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Use of Financial Instruments and Interaction with Islamic Financial Law

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Abstract
This research provide an analysis of how financial instruments are used in markets, and to what extent they are related to Islamic financial law. Islamic law prohibits usury, uncertainty, and those transactions that involve ambiguity. Conventional finance on the other hand is debt based and involves a lot of risk. We used structured interview questionnaire, and experts from the field of conventional and Islamic finance were interviewed. Results of structure interview reveal that many things are common between Islamic and conventional finance such as rent for services in case of both conventional and Islamic lease. The Murabaha is somewhat similar to asset backed risky loan. The features of Mudaraba are closer to European option such that profits from Mudarabah offset call price. In addition the deposits are collected under both systems. This research also found that best financial instrument for increasing value of a firm is equity financing, while debt financing is not a good choice, because the later increases risk and decreases value of a firm. Swaps and forwards are used for hedging risks and saving the future. It is concluded that most of the conventional instruments are not prohibited, and they intersect at various points with Islamic financial law. The gap of two systems can be reduced by taking number of steps such as transferring ownership of a leased asset after first installments. Furthermore the gap can also be reduced if shares are offered for purchase of an asset at beginning, and when that asset begins to produce cash flows, then distributing profits equally, but the bank or organization providing services will be provided service charges.
Keywords: Islamic Financial Instruments, Conventional Instruments, Sukuk.

1. Introduction

Financial instruments are tradable assets like shares of a company, options, futures, certificate of deposits (CFD's), depository receipts, mortgage bonds, state treasury bonds etc. Financial instruments play an important role in creating cash flows for any financial institution's and organizations. Financial instruments are used for various purposes such as, liquidity management tool, hedging risk, and for the purpose of raising funds. There are two kind of financial instruments, conventional and Islamic financial instruments. Each source of financial instrument have common and different features.

Islamic financial law stated that money cannot be used as a subject matter of trade and cannot be treated as asset itself. In addition Islamic law prohibits transaction that involves uncertainty. In case of any investment profit has to be distributed in predetermined ratio and reward cannot be fixed. The main Islamic financing principles includes, asset based financing, certainty of an event, predetermined profit distributions, and prohibition of usury.

In conventional finance many transactions involves *Riba*[1]. It involves receiving money from one party and then lending money to another party to have a gain on that amount alone. In organizational perspective, shareholders have some capital gain or loss without any sound contribution to economy, so it cannot be treated as *Shari'ah*[2] complaint at any stage but under some strict conditions. Risk hedging in conventional finance may be good for one entity but it may destroy another company, such as in case of insurance if the stated event occur and insured amount is so huge then it can exert a great deal of pressure on insurance company.

Efforts have been made to reduce the distance between two financial systems i.e. Islamic and conventional. The jurists and experts created a new Islamic financial product named *Sukuk*[3]. From the past few

[1] The word *Riba* literally means an increment. According to Islamic law, Riba is an unjustified increment received by lender, by lending money to borrower. It is money paid by the borrower above the amount of the loan.
[2] The word *Shari'ah* means Islamic law. It has two primary sources, namely Quran (Muslims Holy Book) and Hadith (The prophet's sayings, deeds and his endorsements)
[3] Sukuk refers to Islamic equivalent bonds. It is different from the conventional bond because it adhere Shariah principles and prohibits the payment of interest. It grants the investor a share of an asset, with portion of cash flows and risk.

years, Sukuk has been used globally but the market of Sukuk is still in development stage. These Islamic bonds i.e. Sukuk are designed to generate return without confronting with the Islamic law. The Sukuk are one of the significant developments of Islamic capital markets. Most of the features of Sukuk and conventional bonds are common like; maturity, constant stream of cash flows along with principle payment. However the main difference is that the underlying asset in Sukuk is asset based rather than debt based as it is in conventional bonds. In addition the underlying asset should be Shariah compliant in nature and use. The eligibility of the Sukuk rests on finding a Shariah compliant asset or service. The notable condition is that the Sukuk holder is responsible for the asset related expenses. Sukuk price can rise with the increasing creditworthiness of the issuer as well as with the increase in the price of the underlying asset.

