ABSTRACT
Why did Islam prohibit interest? What is the logic behind that? What types of interest has Islam prohibited? These are certainly the questions that face both Muslim and non-Muslim economists. When Islam was introduced 1400 years ago, one of the main issues discussed, was Riba or interest Sharia prohibits the payment of fees for the renting of money (Riba, usury) for specific terms, as well as investing in businesses that provide goods or services considered contrary to its principles (Haraam, forbidden). It is the finding of this study that both Islamic and conventional banks can operate harmoniously in Nigeria. It was also recommended that Islamic banking be given a chance for rapid economic recovery of the economy.

Keywords: Islamic banking, Sharia, usury, Interest-free banking

INTRODUCTION
Islamic banking refers to a system of banking or banking activity that is consistent with the principles of Islamic law (Sharia) and its practical application through the development of Islamic economics. Sharia prohibits the payment of fees for the renting of money (Riba, usury) for specific terms, as well as investing in businesses that provide goods or services considered contrary to its principles (Haraam, forbidden). The basic principle of Islamic banking is the prohibition of Riba- (Usury - or interest): "While a basic tenant of Islamic banking - the outlawing of riba, a term that encompasses not only the concept of usury, but also that of interest - has seldom been recognised as applicable beyond the Islamic world, many of its guiding principles have. The majority of these principles are based on simple morality and common sense, which form the bases of many religions, including Islam. "The universal nature of these principles is immediately apparent even at a cursory glance of non-Muslim literature. Usury was prohibited in both the Old and New Testaments of the Bible, while Shakespeare and many other writers, particularly those writing in the 19th century, had attacked the barbarity of the practice. Riba is prohibited in Islam in all forms and manifestations. This prohibition, which is based on the Divine Authority and not on an economic theory, is strict, absolute and unambiguous. The holy Qur’an says “O ye who believe! Fear Allah and give up what remains of your demand for riba; if you are indeed believers” (2:278). The next verse says “If you do it not, take notice of war from Allah and His
Messenger. But if ye turn back, ye shall have your capital sums. Deal not unjustly and you shall not be dealt with unjustly.” (2:279). In the light of these guidelines, riba can be defined as “Any amount, big or small, over the principal, in a contract of loan or debt is Ribah(interest), prohibited by the Holy Qur’an regardless of whether the loan is taken for the purpose of consumption or for some productive activity. It is important to note that in money lending transactions, anything recovered, paid or received, in excess of the principal amount, as per agreed arrangements is riba. It does not make any difference by whatever name it is called, riba, usury, interest, profit, biyaj, mark-up or service charge etc. It must also be clearly understood that riba is prohibited as it may lead to injustices (zulm) and Islam is against all forms of injustices and exploitations and pleads an economic system that aims to secure extensive, socio economic justice.

**Historical Development**

Early seventies saw the institutional involvement. Conference of the Finance Ministers of the Islamic Countries held in Karachi in 1970, the Egyptian study in 1972, First International Conference on Islamic Economics in Mecca in 1976, International Economic Conference in London in 1977 were the result of such involvement. The involvement of institutions and governments led to the application of theory to practice and resulted in the establishment of the first interest-free banks. The Islamic Development Bank, an inter-governmental bank established in 1975, was born of this process. The first private interest-free bank, the Dubai Islamic Bank, was also set up in 1975 by a group of Muslim businessmen from several countries. Two more private banks were founded in 1977 under the name of Faisal Islamic Bank in Egypt and the Sudan. In the same year the Kuwaiti government set up the Kuwait Finance House.

The first modern experiment with Islamic banking was undertaken in Egypt under cover without projecting an Islamic image—for fear of being seen as a manifestation of Islamic fundamentalism that was anathema to the political regime. The pioneering effort, led by Ahmad Elnaggar, took the form of a savings bank based on profit-sharing in the Egyptian town of Mit Ghamr in 1963. However, small scale limited scope interest-free banks have been tried before. One in Malaysia in the mid-forties and another in Pakistan in the late-fifties. Neither survived. In 1962 the Malaysian government set up the “Pilgrim’s Management Fund” to help prospective pilgrims to save and profit. The savings bank established in 1963 at Mit-Ghamr in Egypt was very popular and prospered initially and then closed down for various reasons.

