

Islamic Banking: Ijarah and Conventional Leasing

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1. ABSTRACT

The purpose of this study is to eliminate interest base system in financial institutions. As we know interest is prohibited in Islam so we are going to define permissible way of transactions under Islamic banking. Basic need of this project is to identify how we can run our business without involving interest in our transactions. I have intensive knowledge in Islamic Banking its transactions, what Shariah says about transactions and like that as well as we have command on conventional banking so we can easily understand what Shariah says about the transactions and what is right and what is wrong. The paper reveals their existing relationship between the Islamic banking and factors affecting in Ijarah and conventional lease.

Keywords: Ijarah and conventional lease

2. INTRODUCTION

Islamic banking deals with the help of Shariah rules. Islamic banking is totally free of interest and its product and services also. Islamic banking is the contract base system where two or more parties run business with mutual consent of profit & loss ratios, dividing risk among parties as well as written contract among them. In Islamic banking there are some mode of finance exist there which plays a vital role in Islamic banking. Conventional Banking is an interest base banking system. (Fatima, 2006) Its products and services are totally interest base. In conventional banking there is no mutual understanding among the parties of profit & loss, no liability sharing, no risk deviation among parties. It is a fixed profit system against investment and no loss or risk against investment. (Kamali, 2007)

This type of banking is prohibited in Islamic Shariah rules. At this stage Islam gives us some products how to invest our savings in the light of Shariah rules. In which one of them is Islamic Lease (Ijarah). The term “**Ijarah**” has been defined as a contract between two parties, the lessor and the lessee, where the lessee enjoys or reaps a specific service or benefit against a specified consideration or rent from the asset owned by the lessor. It is a lease agreement under which a certain asset is leased out by the lessor to a lessee against specific rent or rental for a fixed period. (Fatima, 2006). **Conventional leasing** contract is a contract between a Lessor and a Lessee for the hire of a specific asset. The lessor retains the ownership of the asset but the right to use the asset is given to the lessee for an agreed period of time in return for a series of payments paid by the lessee to the lessor. (Kamali, 2007)

3. LITERATURE REVIEW

Published literature concerning Islamic Lease (Ijarah) and Conventional Lease discussed separately as under.

3.1 Islamic Lease (Ijarah)

The term “**Ijarah**” has been defined as a contract between two parties, the lessor and the lessee, where the lessee enjoys or reaps a specific service or benefit against a specified consideration or rent from the asset owned by the lessor. It is a lease agreement under which a certain asset is leased out by the lessor to a lessee against specific rent or rental for a fixed period. (Fatima, 2006).

“Muajjir” (lessor) is the owner of the leased property. The rental falls due from the date of handing over the asset to “Mustajir”. Penalty can be charged to the lessee for delayed payment though the amount recovered is only to be used for charitable purposes by the lessor.

(Fatima, 2006).

There can't be two contracts in one contract. Since the purpose of “purchase bargain option” is entirely different than the purpose of transferring the usufructs of an asset. Inserting the clause of “purchase bargain option” serves the purpose of another contract. (Kamali, 2007) On the one hand it allows the lessee to avail the usufructs of the leased asset and on the other hand it also gives the right to the lessee to purchase the same leased asset, which is not allowed in Shariah.

A leased asset must have a value upon completion of the agreed leased period. From the time of termination, the lessee is not obliged for rental payment. Sale and lease back are allowed, but only as two separate transactions. Rent is determined by market given forces. In practice, the market rate of interest is used to determine the rental rate, although this is not explicitly stated. Leasing differs from sale in the way that it does not transfer the corpus or ownership of the property, which remains with the transferor

3.2 Conventional Lease

A conventional lease agreement is a contract between a landlord and tenant for Hire of a specific asset. The lessor retains ownership of the asset, but the right to Use the asset to the lessee is given for a period of time in exchange for a series of Payments made by the lessee to the lessor. (Fatima, 2006)

Lessee is the owner of the lease property

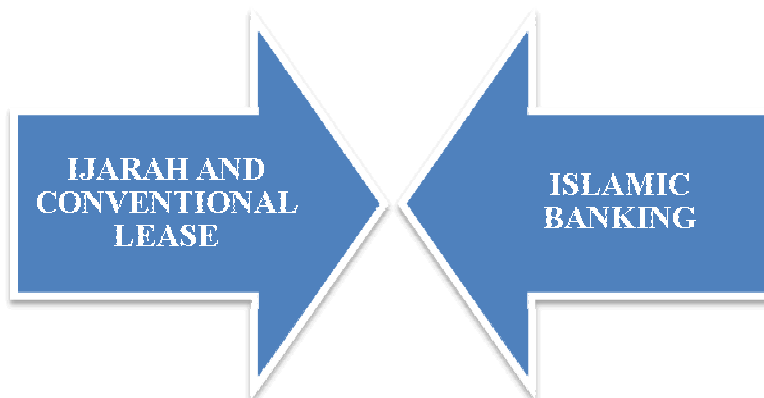
The rental falls due from the date when the lessee accepted the goods

The leased equipment must not be “limited use” property. Penalty can be charged to the lessee for delayed payment. The lease must not contain an option to purchase the asset at a bargain price. The asset must have secondary value after the expiry of the primary lease term.

