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**ASSESSING THE ISLAMIC BANKING
CONCEPTS AND PRACTICE IN EGYPT
(1998-2003)**

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EXECUTIVE SUMMARY

This research discusses the theory of Islamic banking and analyzes its applications in Egypt for the last six years from 1998 until 2003. In it we will try to evaluate the performance of Islamic banks in Egypt and try to suggest solutions for the problems they are facing.

Islamic Banking is established based on the prohibition of dealing in interest rate by the Islamic law as it is considered a form of usury. Until a few hundred years ago any extra amount demanded by the lender in addition to his capital was called usury which was condemned by, not only Islam, but all religions. Usury was forbidden by law in the beginning of the twelfth century as well, and this law was effective throughout the Scholastic period. Today, the new "moderate" form of usury – interest – is legal and acceptable; both in theory and practice. But interest rates may increase the money supply, which will result in having interest based money supply. Here, Islamic banks offered the society a replacement for such conventional thinking with a new theory that takes the Islamic law as the source for the definition of their objectives, rules and responsibilities.

Islamic banking replaced the charging of a fixed or predetermined rate of interest, by the Profit-and-Loss-Sharing (PLS) principle. In this principle, the distribution of profits is done according to bargaining between the depositor and the bank on one hand, and the bank and the investor on the other hand. Islamic banks are equipped with different financial instruments based on PLS principle that give them the ability to invest the deposited money according to Islamic law and in profitable ways. These instruments cover financing the investment, trade, paying loans and other types of operations.

In Egypt, there are three Islamic banks, which are applying *Sharia* or Islamic law in all their business. These banks are, Faisal Islamic Bank of Egypt (FIBE), Egyptian Saudi Finance Bank (ESFB), and International Islamic Bank for Investment and Development (IIBID). This research studies the performance of these three Islamic banks in Egypt by comparing their performance with the rest of the conventional banks in Egypt and by analyzing the different performance indicators of these banks.

There are problems for Islamic banking in Egypt. Some of these problems are general problems that we can find in any other country including Egypt, and some of them are specific to Islamic banks in Egypt. This research studies these problems and tries to recommend solutions for them.

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All praise is due to Allah, Lord of all the worlds. Peace and blessings of Allah be upon the Messenger, his household and companions.

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LIST OF ABBREVIATIONS

CBE	Central Bank of Egypt
ESFB	Islamic Saudi Finance Bank
FIBE	Fisal Islamic Bank of Egypt
IDB	Islamic Development Bank
IIBID	Islamic International Bank for Investment and Development
IRTBS	Increase Rate of the Total Balance Sheet
RCATD	Ratio of Current Accounts to Total Deposits
RFASE	Ratio of Fixed Assets to Total Shareholders' Equity
RIATA	Ratio of Investment Accounts to Total Assets
RIATD	Ratio of Investment Accounts to Total Deposits
ROA	Return on Assets
ROITD	Ratio of Operating Investment to Total Deposits
RRSATD	Ratio of Return on Saving Accounts to Total Deposits
RSETA	Ratio of Shareholders' Equity to Total Assets
RTCTD	Ratio of Total Cash to Total Deposits
RTDTA	Ratio of Total Deposits to Total Assets

INTRODUCTION

In the era of globalization, the need to engage in banking activities became unavoidable and urgent. Governments, businesses, and individuals began to transact business with the banks, with or without liking it. On the other hand, there is an agreement that dealing with those conventional banks is unlawful in Islamic law, if an Islamic bank is available as a replacement to such banks¹ (In Egypt there are three Islamic banks). This means that Islamic banking becomes an unavoidable solution as well.

The payment and receipt of a fixed or predetermined rate of interest is replaced, by Islamic banking, with the concept of profit and loss sharing and its arrangements whereby the rate of return to financial assets held with banks is not known and not fixed prior to the undertaking of each transaction.

There are three Islamic banks operating currently in Egypt, FIBE, IIBID and ESFB ordered by the time of establishment. These are three applications for the Islamic banking in Egypt and after we understand the different concepts of Islamic banking, this research will try to analyze the performance of these Islamic banks to evaluate these applications and be able to measure the development of Islamic banking in Egypt.

Introduction to Islamic Banks

In Muslim communities, limited banking activity, such as acceptance of deposits, goes back to the time when the Prophet Muhammad (prayers be upon him) was still alive. At that time, people deposited money with the Prophet or with Abu Bakr Sedique, the First Khalifa of Islam.