So far there have been few Islamic financial products introduced. However most of the Islamic financial products received several criticisms from the jurists. The most common criticism was that the Islamic financial products didn't follow the Islamic Shari'ah principles. This reason led to non development of most of the financial instruments and most of the Muslim's investors are reluctant to invest in such kind of instruments. This study will try to revisit the phenomenon, whether there are some common or different features of existing Islamic financial instruments and conventional financial instruments. This study will try to shed light on how Islamic and conventional financial instruments interact with each other. Furthermore how these products can be combined together and develop a new product, which is generally accepted by both investors of Islamic and conventional products. This study will provide valuable information to both academician and practitioners. The investors may benefit by having information of the financial products and can design their investment decisions.

The rest of the study is organized as follows. The second section reviews various Islamic and conventional products. The third section discusses the similar features of Islamic and conventional instruments. The fourth section presents the methodology. The fifth section discusses the results obtained from the questionnaires. The last section concludes and recommends.

2. Review of Conventional and Islamic Financial Instruments

2.1. Conventional instruments

Financial instruments are contract made between different institutional units. It includes liabilities and financial claims between institutional units including guarantee, commitments etc (Financial Derivatives, A Supplement to the fifth edition of the Balance of Payments Manual, IMF, Washington D. C., 2000). Financial instrument is any contract that gives rise to financial asset of one entity and financial liability of other entity (AS 31). Financial instruments are easily tradable package of capital, each have unique characteristic and structure, and can be equity based or debt based. There are various financial instruments like tradable assets which includes shares of a company, options, futures, certificate of deposits (CFD's), depository receipts, mortgage bonds, state treasury bonds etc.

Financial markets are in the continuous phase of experiencing explosions of innovation since 1980's. The rise of capital through the use of stock and bond is still important but is now a sideshow, and are overtaken by derivatives and securitized instruments. Derivatives are not easily understandable instruments and derived their value from some underlying asset[1]. Securitized instruments on the other hand transfer unwanted risk from one party to the other party that is inclined to take the risk. The financial markets package and repackage, bundle and unbundle transfer and retain risk with great flexibility. However innovation of these new instruments does introduce concern and has added some additional risk to the financial markets, because where ever the instruments are introduced they tend to change the velocity of market and impacting volatility, liquidity and inject additional leverage. Despite that it has also broaden the basket of risk. (Ernst N.Csiszar, 2007)

2.1.1. Equity financing

Equity represents ownership of an individual's in some organization in the form of a share's. Equity can be used as a source of financing for any organization in exchange for ownership and an expected return to the investor's. Unlike the debt financing the equity financing does not need any collateral. Two primary types of equities are common shares and preferred shares. Preferred shares protect the right of the investor such as giving priority in the case of liquidation, anti-dilution protection and the redemption rights. When an investor invests money in some organization he is actually purchasing shares of the firm and the price per share is determined by total value of the firm divided by total number of shares. The idea behind the equity financing is that over the time when new investments are brought in, the value of the firm will increase (James Macon, 2012).

2.1.2. Fixed income securities.

Fixed income securities are those financial claims that promise fixed payment of cash at fixed dates. These types of securities include treasury bills (T bills), federal agency securities, corporate securities, and municipal securities (J Wang, 2006). Fixed income securities are classified according to their nature of time. Those with short term maturities are referred as money market and cash investments, as their maturity is short term they can

[1] The underlying asset is the financial instruments such as stock, bond, commodity, index, future etc.

be easily converted in to cash, while bonds are long term instrument having maturity up to 30 years. The fixed income securities are those securities that yield predictable return after fixed interval of time. These securities have low volatility and are ideal investments for the people seeking fixed returns.