On termination of lease contract, all obligations that are still executory on both sides are discharged. (Kamali, 2007). This transaction involves the sale of the property by one company to another which in turn leases the same property back to the original seller

Lessors consider market related forces while scheduling lease payments. The market rate of interest provides a basis for lease determination. A manufacturer or dealer doesn't recognize any selling profit on entering into an operating lease because it is not the equivalent of a sale. (Kamali, 2007)

4. THEORETICAL FRAMEWORK



5. HYPOTHESIS

H1: There is positive relationship between Ijarah and Islamic Banking.

6. RESEARCH METHODOLOGY

6.1 Data collection

The respondents of the study are to eliminate interest base system in financial institution and Islamic banking shows how to remove the interest base system in our country Ijarah is one of them. Conventionally, study (Fatima, 2006) was conducted to evaluate the performance Islamic banking so bankers and businessman are selected as respondents due to convenience and get better results.

6.2 Sample size determination

According to (Fatima, 2006) our sample size is 50. Simple random sampling was used to collect the data. Out of which 60 questionnaire, 50 questionnaires were received and are finally used for data analysis.

6.3 Research instrument

Data was collected by using questionnaire adopted from the study of (Fatima, 2006). The questionnaire consists of 20 questions related to our variable. The respondent of this study were asked to rate on five point Likert scale 1 being strongly agree and 5 being strongly disagree.

6.4 Data analysis

Data was entered, edited and analyze by using software SPSS version 16 and Microsoft excel by applying the following techniques; Cronbach's alpha, correlation and Regression.

Cronbach's Alpha

To check the internal reliability of the instrument, Cronbach's alpha was run. The value of Cronbach's Alpha comes to 0.783 which is above the standard value proposed by (Nummally, 1978) of 0.790 this shows that our instrument is reliable and we can confidently apply different statistical tests and interpret the results with confidence.

Reliability Statistics

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
.783	.790	20

CORRELATION ANALYSIS

		ISLAMIC BANKING	IJARAH AND CONVENTIONAL LEASE
ISLAMIC BANKING	Pearson Correlation	1	.733**
	Sig. (2-tailed)		.000
	N	50	50

Pearson correlation was run to check the relationship of variables with each other from the above table it is observed that all relationships were found significant. The correlation value of Ijarah and conventional lease is .773 which shows that Ijarah and Conventional Lease have large impact on Islamic Banking. There is strong relationship between Ijarah and Conventional Lease and Islamic Banking.

REGRESSION ANALYSIS

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.733 ^a	.538	.528	.26882

a. Predictors: (Constant), IJARAH AND CONVENTIONAL LEASE

As the table shows the model summary of in which the value of R is .733 which shows that there is strong correlation between independent and dependent variable. The value of R square is 0.538 which shows that model is good fit. Therefore our all alternative hypothesis are accepted with the significance value less than 0.05 which shows that all independent variables have great influence on dependent variable Islamic Banking.

ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	4.036	1	4.036	55.852	.000 ^a
	Residual	3.469	48	.072		
	Total	7.505	49			

a. Predictors: (Constant), IJARAH AND CONVENTIONAL LEASE

b. Dependent Variable: ISLAMIC BANKING

The above table shows that F significance is 0.000 which is less than 0.05 which shows all independent variables do a good job in explaining the dependent variable.

7. FINDINGS

The findings of this study indicate that there are various different factors that affect the Islamic banking. Here the Islamic banking is measured in terms that how effectively and efficiently they perform. And the study explores the factors that hinder them to effectively perform their duties. So the aspect of Islamic banking is Ijarah and conventional lease as a result of providing their services. The study discovers that how Islamic banking is working and what effects it is showing Ijarah is working.

The important fact is that under Shariah the leasing and sale/purchase transactions are two separate things and should not be mixed up in one contract, as both are independent and governed by separate rules.

8. CONCLUSION

This study helps in understanding that how Ijarah affects on Islamic banking. Being a Muslim is our duty to avoid all those activities that are prohibited in Islam interest is one of them in our society people don't know what actually Islam says about transactions. Shariah give us a facility of Islamic mode of finances our objective is to define how financial organization like Islamic Banks implements on it and facilitate their customers. The data was collected by the businessman's & Banks by adopted the questionnaire.

Three tests were applied Cronbach's Alpha, correlation and regression. Cronbach's Alpha shows that questionnaire is reliable. From the regression analysis it indicates that model is a good fit. By applying correlation technique all relationships were found significant. There is strong relationship between Ijarah and Conventional lease and Islamic Banking.

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