However this experiment led to the creation of the Nasser Social Bank in 1972. Though the bank is still active, its objectives are more social than commercial. In the ten years since the establishment of the first private commercial bank in Dubai, more than 50 interest-free banks have come into being. Though nearly all of them are in Muslim countries, there are some in Western Europe as well: in Denmark, Luxembourg Switzerland and the UK. Many banks were established in 1983 and 1984. In most countries the establishment of interest-free banking had been by private initiative and was confined to that bank. In Iran and Pakistan, however, it was by government initiative and covered all banks in the country. The governments in both these countries took steps in 1981 to introduce interest-free banking. In Pakistan, effective 1 January 1981 all domestic commercial banks were permitted to accept deposits on the basis of profit-and-loss sharing (PLS). New steps were introduced on 1 January 1985 to formally transform the banking system over the next six months to one based on no interest. From 1 July 1985 no banks could accept any interest bearing deposits, and all existing deposits became subject to PLS rules. Yet some operations were still allowed to continue on the old basis. In Iran, certain administrative steps were taken in February 1981 to eliminate interest from banking operations. Interest on all assets was replaced by a 4 percent maximum service charge and by a 4 to 8 percent ‘profit’ rate depending on the type of economic activity.

Interest on deposits was also converted into a ‘guaranteed minimum profit.’ In August 1983 the Usury-free Banking Law was introduced and a fourteen-month change over period began in January 1984. The whole system was converted to an interest-free one in March 1985. The paper is divided into four sections, the present section introduced the study, which covered the introduction and historical
development, section 2 covers the theoretical concepts, section 3 covers the modes and principles of operations and section 4 concludes.

Theoretical Concepts
Interest-free banking seems to be of very recent origin. The earliest references to the reorganisation of banking on the basis of profit sharing rather than interest are found in Anwar Qureshi (1946), Naiem Siddiqi (1948) and Mahmud Ahmad (1952) in the late forties, followed by a more elaborate exposition by Mawdudi in (1950 & 1961). Muhammad Hamidullah’s 1944, 1955, 1957 and 1962 writings too should be included in this category. They have all recognised the need for commercial banks and the evil of interest in that enterprise, and have proposed a banking system based on the concept of Mudarabha - profit and loss sharing.

In the next two decades interest-free banking attracted more attention, partly because of the political interest it created in Pakistan and partly because of the emergence of young Muslim economists. Works specifically devoted to this subject began to appear in this period. The first such work is that of Muhammad Uzair (1955). Another set of works emerged in the late sixties and early seventies. Abdullah al-Araby (1967), Nejatullah Siddiqi (1961, 1969), al-Najjar (1971) and Baqir al-Sadr (1961, 1974) were the main contributors.

MODES AND PRINCIPLES/INSTRUMENTS OF OPERATION
Islamic banking has the same purpose as conventional banking except that it operates in accordance with the rules of Shariah, known as Fiqh al-Muamalat (Islamic rules on transactions). The basic principle of Islamic banking is the sharing of profit and loss and the prohibition of riba (usury). Amongst the common Islamic concepts used in Islamic banking are profit sharing (Mudharabah), safekeeping (Wadiah), joint venture (Musharakah), cost plus (Murabahah), and leasing (Ijarah).

Lending
Lending has to be a virtuous act as per the principles of Shariah. The principle that holy Qur’an has given in Verses 2:278 and 2:279 is that, in both cases of loans and debts the creditor has the right to the principal amount only; in former case, exactly the amount given as loan, and in latter case, the amount of debt generated from the credit transactions etc. At the most, they can recover from the debtors a service charge not exceeding the actual proportionate cost of the operations, excluding the cost of funds or opportunity cost in the conventional sense. As Islamic banks are commercial organisations, lending is not their major activity.

