islamic Banking. The following hypotheses are constructed on the basis of previous context of Islamic banking and Car Ijarah:

- i. there is a positive relationship between car Ijarah and Islamic banking.

ii. Islamic banking product of Car Ijarah effects positively on growth of Islamic banking.

Research Methodology

a. Sources:

The secondary data is collected from the annual reports of five Islamic banks in Pakistan i.e; Meezan Bank, Habib Bank Limited (HBL), Bank Alfalah, Allied Bank and Askari bank. The financial information of Ijarah vehicle financing of last ten years are used to analyze the performance of this Islamic banking product of Car ijarah.

b. Sampling:

The primary data is collected from customers of Bank al Habib Limited Islamic banking division. Online survey form was circulated to collect data. The aim was to gather information based on their experience and knowledge of Ijarah car financing. Total 30 responses are collected. Also, a survey was shared with the Head of auto finance department of Bank Al Habib to evaluate the practical application of auto financing of BAHL Islamic banking. All the responses were used to analysis the results of the study.

c. Data Analysis:

The quantitative research conducted through online survey, is analysed by Regression Analysis and descriptive statistics.

i. Regression Analysis

Regression analysis is divided into 3 major sections;

1. **Summary output:** how closely the generated linear regression equation matches the data from your source.

Multiple R: It is the Correlation Coefficient that measures the strength of a linear relationship between two variables. The value of multiple R can be between -1 and 1. In this data analysis, the value of multiple R is 0.649, which indicated fairly good relationship between dependent and independent variables.

R Square: It is the Coefficient of Determination, which is used as an indicator of the goodness of fit. Normally, value between 0.3 and 0.5 is moderate and this data analysis shows a value of 0.422, which indicated independent variable of Car ijarah financing, has a moderate effect on dependent variable of Islamic banking.

Adjusted R2: It is the R square adjusted for the number of independent variable in the model. Adjusted R2 is always less than or equal to R2. This data analysis shows the value of adjusted R2 to be 0.271 which is less than the value of R2.

Standard Error: It is an absolute measure that shows the average distance that the data points fall from the regression line. The value of 1.158 for S.E is considered low and it indicates that the data follows the regression line more closely and may predict the outcomes at a certain dependent variable level more precisely.

2. **ANOVA output:** It divides the sum of squares into separate elements that reveal the degrees of variability in your regression model.

df: Is the number of the degrees of freedom associated with the sources of variance. (df) = the sample size - 1. In this data analysis; sample size is 30 less 1, the df is 29.

SS: SS is the sum of squares. The smaller the Residual SS compared with the Total SS, the better the model fits the data. In this data analysis, the residual SS is 30.84 which is less than total SS 53.36. It indicates that the variables selected are in line with each other.

MS: MS is the mean square. The value of MS for this data analysis is 3.753.

F: F is the F statistic or F-test for the null hypothesis. It is used to test the overall significance of the model. The value of F for this data analysis is 2.789. Significance F is the P-value of F. Significance F should be less than 0.05 (5%). For this data, it is 0.03, which means the model for research is a perfect fit.

3. **Coefficients:** provide precise details regarding the elements of your analysis.

In most fields, lower values for the coefficient of variation are considered better because it means there is less variability around the mean. In this data analysis, the value for coefficient of variation is 1.919.

ii. DESCRIPTIVE STATISTICS

Descriptive statistics include basic statistical functions like mean, median, mode, range and standard deviation. In this research, the data collected has two variables: dependent variable is Islamic banking and independent variable is Car ijarah financing. First, descriptive statistics analysis is performed on the dependent variable which shows the mean value of 3.48, indicating that people have mixed perception about Islamic banking. Second, the analysis is performed on the independent variable which has the mean value of 3.65, indicating that car Ijarah by Bank Al Habib is moderately supported by the customers.

Both the variables' analysis is indicating moderate results, neither negative nor positive. The standard deviation for dependent and independent variable is 1.32 and 1.28 respectively.

Comparison

In this study, the dependent variable is Islamic banking while Car Ijarah is taken as the independent variable. The hypothesis constructed for this research states that Islamic banking product Car Ijarah has a positive effect on Islamic banking. Means, Ijarah financing for vehicles has contributed positively to the growth and profitability of Islamic banking. It is now widely used by people to finance their vehicles, as it is based on Islamic laws. To perform this study, the Islamic banking division of Bank Al Habib is selected. BAHL is providing car ijarah financing to its customers, and it has been a profitable product for them. So, the research is conducted to study the relationship between Car Ijarah and Islamic banking.

Findings

This study is comprised of two types of data i.e primary data which is gathered through an online survey from a pool of customers of Islamic banking division of BAHL who have taken the product of Ijarah auto finance, and also from an interview conducted from the Head of auto finance department BAHL IB.

The results which are generated after analysing the survey data shows that the hypothesis constructed for this study is supported by the data collected. The hypothesis are as follows:

- i. there is a positive relationship between car Ijarah and Islamic banking.
- ii. Islamic banking product of Car Ijarah effects positively on growth of Islamic banking.

The findings of this research proposes that the assumptions made are appropriate and it is supported by the results that customers have this perception that Car Ijarah is an effective way of financing for their vehicle and this product have greatly contributed to the profitability of Bank Al Habib Islamic Banking.