A treasury bill (T-bills) has maturity less than one year. T-bills are zero coupon securities and should not be confused with bonds because they have short term maturity. T-bills are issued in the denomination of 5,000$ but it varies from country to country. The price of T-bills are not directly quoted for example Wall Street ranks T-bills according to their maturity and maturity dates is followed by prices (Gray Strumeyer, 2012)

The bond is long terms instrument having maturity greater than one year. There are many types of bonds such as ordinary bonds, priority bonds, subordinated bonds, zero coupon bonds, index bonds, convertible bonds, perpetual bonds and annuity bonds. Ordinary bonds are fixed term bonds and in the case of liquidation of the issuer they are reimbursed when all preferential creditors are paid. Subordinate bond holders are reimbursed when all other bond holders are paid. In zero coupon bonds, interest are not paid annually but capitalized until maturity. Index bonds are those bonds yield of which depends upon one or more indices such as inflation. Perpetual bonds have no maturity and accompanied by call. (Philippe Wallez, 2010)

2.1.3. Derivative financial instruments

Derivative financial instruments are designed to reduce risk associated with vitality exchange and interest rates. They derived their value from the underlying assets. They are intended to hedge that's why they are named derivatives instruments. It can be used for speculation as well as hedging. A financial derivative gives its holder the right to sell or buy an underlying asset during and prior to expiry period (Rene M Stulz, 2005).

Transactions under financial derivatives should be treated as separate transaction rather than an integral part of the underlying asset to which they are linked. They help to trade special financial risk such as currency, commodity, and equity price risks to other parties who are more willing to take the risk. The risk that is embodied in derivative agreement can be traded by trading the contract itself such as in the case of options or creating a new contract that matches the risk characteristic in a countervailing manner to the existing contract, latter process is called offset ability. There are many types of derivative instruments namely, forward and future contracts, options and swaps (Statistic department IMF, 1998).

In forward contracts, one party is obligated to buy some underlying asset at future date at a fixed price from other party who is obligated to sell at that date at fixed price (Rene M. Stulz, 2005). Future contracts are forward contracts traded on organized exchange, which allows a trader to undertake, accept or make the delivery of a financial asset in future on a price set today. The party who is agreeing to deliver the asset is short in position while other party accepting the delivery is long in position. (Gary R. Evans, 2013)

Options are financial contracts that give its holder the right but not obligation to buy or sell some underlying asset at a pre-determined price and predetermined date or during the agreed period. Some options are not linked to a share but basket of shares whose price is determined by stock market index. When the holder of option wishes to carry out transaction, then the seller is obliged to perform, and seller will receive premium. Options can be traded in the secondary market which is comparably less expensive (Philippe Wallez, 2010)

Swap means exchange. The Swap is a contract for the exchange of cash flows over a specific period. Nominal amount principle is used to compute the cash flows. For example suppose you have 200,000$ million adjustable mortgage and current annual payments are 11,000$. Ff interest rates double then your payment per month will also double, to reduce this risk you will agree to pay payments to bank at a fixed rate applied to 200,000$ and in exchange the bank will pay you floating rate applied to 200,000$ and you can use this payments to pay your mortgage payments. (Rene M. Stulz, 2005)

2.1.4. Monetary gold and Special Drawing Rights (SDR)

Monetary gold and Special Drawing Rights (SDR) are only financial assets against which there is no liability. Monetary gold is used by bank and governments as official reserve. Transactions by the monetary gold are operations for the sale and purchase of gold and these transactions are carried out between central banks or central banks and international financial organizations. SDR are international reserve held by the international monitory fund and is allocated to the members companies to supplement official reserve. SDR can be thought as an artificial currency that is used by the IMF for international accountings purposes and is not treated as IMF liability. (Retrieved from http://www.imf.org)

2.2. Islamic financial law

Islam has simply prohibited Riba and Quran (The Holy Book of Islam) several times condemns those who take Riba. Riba is some sort of increase on the capital sum, but every increase cannot be considered as Riba. The Islamic principle also prohibits *Gharar*[1] and gambling. Numbers of restrictions are placed on sale of different financial instruments in order to protect the interest of both parties. However exceptions include in case of prepaid forward (Salam) sale and manufacturing by the contractor (Istisna) (Mohammed el gammal, 2006).

[1] Gharar is considered as uncertainty.