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, which was anathema to the political regime. The pioneering effort, led by Ahmad El Najjar, took the form of a

¹ Youssef Al-Qaradawy, Bank Interest is the Forbidden Riba, (Cairo: Maktabat Wahba, 2001, 2ed edition) [in Arabic] pp. 146-150

savings bank based on profit-sharing in the Egyptian town of Mit Ghamr in 1963. This experiment lasted until 1967. The number of depositors increased from 17,560 in the first year of its operation to 251,152 by 1966/67 by an impressive annual rate of 538.3%. Loans were provided by the bank according to PLS principle to small entrepreneurs for periods ranging from one to five years. The management opened seven branches located in the Delta and in Cairo.²

The Nasser Social Bank, established in Egypt in 1971, was declared an interest-free commercial bank, although its charter did not refer to Islam or Sharia (Islamic law).

The Organization of Islamic Countries (OIC) established the Islamic Development Bank (IDB) in 1974, but it was primarily an inter-governmental bank aimed at providing funds for development projects in member countries. The IDB provides fee-based financial services and profit-sharing financial assistance to member countries. The IDB operations are free of interest and are explicitly based on Islamic law principles.

In the seventies, the political climate changed in many Muslim countries. A number of Islamic banks, both in letter and spirit, came into existence in the Middle East, e.g., the Dubai Islamic Bank (1975), the Faisal Islamic Bank of Sudan (1977), the Faisal Islamic Bank of Egypt (1977), and the Bahrain Islamic Bank (1979), to mention a few. The Asia-Pacific region was not oblivious to the winds of change. The Philippine Amanah Bank (PAB) was established in 1973 by Presidential Decree as a specialized banking institution without reference to its Islamic character in the bank's charter.

Some Islamic financial institutions established in countries where Muslims are a minority. There was a rise in interest-free savings and loan societies in India during the seventies. The Islamic Banking System (now called Islamic Finance House), established in Luxembourg in 1978, represents the first attempt at Islamic banking in the Western world. There is also the Islamic Bank International of Denmark, in Copenhagen, and the Islamic Investment Company in Melbourne, Australia.³

² Mahmoud Mohieldin, Islamic Finance in Egypt, (Cairo: Egyptian Center for Economic Studies, 1997), pp 13-14

³ Mohamed Ariff, Islamic Banking, (Asian-Pacific Economic Literature. Vol. 2, No. 2, 1988), pp. 46-62

Importance of the study

Many people do not know the difference between conventional banks and Islamic banks. That makes a lot of them accept the idea that Islamic banking is just a curtain that hides a conventional bank behind it. Based on this idea they accept dealing with conventional banks as they offer higher benefits for them. Only conventional banks took the benefit of this idea and to make it more acceptable they established special branches and called these branches as Islamic branches.

The importance of this research comes from its trial to introduce the concepts of Islamic banking to those who will read it and give them a clear idea about the difference between Islamic banking and conventional banking. This will encourage them to go to Islamic banks and then Islamic banks get bigger, increasing the benefits for the society and decreasing the bad effects of conventional banks gradually.

Moreover, the research will try to help the reader to decide which Islamic bank in Egypt he would deal with. The research will help in that by making analysis for the performance of the three Islamic banks operating in Egypt

Research Hypotheses

The research is trying to verify the following hypotheses:

1. Islamic banks are following the Islamic law in all their operations and services.
2. Clients are trusting Islamic banks more than conventional banks to deposit their money.
3. Islamic banks put more concentration on the long-term investment projects, which are more beneficial for the society than the short-term investment projects.
4. The central bank of Egypt gives a great understanding for the special nature of Islamic banks and gives them the needed facilities, which supports their operations.

Research Objectives

This research is giving great considerations for understanding the nature of Islamic banks and its different operations. The understanding of this nature will come first from the understanding of the Islamic law and believing that the Islamic law should control even our economic system.

Another objective of this research is to give an idea about the different instruments and tools available for Islamic banks to be able to use them in profitable and beneficial investment to reuse the available non working capital.

The research is assessing the capabilities of Islamic banks in Egypt to understand the weak points to work on treating them as well as the powerful points to try to get the maximum benefit from them.

To make this research practical, it will try to highlight the different problems that are facing Islamic banks in general and Islamic banks in Egypt specifically. It gives some recommended solutions for these problems as well.

Research Limitations

Annual reports of 2003 for both ESFB and IIBID were not available by the time of conducting this research, as these banks did not publish them. The only available data was the financial statements of the third quarter for both banks. This puts some limitations on the comparison of the financial performance indicators for those two banks in 2003.

CHAPTER 1 ISLAMIC BANKING CONCEPTS

Islamic Banking is centered on the principle of the elimination of interest rate, which is forbidden in the Islamic law as it is considered a form of usury. In this chapter, we discuss the concept of usury from three different views, first the relation between usury and interest, second usury in Islam, then an economic point of view for the usury. After that, we will explain the theory of Islamic banking as we define it, and highlight the objectives and the different types of Islamic banks.