Shirkah-based; Mudarabah (Profit & Loss Sharing) PLS modes
Shirkah can be defined as an arrangement where two or more persons combine either their capital or labour or credit-worthiness together, having similar rights and liabilities, to share the profits or a yield or appreciation in value and to share the loss, if any, according to their proportionate ownership. Shirkah can be divided into two broad types of Shirkatul Milk (partnership through ownership) and Shirkatul Aqd (through contract) with Shirkatul ‘Inan. The latter, that is more relevant to the general partnership business and generally termed as commercial partnership, is divided into further three types i.e. Shirkah al Amwal (Capital), Shirkah al A’amal (work) and Shirkah al Wajooh (based on credit worthiness). Shirkatul Milk is the mixing of ownership mandatory or by choice. It is not for any commercial business or sharing of profit. The co-owners may use the property jointly or individually or share in its appreciation / depreciation when disposed off. If joint property is used by one partner, other partner may demand rent for his part of the property. The distribution of the revenue of Shirkatul Milk is always subject to the proportion of ownership. Shirkatul ‘Inan is a valid form of contractual partnership in the eyes of all schools of thought. It means a joint enterprise formed for conducting any business with the condition that all partners shall share the profit according to agreed ratio while the loss will be borne according to the ratio of contribution to the joint business. Each partner is an agent to other partners. Below is discussed, the commonly used terms of musharakah and mudarabah.
Mudaraba
Mudaraba is a type of partnership whereby skill and money brought together to conduct business. Profit is shared according to agreement while loss is born by capital provider only. Under this scheme of financing IFIs provide capital to financially weak but skilful people to do the business and share outcome with IFIs. This scheme is also used in deposit collection. Mudaraba contract can be restricted or unrestricted. No one can claim a lump sum amount of profit, it must be based on actual outcome (Sharia standard 13).
In other words, this is an arrangement or agreement between the bank, or a capital provider, and an entrepreneur, whereby the entrepreneur can mobilize the funds of the former for its business activity. The entrepreneur provides expertise, labor and management. Profits made are shared between the bank and the entrepreneur according to predetermined ratio. In case of loss, the bank loses the capital, while the entrepreneur loses his provision of labor. It is this financial risk, according to the Shariah, that justifies the bank's claim to part of the profit. The profit-sharing continues until the loan is repaid. The bank is compensated for the time value of its money in the form of a floating rate that is pegged to the debtor's profits.

Musharaka
According to Hadith Qudasi (revelation reported by Prophet Muhammad PBUH) Indeed, Allah the Exalted says: I am the third of the two partners so long as the one does not cheat the other, and when he cheats, I withdraw myself” (Khan, 1989). Literal meaning of Musharaka is sharing. Its root in Arabic language “Shirka” means being a partner. Musharaka means a joint enterprise formed conducting some business in which all partners share the profit according to pre agreed ratio while loss is shared according to the ratio of contribution (Meezan bank guide 2002). For a valid Musharaka fulfillment of certain conditions required. First is there must be an agreement written (verbal) among the partners stating clearly the terms and conditions including management, capital contributions, profit and loss sharing among the partners. Second capital can be contributed in cash as well as in assets. However once an asset is contributed as capital that belongs to firm and contributing partner is relieved from the bar of risks and returns attached with ownership. Third profit is distributed according to agreement of partnership however sleeping partner cannot claim share in profit more than his proportionate share in equity. None of the partner can guarantee the capital or profit share to any other partner (Sharia standard 12). Under Musharaka IFIs are receiving deposits and finances business requirements for profit and loss sharing.

Diminishing Musharaka
Diminishing Musharaka is a form of declining partnership between IFI and client generally used to finance real estates. When a customer requests to IFI for financing to purchase an asset IFI participates in the ownership of asset by contributing required finance. Certain portion (e.g.20%) must be contributed by customer. Total equity of bank is divided into units of smaller amounts which are purchased by client in installments. Under this mode of financing one of the partners (client) promises to buy the equity share of the other partner (IFI) gradually until the title to the equity is completely transferred to him. Buying and selling of equity units must be independent of partnership contract and must not be stipulated in partnership contract. Generally IFI rent out his share to client and earns rentals. Any profit accruing on property is distributed among the co-owners according to agreed ratio however losses must be shared in proportion of equity (Sharia standard 12). Diminishing Musharaka is used for house financing by IFIs and has replaced successfully conventional mortgages.