Islam has allowed exchanged of things such as silver for silver, gold for gold, hand to hand, in equal amounts and any increase is considered as Riba. Some scholar mistakenly understood that only high amount of interest is prohibited and normal charge on loan is allowed as they carried a view that any charge on loan is considered as Riba only if it doubles or redoubles. It is argued that normal interest working in banking system cannot be termed as Riba as it is no excessive. However this argument is against the Islamic principles.

2.2.1. Riba

Riba and usury are close in nature with the difference that interest is moderate compensation of the capital while the usury is some time inflammatory. Some jurists says that only usury should be considered as haram[1] but majority hold the opinion that any increase in the amount of the money borrowed is Riba. Inflation is also part of the Riba debate, since some scholars have the opinion that Riba only applies to the real interest rate and not the nominal interest rate (Warde, 2000).

2.2.2. Gharar

Gharar or uncertainty is also prohibited by Islamic law. Gharar means uncertainty and in the context of finance it can be regarded as risk and speculation. Shari'ah has banned contracts that have uncertainty of existence. More specifically, Gharar refers to contracts that include uncertain events and unlikelihood of the delivery (Vogel and Hayes, 1998). It is impossible that a contract has no certainty, so some scholars differentiate minor Gharar from the major Gharar, means tolerable uncertainty and intolerable uncertainty. To be deemed as haram, Gharar must affect some principal component such as price. Like for example, the sale of pregnant cow which is the object of the sale but not the unborn baby, because the status of the unborn baby is uncertain (El gammal, 2002)

While Riba is banned by the Holy Quran, the condemned of Gharar is evident from Hadith[2]. In business term Gharar is referred as undertaking a venture blindly without having sufficient knowledge or making an excessively risky transaction. Any transaction's where basics pillars of contract are ignored such as measurement of the object and consideration and hence takes risk. This kind of risk is not allowed by Shari'ah. Gambling is also prohibited by Islam, where large amount of risk is involved. However general commercial risk is allowed (Haluk Gurulkan, 2010)

In Islamic finance the party who invests his money shares a very good part of the risk with those who carry out the transactions (Al Jahri et al, 2004). The other common feature of Islamic financing is asset backed financing, which means that every transaction must be backed by some identifiable and tangible useable asset. Islam does not permit money as the subject matter of trade (Taqi Usmani, 2002)

The main theme behind the Islamic finance is asset backed financing which is opposite to conventional banking system where only money and monetary papers are used. Islam doesn't recognize money as the subject matter of trade, but in some very special cases. Money has no intrinsic utility and act as a medium of exchange only. The modern financial system recognizes entrepreneur and capital as two different things, where the former gets interest and the latter receive profit. Islam on contrary side does not recognize capital and entrepreneur as two different things, but every person who contributes capital to the organization is exposed to the loss of risk and also receive some proportion of profit. In Islamic financial case capital provided has intrinsic element of "entrepreneur" and is equally entitled for the profit (El Gammal, 2002)

3. Interaction of Islamic law and financial instruments

Islamic laws have all the features of conventional finance such as capital markets, fund manager, investment fund and insurance company. But all of these govern under the Islamic law. Islam has allowed providing equity capital to a project or a venture, losses are shared on equity bases and profits are shared on a predetermined such as Musharaka and Mudarabah (internationalfinancemagazine.com).

There are many debt instruments introduced in the market under the Islamic financial law namely Bai-Murabaha, Mai-Muajjal and Ijarah. In Bai-Murabaha, Islamic banks facilitate purchase of a good for his agent and charge a fee on it. Title of the good is passed to the agent. This feature resembles to Riba but has been permitted by Islamic scholars and Jurists such as Ibn Al-Arabi and Al-Qurtabi (Ismail, 1992).

From the modern prospects of finance, Murabaha is similar to asset backed risky loan. If the capital markets are perfect and all consumers have same access to the information then competition between Islamic banks and conventional banks will result in Murabaha, having the same expected return as that of Ribawai rate. Due to the integration of global capital markets Islamic finance authorities are constrained to price their loans on their ex-antae basis (Thomas R, 1995).