1.1 Usury and Interest

Until a few hundred years ago, any extra amount demanded by the lender in addition to his capital was called usury. Early European philosophers such as Plato (427-347 BC) and Aristotle (384-322 BC) condemned the practice of taking usury. The Roman Empire, in its early stages, prohibited charging of usury. The Christian Church prohibited all usurious transactions. The famous incident in Jerusalem where Jesus Christ chased away the moneylenders from the Temple was kept alive in Church preaching. Though, usury was practised all over the Christendom and elsewhere the Church was consistent and vehement in its condemnation of usury.⁴

Hence charging of interest was forbidden by law in the beginning of the twelfth century and was effective throughout the Scholastic period. As time went on, some pardons were made regarding the charge of interest, such as the case of charging it to political enemies; using it as a penalty on the borrower if he fails to return the principal on the agreed date; using it as a compensation for the lender if he suffered damage during the lending period; compensating the lender for losing a gain because of the loan; using it in a form of gift as a reward provided by bankers to depositors in the early stages of deposit banking.⁵

⁴ A.L.M. Abdul Gafoor, Interest, Usury, Riba And The Operational Costs Of A Bank.

⁵ Mahmoud Mohieldin, op. cit., p. 2.

However, by the end of the thirteenth century several factors appeared which considerably undermined the influence of the orthodox Church. Eventually, the reformist group, led by Luther (1483-1546) and Zwingli (1484-1531), agreed to the charging of interest on the plea of human weakness. According to Encyclopaedia Britannica,⁶

“In Old English law, the taking of any compensation whatsoever was termed usury. With the expansion of trade in the 13th century, however, the demand for credit increased, necessitating a modification in the definition of the term. Usury then was applied to exorbitant or unconscionable interest rates. In 1545, England fixed a legal maximum interest; any amount in excess of the maximum was usury. The practice of setting a legal maximum on interest rates was later followed by most states of the United States and most other Western nations.”

Thus, beginning in the mid-sixteenth century, the prohibition on usury (in the old sense) was legally removed in all Western countries. The environment in which it took place, as evidenced by the above quote, is noteworthy – expansion of trade and demand for credit. Borrowers were mainly the rich merchants, and they used the short-term credit for buying and selling goods. Moneylenders were lending their own money and/or that of their wealthy clients. The borrowers knew how much they could make using a given amount of credit, and they paid the lenders a portion of this profit. This supplied the justification for demanding the extra amount.

But this justification for “limited interest” under a particular circumstance was, in the course of time, stretched out and applied in general. Support was forthcoming on other grounds too. For example, Sir Francis Bacon (1561-1626) advocated, “Since of necessity men must give and take money on loan and since they are so hard of heart that they will not lend it, otherwise there is nothing for it, but that interest should be permitted.”⁷

⁶ Encyclopaedia Britannica 2001, CD-ROM edition Quoted in (A.L.M. Abdul Gafoor op.cit.).

⁷ Bacon, *Discourse on Usury*, Quoted in (A.L.M. Abdul Gafoor ibid..)

Now that the new “moderate” form of usury – interest – was legal and “moral”, economic theories were developed with this limit and justification as the base. Theories found their way into textbooks, more theories were developed, and interest became an integral part of economic theory. In practice, the theory was applied universally whether the original conditions which justified the extra payment existed or not. Practice reinforced theory and, once incorporated into the foundations of economics, it is now difficult to think of any economic theory or activity without interest being an integral part of it.

In 1545, the “legal maximum interest” rate in England was fixed at ten percent per annum, but it did not remain fixed for long. It varied from time to time and from place to place, depending on the economic and political circumstances.⁸

With the start of the era of individualism and laissez faire, the Scholastic doctrine was abandoned. The publication of Bentham's Defense of Usury in 1787, in which he emphasized absolute freedom in determining the terms of loans, reflected the growing view of his time. Attempts to apply the old usury laws failed during the 19th century, which witnessed, in 1854, the abolishment of Usury laws altogether in the UK. Moreover, the Code of Cannon Law of 1917 permitted the creditor to accept the legal rate of interest and more than that rate in particular circumstances.⁹

Eventually, the concept of “maximum interest” ceased to exist, and usury as a word even went into disuse. Today, practically everywhere, charging and paying interest is legal, no matter how much, and it is acceptable both in theory and practice.

1.2 Usury in Islam

In Islam every person is measuring his own actions is right or wrong against the **Sharia** or Islamic Law. The main two sources of Sharia are the Quran which is the wholly book of Islam, and **Sunnah** which is the teachings and traditions of the Prophet Mohammed (Salat and Salam from Allah be upon him). The prohibition of **Riba** or usury is referred to in both Quran and *Sunnah* as the following:

⁸ A.L.M. Abdul Gafoor *ibid.*,

⁹ Mahmoud Mohieldin, *op. cit.*, p. 2.