Murabaha-Muajjal: Murabaha means mutually stipulated margin of profit in a sale transaction where the cost of the commodity is made known to the buyer. The parties negotiate the profit margin on the known cost. If payment of the sale price is deferred, it becomes murabaha-muajjal. Credit sale is allowed by the texts of the Shariah. The installments sale with price higher than the cash market price is also permitted as a normal reflection of market-based commercial activities. The price and the due date of payment must be fixed in an unambiguous manner. Other terms used for similar transactions are installments sale, cost-plus/mark-up based sale, etc. Murabaha, as in vogue in Islamic banking, is used with a prior promise to buy or a request made by a person interested in acquiring goods on credit from a bank. The customer is normally appointed as agent of the bank for purchase of the item on it’s behalf.
such, it is called ‘murabaha to Purchase Orderer’ (MPO) which normally comprises three separate agreements including promise to buy or to sell, agency contract and the actual murabaha contract. According to contemporary Shariah scholars, murabaha is legitimate provided the risk of the asset being sold is borne by the bank until the possession is passed on to the murabaha customer. For such a transaction to be legal, the bank must purchase a commodity through a contract and sell it to the customer under a separate contract. Murabaha can be used only where a commodity is intended to be purchased by the customer. Banks can promise to sell something that is not yet owned or possessed by them. However, the actual sale will have to be effected through offer and acceptance after the commodity comes into the physical or constructive possession of the seller (bank).

The ideal way of conducting murabaha is that the bank itself purchases the commodity directly from the supplier and after taking its delivery, re-sells it on murabaha basis. Alternatively, bank may take the services of a third party for the acquisition of goods. Keeping in view the problems involved in purchasing directly or through third party agent, the Shariah experts have allowed that a bank makes the customer his agent to buy the commodity on its behalf. Whatever the procedure for Shariah compliance, the commodity before selling it to the client must remain at the risk of the bank, the seller in this finance-cum-trade transaction. The appointment of customer as bank’s agent is not however, considered desirable. Banks should make sure that the client really intends to purchase the commodity. The buy-back arrangement is not allowed. The purchase price should be paid directly to the supplier instead of giving funds to the customer. The client should not be made dual agent doing everything himself and purchase by the bank should be evidenced by invoices or similar other documents to ensure that all conditions of valid murabaha are fulfilled. The commodity must come into the possession of the bank, whether physical or constructive, in the sense that it must be at bank’s risk. The bank should arrange for physical inspection on random basis of the purchased commodities so that the supplier and the client may not end up in any under-hand dealing.

In case of default, murabaha contract cannot be rolled over because the goods once sold by the bank are property of the client and hence cannot be resold by the bank. As the murabaha is basically a sale, all the necessary ingredients of sale acceptable to Shariah must be duly observed otherwise it may involve an element of riba. The fuqha have accordingly laid down strict parameters for its permissibility. The following requirements should therefore, be strictly observed by Islamic banks:
(a) The commodity being sold must be in existence at the time of sale.
(b) Seller must have a good title to the commodity and should be competent to sell it.
(c) The commodity must be in physical or constructive possession of the seller. The constructive possession means that although physical delivery of the commodity has not been taken, it has come into bank’s control that has also assumed the risk of it’s loss or destruction even though for a very short period.

**Musawamah:** Musawamah is a general and regular kind of sale in which price of the commodity to be traded is bargained between seller and the buyer without any reference to the price paid or cost incurred by the former. Thus, it is different from murabaha in respect of pricing formula. Unlike murabaha, seller in musawamah is not obliged to reveal his cost. Both the parties negotiate on the price. All other conditions relevant to murabaha are valid for musawamah as well. Musawamah can be used where the seller is not in a position to ascertain precisely the costs of commodities that he is offering to sell. Musawamah can be both cash and credit sale but, when used by banks, it will generally be a deferred payment sale in which they will bargain with clients on the price of the goods/assets. Islamic banks may sometimes get a discount from the supplier over the normal retail price. If the purchase price or the actual profit is not brought into the notice of the customer, such sale should be conducted through musawamah and not murabaha.

**Ijarah:** Ijarah is a contract under which one party obtains the right of usufruct of an asset owned by another party for an agreed period against an agreed consideration namely rent. The term Ijarah is very much similar to the ‘leasing’. The rules of Ijarah in the sense of leasing are similar to the rules of sales because both cases involve transfer of some property to another. The only distinctive feature is that in the
case of sale, the corpus of property is transferred to the purchaser while in the case of Ijarah, the corpus of the property remains in the ownership of the lessor and only its usufruct is transferred. The following are two basic differences between leasing by conventional banks and the Ijarah financing by Islamic banks.