According to Rohmatunnisa (2008), Conventional lease is an agreement where which give right to the leasee to use the asset in exchange for series of fixed payments. Analogy to conventional lease is Ijarah. In Ijarahm Islamic bank act as a leasor, buying an asset and then leasing it to the leasee. Payments are determined at the begging of the contract and are paid during the process of temporarily possession.

[1] Haram is an Arabic word, which means the things prohibited by Islamic principles.
[2] Hadith means the sayings of the Holy Prophet Hazrat Muhammad (S.A.W.W)

Deposits are collected under both financial system, but the difference lies in the method of reward. Under conventional system, the reward is fixed and under Islamic system, reward is varied and depends upon revenue of business in which the money is invested. The difference in the two financial system lies in risk and reward, under conventional system, total risk is borne by the banks and all profit belongs to him after all clients are paid, while in Islamic system, risk is shared between investor and the manager of fund (Mohammed Hanif, 2010).

Classical Mudarabah can be explained where an investor will reinvest until the principal is returned to the Rab-ul-Maal[1] and the rest is shared according to predetermined ratios. In the context of modern finance, this is similar to allocating a fraction of income of the project. From the income of the project, investor's is given revenue of the project and principal is returned on the completion of the project. This sort of financing is similar to the conventional income bond. The feature of Conventional finance and Islamic finance are somewhat common in case of growth and income. Mudarabah in which the investor is given income as well as appreciation of the venture (Shahid Ibrahim, 2010)

3.1. Introduction to Sukuk

The growth of the Islamic finance is exceptional since the Bank of Bahrain issued first sovereign Sukuk bonds in 2001(www.accaglobal.com). Shari'ah compliant securities and procedures are becoming main stream of the world economy since last decade (Abdul khaleq, Ayaman H, & Christopher H Richardson, 2006, New Horizons for Islamic Securities: Emerging Trends in Sukuk Offerings.). According to the conservative sources, the assets of the Islamic institutions are two hundred and thirty billion dollars (Mohammed Obaiullah, 2005). As a result, number of countries in Islamic world has suffered because of high prices and cost related to the foreign direct investment, new form of Islamic finance and investment has emerged (Abdel-Khaleq et al, 2006). Many financial institutions now act as facilitators in providing Islamic securities named "Sukuk" (Mohammed Obaidullah, 2005). The term Sukuk is first proposed in the Islamic jurisprudence session of Islamic development banks in 2002 (Majid Pireh, 2005). Sukuk is defined as certificates that represent the holder proportion in an undivided part of the underlying asset (Mohd Nazri Bin Chik, 2012). Sukuk are documents or certificates that represent ownership of an asset (Tan Wen Yen, 2007). It should not be simply regarded as alternative for the conventional interest based securities (Rodney Wilson. Overview of the Sukuk market). Sukuk are of various types depending on the type of the agreement such as Istisna, Murabaha, Mudaraba, Musharaka and Salam (Heri Fathurahman, & Rachma Fitriati , 2013).

Sukuk is the most common Islamic debt market instrument (Mohd Nazri Nin chik, 2012) and has shown tremendous growth since its appearance in 2002 and the first global Sukuk is issued by government of Malaysia of amount 600bn in 2002 (Zohra Jabeen and Mohammed Tariq Javed, 2008) followed by the government of Qatar in 2003 and Government overnment of Pakistan in 2005 (Zohra Jabeen et al, 2008). Islamic fixed income securities are emerging as a significant class of assets and are equally as important for Muslims, just like bonds are important to the conventional security investors (Rodney Wilson, 2005). The conventional bonds are attractive because they are used as liquidity management tools but Islamic institutions cannot hold such Riba based instruments (Rodney Wilson. Overview of the Sukuk market). The first step to overcome liquidity problem is undertaken by bank Negara Malaysia (Rodney Wilson).

According to Taqi Usmani (2010), Sukuk are almost similar to the financial instruments but differ in the sense of that Sukuk are asset based while the bond are debt based. Although some issuers are issuing Sukuk in which there is doubt in representing of the ownership. Such asset in Sukuk may be share of a company that do not confer the true ownership and only entitled return. The aforementioned feature doesn't led the Sukuk market to develop more significantly.