The prohibition of Riba was referred to in four **surahs** or chapters¹⁰: Surah 2: Al-Baqara, Verses: 278-281, Surah 3: All-Emran, Verse 130, Surah 4: Al-Nisaa' Verse: 161,

In Sunnah we have more than one **hadeeth** from prophet Mohamed (prayers be upon him) which is used to judge the different kinds of buying and selling and identify whether these transactions are **halal** (i.e. accepted), or **haram** (i.e. forbidden) because it is *riba*. An example for one of these *ahadeeth* is the following¹¹:

Jabir (ra) said that Allah's Messenger (prayers be upon him) cursed the acceptor of interest, its payer, and the one who records it; and the two witnesses; and he said: They are all equal. (Sahih Muslim, Hadith no.3881)

To define the term *Riba* in Islam, we can say that the word *Riba* in Arabic language is a generic term that means all kinds of excesses above the value of a thing. In *Sharia*, or Islamic Law, the term *Riba* is used for two different types of *Riba*, one is called ***riba al-Nasiah*** and the other ***riba al-Fadl***. The first type of *riba* was widely used by Arabs long time before the advent of Islam and that is why it was named ***riba Al-Jahilia*** as in that time, the old Arabs were asking for extra money above their money when the due date of the loan is reached.¹² There is an agreement that this type of *Riba* is prohibited in *Sharia*. This is what we will focus on while and the other type of *Riba* is out of the scope of this research.

It is established that all forms of predetermined fixed return which are tied with the size and the duration of the loans, regardless of loans' purpose, are considered by Muslim scholars as *riba*¹³.

¹⁰ The English translation of verses of *riba* is from <http://www.al-islam.com>. For Arabic text and translation of these verses, refer to Appendix A

¹¹ Refer for the following URL <http://hadith.al-islam.com/Display/Display.asp?Doc=1&Rec=3816> for the detailed reference of *hadeeth* and its Arabic text.

¹² Hassan Aioub, Fegh of Business Transactions in Islam. (Cairo: Dar Al-Salam for printing and publishing, 1st edition, 2003) [in Arabic], - pg. 132

¹³ Al-Qaradawy, *ibid.*,

The prohibition of fixed predetermined interest rates can be explained by Islam's position regarding property rights. Islam recognizes two groups of property rights. First, property rights that are an outcome of the combination of individual's labor and natural resources. Second, property rights that are acquired through exchange, inheritance, grants, etc. A loan is just a transfer of some (or all) of these rights from a lender to a borrower and providing it should not entitle the lender to an increase in his property rights. Such an increase violates the pivotal rule of transactions according to Islam, which is justice. Accordingly, interest on loans is unjustified as it indicates an instantaneous creation of a claim for the lender on the borrowers' property, once the contract is concluded and regardless of the outcome of the project for which the loan was provided¹⁴

The rules regarding Islamic finance are quite simple and can be summed up as follows: ¹⁵

- **Any predetermined payment over and above the actual amount of principal is prohibited.** Islam allows only one kind of loan and that is qard-el-hassan (literally, good loan) whereby the lender does not charge any interest or additional amount over the money lent. Therefore, we emphasize that any associated or indirect benefits are prohibited.
- **The lender must share the profits or the losses that results from the purpose for which the money was lent.** Therefore in banking terms, the depositor, the bank and the borrower should all share the risks and the rewards of financing business ventures. This is unlike the interest-based commercial banking system, where all the pressure is on the borrower: he must pay back his loan, with the agreed interest, regardless of the success or failure of his venture. Islam encourages the concept of higher risks and higher returns and leaves no other way available to the investors.
- **Making money from money is not acceptable in the Islamic law.** Money is only a medium of exchange, a way of defining the value of a thing; it has no value in itself, and therefore should not be allowed to give rise to more money, via fixed interest payments, simply by depositing it in a bank or lending it to someone else. Muslim jurists consider money as potential capital rather than capital, meaning that money becomes capital only when it is invested in business. In Islam, money

¹⁴ Mahmoud Mohieldin op. cit., p. 4.

¹⁵ Nida'ul Islam magazine. Principles Of Islamic Banking. 10th issue, November-December 1995.

represents purchasing power which is the key for the economy and is considered to be the only proper use of money. This purchasing power (money) cannot be used to make more purchasing power (money) without undergoing the intermediate step of it being used for the purchase of goods and services.

- **Gharar (Uncertainty, Risk or Speculation) is also prohibited.** Under this prohibition, any transaction should be free from uncertainty, risk and speculation. Contracting parties should have perfect knowledge of the counter values intended to be exchanged because of their transactions. In addition, parties cannot predetermine a guaranteed profit.
- **Investments should only support services or products that are not forbidden** -or even discouraged- by Islam. Trade in alcohol, for example may not be financed by an Islamic bank; a real-estate loan may not be made for the construction of a casino; and the bank could not lend money to other banks at interest.