The concept of Ijarah is used by some Islamic Banks (the Islami Bank in Bangladesh), to apply to the use of money instead of the more accepted application of supplying goods or services using money as a vehicle. A fixed fee is added to the amount of the loan that must be paid to the bank regardless if the loan generates a return on investment or not. The reasoning is that if the amount owed does not change over time, it is profit and not interest and therefore acceptable under Sharia.

In leasing, the lessee’s liability to pay rent starts from the date the payment has been made by the conventional bank to the supplier and not from the date the delivery of the asset is taken by the lessee. The Islamic bank, however, charges rent only from the date the delivery of the asset in working condition is taken by the lessee and not from the date the price has been paid to the supplier. Ownership in Ijarah contract, and therefore the risks and expenses relating to ownership, must remain with the lessor. Operating expenses related to use of the asset have to be borne by the lessee. Banks may take the Takaful cover in order to mitigate the risks, but it should be at the expense of the banks. They can, however increase, with the consent of the lessee, the lease rent to recover the Takaful cost. If the Takaful Company does not compensate the entire amount in case of loss / damage, banks have to bear the risk of Takaful claim settlement. This is the key difference between the conventional leases and Islamic banks’ Ijarah contracts culminating into transfer of ownership to the lessee under the separate contracts.

**Takaful (Islamic Insurance)**: Takaful is an alternative form of cover that a Muslim can avail himself against the risk of loss due to misfortunes. Takaful is based on the idea that what is uncertain with respect to an individual may cease to be uncertain with respect to a very large number of similar individuals. Insurance by combining the risks of many people enables each individual to enjoy the advantage provided by the law of large numbers.

**Wadiah (Safekeeping)**: In Wadiah, a bank is deemed as a keeper and trustee of funds. A person deposits funds in the bank and the bank guarantees refund of the entire amount of the deposit, or any part of the outstanding amount, when the depositor demands it. The depositor, at the bank’s discretion, may be rewarded with Hibah, as a form of appreciation for the use of funds by the bank.

**Wakalah (power of attorney)**: This occurs when a person appoints a representative to undertake transactions on his/her behalf, similar to a power of attorney.

**Bai Salam**
Bai e Salam is a form of sale contract where by IFIs purchase goods for spot payment with deferred delivery. Practically it is used in financing of agricultural needs of farmers. Farmers sell their crops prior to harvesting to IFIs in order to get money to purchase seeds and fertilizers. Generally spot price agreed is lesser than future the actual date of delivery, hence IFIs are making profit. As a matter of practice IFIs are entering into a parallel Salam contract with third party to sell the proceeds once taken over however execution of second contract is not conditional to the fulfillment of first (Sharia standard 10).

**Istasna**
This mode of financing is designed to transect business through an order to manufacture and/or supply. It is a sales contract with the exception of existence of subject matter. This tool of financing is useful for infrastructure projects. Parallel Istasna contract is allowed however performance of second Istasna contract must not be conditional on the fulfillment of first contract (Sharia standard 11).

**SIMILARITIES AND DIFFERENCES IN ISLAMIC AND CONVENTIONAL BANKING**
Islamic Financial Institutions (IFIs) are operating in the same society where conventional banks are operating and perform all those functions which are expected from a financial institution. IFIs are assisting business world by providing all the services required to run the economy smoothly, however, the philosophy and operations are different. In this section we will analyze the operations and products of IFIs in comparison with traditional conventional banks. Any financial system is expected to assist in running the economy by providing the following services grouped in two headings. First; Savings
mobilization from savers to entrepreneurs and Second; Provision of general utility services including transfer of funds, facilitation in international trades, consultancy services, safekeeping of valuables, and any other service for a fee. There is no restriction on provision of such services by IFIs as for the service is not against the Sharia. However there exists difference in mechanism of funds mobilization from savers to entrepreneurs as described below. Savings mobilization consists of two phases i.e. accepting deposits and extending financing and investments.