3.1.1. Sukuk al Ijarah

Ijarah is derived from the root word "ajara" mean to compensate (Mohammad Hashim Kamali, 2006). In the contract of Ijarah, the usufruct of an asset is transferred to the other party in return of rental payment and is similar to conventional lease contract (Asaeed & O Salah. Development of Sukuk: Pragmatic and Idealist Approaches to Sukuk Structures). Thus the Sukuk is based on tangible asset acquired by the SPV[2] rather than debt security (Saeed, 2006). Issuers apply procedure of Sukuk to purchase a real state from an originator and later lease it again to the originator (Mohad Zain, 2006). In Ijarah, fixed rent is being paid which is same as the conventional interbank rates like LIBOR because it is not based on the return of the underlying asset but to interbank money market rates (Zohra Jabeen, 2006). Although from the Shari'ah prospective leasee should acquire ownership right of leased property, but in practice the assignment of lease without transferring the right of ownership, the leasor can sell the leased property to the third party and a relation is developed between new owner and leasee (Mohammed Hashim Kamal, 2007).

[1] Rab-ul-Maal means owner of the capital.
[2] SPV means Sukuk borrowing with collateral

3.1.2. Salam Sukuk
Salam is the sale of a commodity, well defined in quality and quantity and is delivered to the purchaser on a specific future date against the full price paid in advance today and the delivery of the goods is differed at some future date (Humayon Dar, 2006). A certificate is issued to by leasor to the leasee and holder of the certificate is owner of the good. It is not important that the commodity is present at the time of the contract but full description of commodity is required (Linklaters, 2012). One of the Shari'ah required rule is that the purchased goods are not resold before possession at maturity because of the debt involved in the transaction (Hamayun, 2006).

3.1.3. Istisna Sukuk
Project can be financed through Istisna contract in which funds are paid in advance for the supplies and the labor cost .Once project is completed the advances are repaid from the profit derived from the project (Nathif J, Adam, & Abdulkader Thomas, 2006). Istisna is a contract where a party agree to produce any good that is possible to made according to certain agreed upon specifications at a fix price for a certain delivery date (*www.isdb.org*, 1997, May 2). The public or private company financing the project provides the details, specification and scheme (Adam, 2006). Bids are asked from the contractors who will specify that how they are going to sell completed parts of the projects and expected installment payment (Nathif, 2006). The installment includes the element of profit over the construction cost (Thomos, 2006). Issues relating to Istisna are that whether an Islamic company can own real property under the local law (Zaheer & Hassan, 2009). It should be noted that Istisna contract cannot be traded in the secondary market because they are debt based (Nathif, 2006).

3.1.4. Mudarabah Sukuk
Mudarabah has been the most successful in case when the investment is placed with the Islamic bank where the profit is calculated annually on the basis of the banks profit (Nathif, 2006). Mudarabah is a contract whereby investor's provide capital to his agent (Mudarib) for the project where profits are distributed on predetermined ratios (Zaheer & Hassan, 2009). It should be noted that Mudarib cannot enjoy the capital gains based on the market valuation of the company and are only restricted to the profits (Adam, 2006). The SPV acts as the silent partner (A Saeed, 2006). In the case of loss, Rab ul Maal gain no return and the agent receives no income (Zaheer, 2009).

3.1.5. Musharaka Sukuk
Musharaka is derived from the root word "Shirka". Musharaka involves establishing partnership with one or number of other persons and the profits are shared by pre-agreed ratio and losses are shared to the size of their investments (Nathif, 2006). Musharaka is perceived as a most preferred form of financing because closely resembles the principle of profit loss sharing. In Musharaka, partners share capital, risk and rewards of the project. All partners have equal rights but have no obligation to participate in the management of the project (Mirakhor, 2007)

In Musharaka, two or more than two persons share their funds and managerial skills for certain business and risk in mutually shared. Musharaka was in practice in Arab before Islam. Shari'ah prohibits the partners to receive guaranteed return and predetermined return on their investment. Partners are equally responsible for management and responsibilities .Under Musharaka the banks make equity contribution towards the company of the client. The bank in return has the right to receive the agreed rate of return and contribute to the losses according to their proportion in the investment. Bank and the client both have the right to manage the Musharaka enterprise. In the case of corporation, the bank appoints its staff in the board of directors (Abdulkader S.thomos et al).