1.3 Interest in Economics

Most economies and financial systems of today, including those of Muslim nations, are interest-based; interest is an integral part of the banking and financial system. Interest rates in the fiat money system increases money supply. Interest rates charged or paid by banks and other financial intermediaries are generally computed on a compounded basis, i.e. interest is computed for a period of time-annually, monthly or even daily. Thus on a compounded basis, interest is also paid for interest earned in earlier periods.¹⁶

1.3.1 Interest and Money Supply

The conventional explanation of the business rationale behind commercial banking has commercial banks acting as intermediators between depositors and borrowers of cash. It is proposed here that the true business rationale of commercial banks is the less benign activity of manufacturing money itself. Commercial banks manufacture money in the process of making loans and by a technique widely termed "fractional reserve banking". For every amount of money that is brought into existence by the

¹⁶ Ahmed Kameel, The Islamic Gold Dinar, (Malaysia : Pelanduk Publications, 2002), p. 7.

banking system there is a corresponding and equal amount of debt. Under such a monetary system, since debt grows at a rate of interest, money supply displays a similar tendency. It is in this sense that there now exists, more or less globally, an interest based money supply.¹⁷

In seeking to protect their loans of created money, it became common for banks to avoid profit sharing investments altogether and to concentrate instead upon interest based loans supported by collateral. The use of interest assured to the greatest extent possible under law that the profit available from the money manufacture process could be realized. The collateral would act as security, assuring repayment of the banker's loan plus interest in the event of the borrower's default. Such criteria for extending loans naturally biased the lending of funds towards wealthy individuals, explaining the quip that "bankers are people who lend you money if you can show that you don't really need it". Wealth would therefore tend to by-pass poorer individuals, whose business ideas might nevertheless have been worthy of receiving finance. This was a feature that would over time encourage substantial wealth inequalities in society, evidenced perhaps by the fact that, today, the world's richest 358 human beings own more wealth than the poorest 2,500 million.

In the conventional economic thinking, interest rate is said to be the price of money capital, following the normal demand supply theory. However, we should notice that interest rates themselves would increase the money supply¹⁸. An example about the interest rate and how it increases money supply, could be found in Appendix B.

However, it is possible for this money supply to shrink back if a depositor withdraws cash from the banking cycle (and keeps it from reentering back into the financial system), or when a loan is repaid, or when a borrower defaults on loan repayment (which at serious levels may cause banking crisis).¹⁹

¹⁷ Tarek El Diwany, About Interest-Based Money

¹⁸ Ahmed Kameel, op. cit., p. 14.

¹⁹ ibid pp. 14-15

The data about Money supply of Egypt is shown in Table 1. This table gives us an idea about the continuous increase in money supply in Egypt and also we can see that the average of the currency outside banks (or state money) always represents about 70 percent on average from the total money supply while the demand deposits in local currency represents the rest of 30 percent.

Table 1
Money Supply in Egypt 1996-2003

(LE mn)

End of June	1996	1997	1998	1999	2000	2001	2002	2003
Currency outside Banks	23643	25829	29518	32875	35042	38161	42299	48258
Demand deposits in local currency	11413	13223	14070	15963	14696	15287	17506	18954
Money Supply (M1)	35056	39052	43588	48838	49738	53448	59805	67212

Source: Central Bank of Egypt, Annual Report 2001/2002 p. 93 and Annual Report 2002/2003 p. 120

In other words, the state money is always double the money created by the banks in Egypt. It is also shown in Figure 1.

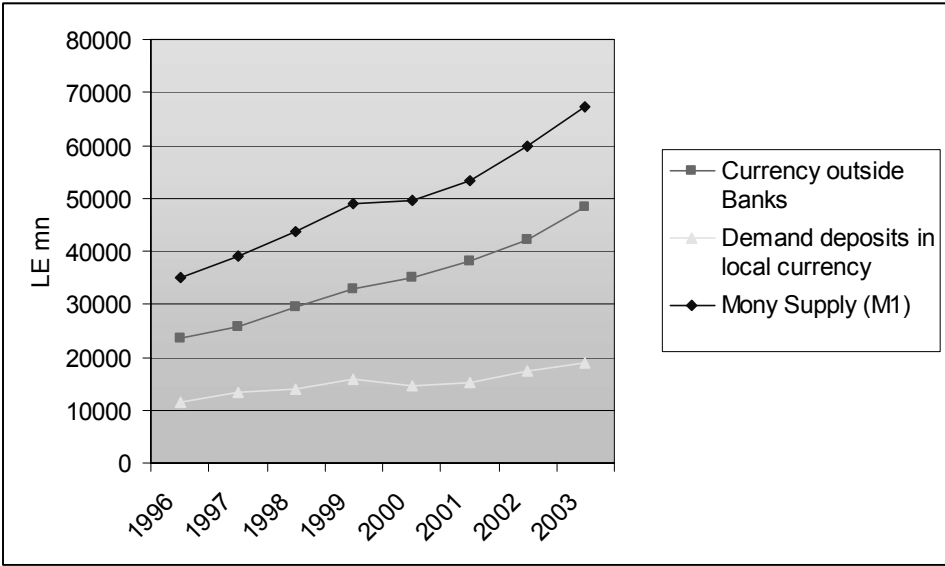


Figure 1 Money Supply in Egypt

Source: Central Bank of Egypt. Annual Report 2001/2002 p. 93, and Annual Report 2002/2003 p. 93