**Deposits**
Deposits are collected from savers under both type of institutions for reward whether a bank is operating under conventional system or Islamic system. The difference lies in agreement of reward. Under conventional system reward is fixed and predetermined while under Islamic deposits are accepted through Musharaka and Mudaraba where reward is variable. Under conventional banking return is higher on long-term deposits and lower for short-term deposits. Same is the practice in Islamic banking to share profit with depositors. Higher weight for profit sharing is assigned to long-term deposits being available to bank for investing in longer term projects yielding superior returns and lower weight for short-term deposits which cannot be invested in long term projects. The only difference in conventional and Islamic system lies in sharing of risk and reward. Under conventional system total risk is born by the bank and total reward belongs to it after servicing the depositors at fixed rate while under Islamic system risk and reward both are shared with depositors. Reward of depositors is linked with outcomes of investments made by IFIs. Under Islamic financial system only those IFIs will be able to collect deposits who can establish trust in the eyes of masses hence leading to optimal performance by financial industry.

**Financing and Investments**
The second phase in savings mobilization process is extension of credit facility to business and industry for return. Both types of institutions (Islamic and Conventional) are providing financing to productive channels for reward. The difference lies in financing agreement. Conventional banks are offering loan for a fixed reward while IFIs cannot do that because they cannot charge interest. IFIs can charge profit on investments but not interest on loans. In conventional banking three types of loans are issued to clients including short term loans, overdrafts and long-term loans. Islamic banks cannot issue loans except interest free loans (Qarz e Hasna) for any requirement however they can do business by providing the required asset to client. The following paragraphs present the comparative working of different products (financing scheme) of both systems.

**Overdraft and Credit Cards**
Conventional banks offer the facility of overdrawing from account of the customer on interest. One of its form is use of credit card whereby limit of overdrawing for customer is set by the bank. Credit card provides dual facility to customer including financing as well as facility of plastic money whereby customer can meet his requirement without carrying cash. Financing through credit cards is not offered by Islamic banks except in the form of Murabaha (which means IFI shall deliver the desired commodity and not the cash) however facility to shop/meet requirement is provided through debit card whereby a customer can use his card if his account carries credit balance. Under conventional banking a customer is charged with interest once the facility availed however under Murabaha only profit is due when the commodity is delivered to the customer. Furthermore in case of default customer is charged with further interest for the extra period under conventional system however extra charging is not allowed under Murabaha.

Third under conventional system customer can avail the opportunity of rescheduling by entering into a new agreement to pay interest for extended period which is not the case under Murabaha. IFIs can claim only the original receivable amount agreed in initial contract. Another practical issue under Murabaha is how to deal with intentional defaulters. Different options are lying with IFIs including to blacklist the defaulter for any further financing facility, to stipulate in the contract that in case of default all installments will be due at once, to stipulate in the contract a penalty shall be imposed but the same shall not form income of IFIs rather it will go in charity (Usmani, 2002).
Short term loans

Short term and medium term loans are provided to customer to meet working capital requirements of firm by conventional banks. Working capital is required by firms to invest in inventories and accounts receivables and meet the expenses. As for inventory investment is concerned that is provided by Islamic banks through Murabaha. As for meeting of day to day expenses of business is concerned financing is provided through participation term certificates where by profit of a certain period (e.g. quarter, six month, one year) is shared by IFIs on prorata basis. However financing through participation term certificates is not as easy as a short term loan from conventional bank due to risk involved for IFIs in the transaction. Firm seeking short-term facility from IFIs has to prove the viability of the project/business to the satisfaction of investor. For meeting the working capital requirements of nonprofit organizations to date there is no arrangement under Islamic financial system. Personal consumption loans are also not issued by IFIs however any individual of sound financial position can acquire anything for his personal use under Murabaha financing whereby a certain percentage of profit is added on cost by IFIs. Murabaha financing is very useful for short to medium term financial requirements of business/nonprofit organizations and individuals. Murabaha financing is asset based financing and anyone can request an IFI for provision of an asset generally used for Halal (lawful) purposes. By default under Islamic financial system IFIs cannot lend cash for interest (only exception is Qarz e Hasna—Charity loan). One of the features of Murabaha is in case of delay in payment by customer IFI cannot ask for extra amount as time value of money like conventional banks. However penalty is imposed on defaulter if stipulated in original contract of Murabaha duly signed by the customer but same cannot be included in the income of IFI. This penalty must be spent for charitable purposes. Under Murabaha scheme of financing facility is linked with assets which leads to economic stability and creates linkage between real and financial sector. It is not zero sum game because utility is created through services and products and not by mere building the blocks of wealth through dealing in paper money. Although Murabaha is being used by IFIs successfully and have succeeded in meeting short to medium term requirements of firms by providing a successful replacement of conventional loans yet certain differences exist in both type of financing. First is one cannot get cash under Murabaha. Second asset is purchased by IFI initially then transferred to customer hence IFI participate in risk. Third refinancing facility is not available under Murabaha. Fourth in case of default price of the commodity cannot be enhanced however penalty may be imposed if stipulated in original contract of Murabaha however same cannot be included in income of IFI. Fifth only those assets can be supplied by IFIs under Murabaha whose general and/or intended use is not against the injunctions of Sharia (e.g. supply of a machine to produce liquor)