3.1.6. Murabaha Sukuk
The widely used and most important financial instrument is Murabaha. It is based on the sale of some commodity or any other thing on the basis of cost plus profit, which is fully known by both of the parties. Murabaha is trade contract where one party buys something from his own account at some cost and then sells it to the other party on some profit. The mark up is not confused with Riba because underlying subject matter is tangible asset and services charges are charged on purchasing for the client. Payments can be made at the spot and also at some other time (Visser et al, 2009)

Murabaha is used as a sale contract where financial institution buys an asset and then sell it latter at a marked up price. Payments can also be made installments. Murabaha usually provide supply for only short term financing (CF Richardson, 2007)

The possibility of having legal Murabaha Sukuk is only in the primary market and they cannot be traded in the secondary market because in some cases when installment are still due and buyer owes some loan to seller and if its traded by buyer it will be deemed as Riba.

4. Methodology
4.1. Population
The population for our research includes commercial banks, both Islamic and conventional and corporations

functioning in Pakistan, including Muslim commercial bank, Alfalah bank, Meezan bank and other corporations.

4.2. Sample

We have taken sample from Wah Noble wahcantt, Albaraka Bank Wahcantt and Habib Bank Limited. The financial experts in the relevant field have been considered from the aforementioned organizations.

4.3. Structured interview questionnaire

We have conducted research using structured interview questionnaire from experts of Islamic and conventional finance. The questionnaires were used to

4.4. Questionnaires

The following are the questionnaires, which have been administered to the experts.

1. Do you think that return given by financial products is similar to the interest that is prohibited in Islam (Moody, 2010)?
2. Which financial instrument is better to increase value of a firm and why (James Maccon, 2012)?
3. From an investor point of view, which investment options are better among SWAPS, options, derivatives etc (Philippe Wallez, 2010)?
4. According to some scholar's, Riba applied only to real interest rate and not nominal interest rate? What is your opinion regarding that (Warde, 2000)?
5. Do you think conventional lease and Islamic lease (Ijarah) are same in nature and Ijarah doesn't include Riba (Rohmatunnisa, 2008)?
6. Do you think that Conventional bonds are attractive because they are used as liquidity management tools but Islamic institutions cannot hold such Riba based instruments (Ronday Wilson, 2005)?
7. Explain how adopting a common financial position can help Islamic economic system?
8. Do you think that Sukuk have been reduced so much that it is almost similar to conventional bonds (Moody, 2010)?
9. Do you support trading money as a subject matter of trade (Taqi Usmani, 2010)?
10. Islamic banks have to deal with uncertainty of installments, explain how can they overcome this problem?
11. In modern Islamic Ijarah, Is the rate negotiated is similar to LIBOR (Mohammed Hanif, 2010)?
12. Financial institutions assist in the running of the economy by two ways, first by saving mobilization from savers to entrepreneurs; second, by providing services globally and on local scale, such as transferring funds and facilitating in international trade. Do you think Islamic economic system can be improved by the latter method (Mohammed Hanif, 2010)?
13. Do you think gambling is involved in financial instruments (Mohammed el gamal.2000)?
14. Conventional instruments are based on the idea that capital and entrepreneur are two different things which Islam does not allow. Do you think Islamic finance can be developed on recognizing capital and entrepreneur as same and still can be developed (El gammal, 2002)?
15. How Islamic finance can help small businesses in both Islamic world and non Islamic world (Samer budeir, 2008)?
16. How a micro credit can help Islamic and non Islamic world to create worldwide Islamic industries (Kevin Newton, 2008)?
17. Do you think Islamic instruments issued by the German company Saxony-anhalt are Shari'ah based? If yes then how, and if no, why (Samer Buider, 2008)?
18. Does risk assessment in Islamic finance and conventional finance are same (Warren Edward, 2011)?
19. How risk management frame work of Islamic finance can improve (Arif Hadiyat Ali, 2011)?
20. How new Islamic products can be developed, either modifying conventional products or bringing completely new Islamic product (Hiba Allam, 2012)?
21. Deposits are collected in both systems; do you think Islamic finance can be justified on giving varied reward as compared to conventional where reward is fixed (Mohammed Hanif, 2010)?
22. According to Taqi Usmani, 85% of Islamic financial products are not Shri'ah compliant. Do you agree (Samer, 2010)?
23. In your opinion what is the greatest difference between conventional and Islamic finance (James Maccon, 2005)?
24. Which conventional instrument is closest to Islamic instruments (Ronday Wilson, 2005)?