In Malaysia during June 1997 the total amount of state money (i.e. notes and coins) in existence was approximately RM19 billion, yet the total amount of money separately available in demand deposit accounts exceeded RM43 billion to give a total 'M1' money supply of RM62 billion. These figures clearly show the extent of money manufacture by banks in the modern world. It also explains why it is that if everyone went to withdraw their money from their bank in cash on the same day, then the banking system would collapse.²⁰

1.3.2 Money creation in Islamic banks

There are different opinions about the money creation concept in Islamic banking and whether it is halal in Islamic law or not. Some of these opinions are against the concept of money creation, while some other opinions agree on this concept to be applied within an Islamic economic system with the condition of having the government as a partner in the profit of these banks. They are suggesting that the money created in Islamic banking could be used with the concept of Profit and Loss Sharing (PLS) as well and the profit in this case will be halal. This will give the Islamic banks the opportunity to compete with the conventional banks to make more profits, which will help the economy and the society. Another team suggested that the government must own these banks to keep the authority to create the money.

There are some other opinions that are attacking the concept of money creation. They are saying that it only leads to instability in the monetary system and it may be the reason behind a lot of economic crisis. Therefore, they are suggesting keeping fractional reserve ratio of 100 percent that will forbid the loans and hence will stop the money creation at banks.²¹

A community that has practiced usury for centuries and which therefore understands it better than those whose religion prohibits it, should be studied first and criticized second. Those who argue against the

²⁰ Tarek El Diwany, Fractional Reserve Banking

²¹ Abd Al-Rahman Youssry Ahmed, Modern Islamic Cases in Money, Banks, and Finance. (Alexandria: Al-Dar Al-Game'ia, 2003), [in Arabic], pp. 297-302.

usurers without understanding the true nature of usury will probably lose their argument, as did the Church, as have countless politicians and ordinary men throughout history.²²

1.4 Definition of Islamic Banking

Islamic banks are those business locations, which collect deposits of money from their clients and try to use it in profitable projects that can help developing the economy and the society. These projects may be owned by these banks or owned by other parties who need financial support from the bank Islamic banks apply the *Sharia* in their business and so they are not accepting work with usury or interest-based deals. They also try to fix the role of the capital in the society to direct it to serve the whole society, not only the capital owner.²³

Islamic banks have three roles financial, developing, and social roles. They have a financial role as they play the role of conventional banks to facilitate the interchange of money between those who are having the capital and those who are able to use it in a profitable and lawful way, which would lead to the increase of the capital as well. They also have a developing role for the economy of the society as they serve the society and try to allocate the money in a beneficial way to develop this society. Finally, Islamic banks have a social role as they try to teach the individuals the benefits of saving money and how they can use it in the right way to increase it and then develop the whole economy of the society. In addition, it encourages the integration between the individuals in the society in a way that helps poor individuals and families to enhance their economic situation using the right of Allah in the money of the rich individuals of this society.

From this, we can note the following points about the Islamic banks:

- Islamic Banks are not just a replacement for the conventional banks, but it is a new and independent way of economic thinking, which has its principles, philosophy and applications.

²² Tarek El Diwany op. cit.

²³ *ibid.*, pp. 8-9 and Muhsen Al-Khodery, Islamic Banks. (Cairo: Itrak for publishing and distribution, 3ed edition, 1999), [in Arabic] pp.17-18.

- They work to avail the needed capital for all those who want to work, not only for those who can guarantee the loan to get more money than what they already had.
- They try to teach the individuals how they can allocate their money and even invest the money according to the Islamic law.
- Finally, they target the development of whole society including its individuals without making a difference between the social side and the economic side of the business, but rather mixing them.

1.5 Distinctive Characteristics of Islamic Banks

We can distinguish between the Islamic banks against the conventional banks with the following characteristics.