Medium to long term loans

Medium to long-term loans are provided for purchase or building of fixed assets by firms to expand or replace the existing assets. Under Islamic financial system requirement of firms and individuals are fulfilled through Murabaha, Bai Muajjal and Istasna. Another financing option for long-term financing is profit sharing under Musharaka and Mudaraba. Although financing under Murabaha, Bai Muajjal and Istasna is very much look like conventional loans with the only difference of provision of asset and not cash to client however differences exist in the contracts which alter the nature of risks and returns. Financing under Musharaka and Mudaraba is challenging for IFIs and firms as well. Under Sharia based financing schemes firms have to prove the viability/profitability of the project/business to the satisfaction of IFIs to get the finance because risk of losing the amount is involved.

Leasing

Leasing is relatively recent source of financing whereby usufruct of an asset is transferred to lessee for agreed amounts of rentals. Under leasing ownership may or may not be transferred. Same facility is provided by IFIs under agreement of Ijara. Under Ijara asset is provided to customer for use with out transfer of ownership for a specific period of time in exchange for agreed rentals. Ownership of asset can be transferred to customer through mutual agreement at the completion of lease term. All ownership risks are born by IFIs during Ijara tenure. Certain differences exist in the transaction under both systems. First is rental under Ijara are not due until asset is delivered to the lessee for use. Second additional rent cannot
be demanded in case of default except a penalty (if stipulated in original contract of lease) which is not the income of IFI. Third during period of major repair rent cannot be demanded by IFI. Fourth if asset is lost or destroyed IFI cannot claim further installments hence all risks of ownership are born by IFI.

**Agricultural Loans**

Agricultural loans include both types of loans short-term as well as long-term. Short-term loans are required by farmers for seeds and fertilizers and long-term loans are required to develop additional lands and purchase of equipments. Normally farmers return these loans after selling the finished crops. Conventional banks are providing credit facility by charging interest. Same facility is provided by IFIs to the farmers under Bai Slam, Bai Murabaha Musharaka and Mudaraba. Under Bai Salam cash is provided to farmers for purchase of seeds and fertilizers however this is not loan rather purchase of finished crops to be delivered by farmers. For purchase of equipments Murabaha facility is used and for development of additional land Musharaka and Mudaraba is used by IFIs. To get finance for land development farmers have to convince the IFIs about profitability of the venture due to risk involved in the transaction.

**House financing**

Housing finance/Mortgages is the more secured form of financing for both conventional banks and IFIs. Under conventional system loan is provided for interest while under Islamic financial system facility is provided through diminishing Musharaka. Under diminishing Musharaka house is purchased jointly by IFI and customer. IFI rents out its share in property to customer for an agreed amount of rent. Share of financier is divided in units of small denomination. Customer pays the installments to IFI consist of rentals plus purchase price of a unit. Stake of customer in property is increasing while that of IFI is decreasing with payment of every installment. Finally with the payment of last installment stake of IFI reaches to zero and property is transferred in the name of customer. Diminishing Musharaka model can help out in avoiding the real estate crisis (like of 2008) because when market value of property decreases both IFI and customer suffers according to their share in property and whole burden is not shifted on customer alone.