Also, the Head of Auto Finance department enlightened about how much of a trustworthy relationship their customers have with them. He acknowledged and highlighted the facts and figures of Car Ijarah and how this product has performed since the last 10 years. The statements highlights that BAML has been going up the chart on average every year, the customers prefer to avail auto finance through Car ijarah from BAML.

About the secondary data, it is extracted from the ten year annual reports of five different banks. It clearly showed on average every bank has a fairly good performs regarding Car Ijarah financing. Car ijarah has effected positively on all the banks, and contributed to the growth and profitability of the banks.

Hence, both primary and secondary data which is analysed shows that overall Car Ijarah is a great product which has a positive impact on Islamic banking. The entire hypothesis proposed for this study has proven to be correct and totally supported by the dataanalysis.

Conclusion

This research was conducted for the purpose of analyzing the relationship between Car Ijarah and Islamic banking. For this, Islamic banking was taken as a dependent variable and Car Ijarah was an independent variable. The hypothesis generated for the study was that there is a positive relationship between Ijarah and IB, and Ijarah effects the growth and profitability of IB. Bank Al Habib Limited IB was taken as the primary bank to study and test the hypothesis. The primary data was gathered through an online survey from the customers of BAHL IB and an interview was also conducted through the Head of auto finance department BAHL IB. the secondary data was collected from the annual reports of five different Islamic banks. It is found that indeed Ijarah has a positive impact on Islamic banking, and through all the years, it has increased the growth and profitability of BAHL as well as other banks selected. People support Car Ijarah as a way of financing for their vehicle and it has led to the growth of Islamic banking.

Recommendations

With the time being, the current features of Car Ijarah arising from different banks may become outdated. As, there are other ways of auto financing from both conventional and Islamic banking. So, to not let the trend of Car Ijarah fade away in the future, the banks need to upgrade the opportunity. Means, there should be included more flexible features for Car ijarah so that would be easier and much relaxing for people to avail the product. Moreover, it should be advertised with more creativity on different platforms to spread awareness among the people and spark interest in them. That way, Car Ijarah would keep benefiting Islamic banking and increase its growth.

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APPENDIX

SUMMARY OUTPUT	
<i>Regression Statistics</i>	
Multiple R	0.649619854
R Square	0.422005955
Adjusted R Square	0.271224899
Standard Error	1.158064644
Observations	30

Figure 1. *Summary output*

ANOVA					
	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>gnificance F</i>
Regression	6	22.52105	3.753509	2.7988	0.034109
Residual	23	30.84562	1.341114		
Total	29	53.36667			

Figure 2. *ANOVA output*

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	<i>Lower 95.0%</i>	<i>Upper 95.0%</i>
Intercept	1.919070223	1.093701188	1.754656796	0.092633	-0.343423064	4.181563509	-0.343423064	4.181563509
X Variable 1	0.652621172	0.254878758	2.560516139	0.017485	0.125364291	1.179878054	0.125364291	1.179878054
X Variable 2	0.025508494	0.273113519	0.093398868	0.926396	-0.539469866	0.590486853	-0.539469866	0.590486853
X Variable 3	-0.083786159	0.272182321	-0.307831012	0.760981	-0.646838189	0.47926587	-0.646838189	0.47926587
X Variable 4	-0.082422589	0.240950711	-0.342072403	0.735402	-0.58086711	0.416021933	-0.58086711	0.416021933
X Variable 5	-0.450001761	0.308833153	-1.457103154	0.158606	-1.088871814	0.188868291	-1.088871814	0.188868291
X Variable 6	0.397819948	0.23463144	1.695509981	0.103476	-0.087552166	0.883192063	-0.087552166	0.883192063

Figure 3. Coefficient output

2	
Mean	3.482758621
Standard Error	0.246256153
Median	4
Mode	5
Standard Deviation	1.326129967
Sample Variance	1.75862069
Range	4
Minimum	1
Maximum	5
Sum	101

Figure 4. Descriptive statistics- dependent variable (Islamic banking)

1	
Mean	3.655172414
Standard Error	0.239436233
Median	4
Mode	5
Standard Deviation	1.289403574
Sample Variance	1.662561576
Range	4
Minimum	1
Maximum	5
Sum	106

Figure 5. Descriptive statistics- independent variable (Car Ijarah)

#	STATEMENTS	RATING				
IJARAH CAR FINANCING– Taken as IV						
1.	<u>Ijarah</u> car financing is one of the best Islamic banking <u>product</u> .	1	2	3	4	5
2.	Service charges are higher for <u>Ijarah</u> .	1	2	3	4	5
3.	<u>Ijarah</u> car financing offers unjust prices.	1	2	3	4	5
4.	Monthly payments are higher in <u>Ijarah</u> .	1	2	3	4	5
5.	<u>Ijarah</u> car financing is free from fraud.					
6.	<u>Ijarah</u> car financing is free from <u>riba</u> .					
ISLAMIC BANKING – Taken as DV						
1.	Islamic banking is in line with Islamic philosophy of doing business.	1	2	3	4	5
2.	Choosing Islamic banking is a good idea.	1	2	3	4	5
3.	I appreciate Islamic banking because the services are offered according to <u>Shariah</u> .	1	2	3	4	5
4.	Customers have positive perception about Islamic banking.	1	2	3	4	5
5.	I will definitely recommend Islamic banking and <u>it's</u> products.	1	2	3	4	5

Table 1. *questionnaire for survey*