- Islamic banks must abide by the Islamic law in all their business operations. They must follow what is lawful in the Islamic law and do not do or participate in any unlawful operation or even those operations that have doubts about their lawfulness from the Islamic point of view. That means for example that the Islamic bank cannot offer its services for a project to make wine, or deal in some operations based on usury.
- Prohibition of usury is the main characteristic of Islamic banks. As discussed before, dealing with usury is absolutely forbidden in the Islamic law. That gives the Islamic bank a very powerful motive to invest their capital in profitable and lawful projects that have a good opportunity to develop and help both the economic and the social side of the country as well as increasing the bank's capital.
- Select the right candidate for running banks project. The bank has the opportunity to work in different types of projects under different sectors, like industrial, agricultural, or financial projects. That means that the bank will need labor with different and high capabilities to cover all these needed skills in different areas.
- Islamic supervision committee supervises Islamic banks. Almost every Islamic bank has a religious supervisory board with members of the most respectable jurists whose opinion is sought on the acceptability of the bank's investment operations and services carried out, and who have to provide a religious audit of the bank's end of year accounts. For example religious supervisory board in Faisal Islamic Bank of Egypt contained his eminence sheikh Mohamed Khater Mohamed El-Shiekh

former mufti of Egypt as a chairman for the board till his death in January, 2004. In addition, Dr. Nasr Farid Wasel former mufti of Egypt as a vice chairman of the board.²⁴

- Paying **Zakat**²⁵ on all the bank's transactions and net profit. This will help to achieve the social objectives for the Islamic banks. We will discuss this in more details in section 2.1.3 when we discuss the source of funds under Islamic banking

1.6 Objectives of Islamic Banks

Based on the definition of the Islamic banks and its characteristics we can identify three main categories for the Islamic banks' objectives, religious, social, and economic objectives.²⁶

1.6.1 Religious objectives

Apply the law from Allah in all business and economic areas, in addition to correct the role of the capital in the society and hang on all teachings coming in all religions, not only Islam, from Allah.

1.6.2 Social Objectives

Participate in the development of the societies in both the economic and social aspects and mix between them. The most important way to do this is helping individuals to pay Zakat on their money.

1.6.3 Economic Objectives

The objectives are:

- Keep the Islamic capital of individuals and organizations from Islamic countries inside these countries.

²⁴ Faisal Islamic Bank of Egypt, Annual report of 2003, p. 5

²⁵ Zakat is the third of the five pillars of Islam which are: *Believing that* there is no god but Allah and Muhammad is his messenger; performing prayers, paying *Zakat*; fasting the month of Ramadan and the pilgrimage to Mekah. Zakat is a compulsory levy teed on all possessions, lure cash, agricultural products, gold and silver,...etc. The rate of such tax is 2.5% per annum on the accumulated wealth and net income that exceed the minimum exemptible level. The aim of Zakat is to achieve social justice. It is worth noting that the collection of *Zakat* is the responsibility of the state not the bank under an Islamic system, and due to the absence of this system Islamic banks took over this responsibility.

²⁶ Mohamed Ibrahim Abou Shady, op. cit., volume 1, p. 54

- Facilitate moving of Islamic capital among Islamic countries and from those countries which have surplus in the capital to those countries which need capital for their projects
- Recycle this Islamic capital inside the Islamic countries to achieve the targeted development of these countries.

1.7 Types of Islamic Banks

The types of banks in the banking system of the modern economics consist of, commercial or deposit banks, investment banks, specialized banks like industrial or agricultural banks, and on the top of them is the central bank.²⁷

It was strange not to include Islamic banks in this classification with its different types although it becomes one of the facts in the modern economic systems. Types of Islamic banks are, Social banks, International development banks, financial banks, governmental banks, banks owned by group of governments, and multipurpose banks.

1.7.1 Social Banks

Although social development is one of the main objectives of Islamic banks but we still have some banks that give more focus on these social objectives as its main goal for it. An example for this is the Naser Social Bank. The bank was formed in 1971 and began its operations in 1972. The bank has been established as a public institution for social welfare and its capital, which reached LE20 million in 1990. The annual collection of Zakat constitutes the main source of funding for the bank in addition to an annual subsidy from the government.

1.7.2 International Development Banks

Development objectives are part of the economic objectives for any Islamic bank. However, some banks made the development objectives as the main target for them. An example for this is the Islamic Development Bank which stated in its annual report that its main purpose is to foster economic

²⁷ Mustafa Al-Nasharty, Monetary and Banking Policies. (Cairo : Dar An-Nahda Al-Arabia, 2003), p. 9.

development and social progress of member countries and Muslim communities in non-member countries individually as well as jointly in accordance with the principles of Sharia i.e., Islamic Law.²⁸

The functions of the Bank are to participate in equity capital and to grant loans for productive projects and enterprises besides providing financial assistance to member countries in other forms for economic and social development. The Bank is also required to establish and operate special funds for specific purposes including a fund for assistance to Muslim communities in non-member countries, in addition to setting up trust funds.

The Bank is authorized to accept deposits and to mobilize financial resources through Sharia compatible modes. It is also charged with the responsibility of assisting in the promotion of foreign trade, especially in capital goods, among member countries; providing technical assistance to member countries; and extending training facilities for personnel engaged in development activities in member countries to conform to the Sharia.