**Investments**

In order to maintain liquidity conventional banks have many avenues including government securities, shorter term loans and money at call and short notices, leasing companies’ bonds, investment in shares etc. Interestingly mandatory reserve maintenance by conventional banks with central banks is also rewarded in the form of interest. Conventional banks can also create liquidity by issuing the bonds against their receivables. Commercial banks are also protected by central bank by providing liquidity in rainy days for interest. Interbank deposits are also rewarded in the form of interest by commercial banks. For IFIs avenues are very limited to create required liquidity at the same time to earn some revenue by investing in short term and liquid securities. IFIs cannot invest in government securities, short term loans, bonds and money at call and short notices because of interest based transactions. Mandatory reserve with central bank is maintained by IFIs but they are not rewarded like conventional banks. Looking towards central bank in rainy days to maintain liquidity is also not as straightforward due to interest demand of central bank. IFIs cannot demand interest on interbank deposits. As for investment in marketable securities are concerned again IFIs are not free to invest in any equity security due to two reasons. First Halal business of the underlying firm is required. Second financial operations of underlying firm should be interest free. Keeping in view the dominance of conventional banking and existing business practices one can conclude safely that a very negligible number of firms meet both conditions.

Recently IFIs have created an avenue to meet their liquidity requirement in the form of Skuks (Islamic Bonds) whereby servicing is fixed like conventional bonds however such types of Skuks can be issued against Ijara receivables. Under Ijara Skuks initially asset is given on rent to the customer for an agreed period and rentals while ownership remains with IFI. To meet liquidity requirements IFI issues Skuks (bonds) to the investors equal to the value of asset, hence ownership of the asset is transferred to Skukholders. While it is known the rentals of the asset so the return on investment is predetermined and known with certainty to the investors. Skuks of Murabaha cannot be sold except at par being sale of loans. Other types of Skuks (Musharaka etc) are not carrying fixed return although tradable in secondary
security market. Underlying principle in issue of Skuks is that illiquid assets should dominate in the portfolio against which Skuks are issued. Under Islamic financial system Skuks are ownership certificates and not mere debt securities hence all risks and rewards are shared by Skukholders.

CONCLUSION
Islamic banking is working within the Sharia framework following certain restrictions include the following: First IFIs cannot provide finance for an activity which is prohibited by Sharia (Islamic law) irrespective of its profitability and economic viability e.g. business of liquor, pork and pornography. Second IFIs cannot lend any amount in cash for interest however need is fulfilled either through supply of required asset or through profit and loss sharing. Consequently certain financial needs of some sections of the society are ignored in financing including personal loans and working capital requirements of not for profit organizations. Third under Islamic financial system when financing is provided under profit and loss sharing although profit can be shared as per agreement between the parties involved however loss must be shared according to capital contribution/ownership. Islamic banking is not as foreign to business world as it is perceived by certain quarters. It is a business very much like conventional banking within certain restrictions imposed by Islamic law. All business needs are being fulfilled by IFIs in efficient ways through Murabaha, Ijara, Bai Muajjal, Bai Salam, Istasna, Musharaka and Mudaraba. Two features of Islamic banking system are worth mentioning. First is linkage between financial and real sector as IFIs cannot extend credit facility without having support from real sector. Financing is either made through sharing risk and reward or must be asset backed. Second, a unique feature of Islamic financial system is in the form of Mudaraba which can play role of catalyst for transforming society into prosperity by extending capital facility to skillful persons lacking capital. Under Mudaraba mode of financing partnership between capital and skill is formed hence it can be used to provide self-employment to jobless skillful citizens.

RECOMMENDATIONS
Islamic banking should be given a fair chance to operate in the Nigerian economy so that genuine investors especially Small and Medium Scale enterprises can take advantage of its products for investments, modernization, expansion, etc. This will be a sure strategy to poverty reduction in the country. This bank should be started in the northern part of the country with high level of Islamic sentiments to not only test their viability and potentials, but also to mobilize idle/immobilized funds due to the fact that many Muslims do not want to involve in any interest-bearing dealings. In absence of a viable alternative to conventional banking they were keeping their savings in private custodies.

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