5. Discussion

This aim of this paper is to add some valuable knowledge to existing literature to know whether the conventional and Islamic finance have similar features. A majority of Islamic population hold opinion that all financial transactions are haram and we should avoid them. It is somewhat true but conventional finance is not against Shari'ah, one or two sources of conventional financing are completely compatible with Islamic finance such as partnership provided that subject matter is Shari'ah compliant. The rest of conventional financing instruments needs some modifications such as share purchasing is allowed by some jurists with restriction that asset against which shares are offered should be physically present and then you can offer shares. This study finds that some jurist's hold the opinion that interest factor is not prohibited up to some extent unless it's excessive (usury). Some says that it is not that interest that is banned in Islam and it's different from Riba of Quran. Majority hold opinion that its Quran Riba as money is used as a subject matter of trade and money generates money which is prohibited. Another group of jurists thinks that interest only applies to real interest and not on nominal interest rate.

Sukuk is combination of modern finance and according to principles of Islamic. Sukuk has been successfully used in many countries and has considerable contributions. However Sukuk legitimacy is still an issue as Taqi usmani, president of Accounting and Auditing Organization for Islamic Financial Institutions (AAOFI) declared that 85% of Sukuk products that are used in capital markets are non Islamic. In addition a jurist says that the rate negotiated during the Ijarah contract is similar to KIBOR and LIBOR. Those banks who use these standards as benchmarks argue that there is a clear fatwa on use of benchmarks, as Shari'ah has permitted usage of benchmark, because the rate remains same for the whole year and some extra rate is added to current prevailing rate of return. Gambling is also involved in conventional finance and it is very clear and not allowed in Islam.

Conventional systems use many financial instruments and this study has showed that the most important instrument for increasing value of firm is equity. As equity brings capital and reduces leverage part. Other benefits of equity financing is that investor face the overall risk of financing alone, not company, and if company fails then organization don't have to pay to the investor's and this is not all, the company will have more money as there are no loan payments. On the other side, in equity financing, company have to priority to those investor having larger percentage in shares and their decisions also affect the company decisions as well. Leverage on the other hand reduces value of a firm because the more a firm heavily leveraged the more chances are that it will not be able to pay back interest to lenders.

6. Conclusion

One of the important aims of this research was to find out if financial instruments used by conventional systems are Riba based and to what extent they meet Islamic financial law requirements. This study concludes that if a benchmark is used for an extended period of time let say 1 year then it is almost Riba free, as one manager says that there is a clear fatwa on using benchmark. The ambiguity arises when we say that, what about fixed reward like deposits are collected by both counterparts and reward is fixed. Financial institutions have arguments that reward is not fixed but can be variable and profit is shared on the basis of pre-determined ratio. The difference between two financial systems occurs when subject matter is prohibited by Islam, such as alcohol. Two financial instruments are close to Islamic instruments, equity financing and Ijarah. Equity financing is permitted as long as company is not engaged in businesses which are haram. The best financial instrument for increasing value of firm is equity financing and money cannot be used as subject matter of trade and is not considered as an asset itself in Islamic financial law.

The aforementioned discussion led us to conclude that both financial systems intersect with each other in some cases; however majority of the features of financial and conventional financial instruments differentiate. A new Islamic financial instrument can be introduced by focusing on the common features of the both system.

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