1.7.3 Financial Banks

Some Islamic banks are established mainly as a financing association more than just a bank, however, these banks may offer the normal banking services as well. An example for this is the “Kuwaiti Finance House” which the financial investments by Musharaka or direct investment was the main objective for establishment.²⁹

1.7.4 Governmental Banks

The Nasser Social Bank is a clear example for the governmental banks. It was established in 1971 as public agency, which was administrated by the ministry of treasury then by the ministry of insurance and social affairs. In addition, the law of the labor system of the public sector is applied on the employees of this bank.

²⁸ Islamic Development Bank, Annual report, (2002-2003) p. 7

²⁹ Mohamed Ibrahim Abou Shady, op. cit., volume 1, p. 29

1.7.5 Banks Owned by Group of Governments

The best example of this type of banks is the Islamic Development Bank. The present membership of the Bank consists of 54 countries. The basic condition for membership is that the prospective member country should be a member of the Organization of the Islamic Conference, pay its contribution to the capital of the Bank and be willing to accept such terms and conditions as may be decided upon by the IDB Board of Governors.³⁰

The international nature of the bank affected the management hierarchy of the bank. Each member country is represented on the Board by a Governor and an Alternate Governor.

Each member has five hundred basic votes plus one vote for every share subscribed. Generally, the Board of Governors is taking decisions based on a majority of the voting power represented at the meeting. The Board of Governors is the highest policy-making body. It can delegate powers to the Board of Executive Directors for the general operation of the Bank. However, only the Board of Governors can deal with issues relating to membership, increase or decrease in the Bank's authorized capital, authorize cooperation agreements with international and regional organizations, election of the President and Executive Directors and decide their remuneration.

1.7.6 Multipurpose Banks

These are the Islamic banks that are offering all the banking services as well as the commercial, investment, financial and development services domestically and globally. An example for this is Faisal Islamic Bank of Egypt (FIBE) and Dubai Islamic Bank.

The establishment law of FIBE states that "The main objective of the bank is to offer all the banking, financial, commercial, and investment operations services, as well as making industrial and development projects internally and externally."³¹

³⁰ Islamic Development Bank, op. cit., p. 7

³¹ Article 3 of the basic system of the Faisal Islamic Bank of Egypt

CHAPTER 2 ISLAMIC BANKING IN PRACTICE

After our discussion about interest and the prohibition of Islam against the payment and receipt of a fixed or predetermined rate of interest, we will find that Islamic banking replaced it, by the Profit-and-Loss-Sharing (PLS) principle. This principle is used either for borrowing from depositors, or for lending to investors. The distribution of profits is done according to bargaining between the depositor and the bank on one hand, and the bank and the investor on the other hand.³²

Based on the PLS concept, the sources of funds as well as the allocation of these funds need to be studied to identify the acceptable financing instruments for Islamic banks.

2.1 Sources of Funds under Islamic Banking

Although it seems from the first moment that there is no difference between sources of money in both of Islamic banks and conventional banks, but we will highlight the difference in case of Islamic banks.³³

2.1.1 External Resources

The external money resources for Islamic banks are the following:

2.1.1.1 Current accounts

Current or demand deposit accounts are virtually the same as in all conventional banks. Deposit is guaranteed. The depositor can withdraw from it at any time. It is the same as in the conventional bank.

2.1.1.2 Investment accounts

Investment deposits are accepted for a fixed or unlimited period of time and the investors agree in advance to share the profit (or loss) in a given proportion with the bank. Capital is not guaranteed.³⁴

³² Mahmoud Mohieldin, op. cit., p. 5.

³³ Mohamed Ibrahim Abou Shady, op. cit., Volume 2, pp 69-71

2.1.1.3 Savings accounts

Savings deposit accounts operate in different ways. In some banks, the depositors allow the banks to use their money but they obtain a guarantee of getting the full amount back from the bank. Banks adopt several methods of inducing their clients to deposit with them, but no profit is promised. In others, savings accounts are treated as investment accounts but with less stringent conditions as to withdrawals and minimum balance. Capital is not guaranteed but the banks take care to invest money from such accounts in relatively risk-free short-term projects. As such lower profit rates are expected and that too only on a portion of the average minimum balance on the ground that a high level of reserves needs to be kept at all times to meet withdrawal demands.³⁵

2.1.1.4 Islamic Finance Certificates³⁶

Islamic banks are issuing these certificate as another way to attract their clients to save their money in the bank and these certificates abides with the Islamic law as well as their profit rates are not predetermined as well. There are different types of these certificates. An Islamic bank may issue some certificates to participate in the capital of the bank for a temporary time. The bank can also issue some savings certificates for its client with a medium term which is more than one year and not less than five years,. An example for this certificate is the Saving Certificate of three years which is issued by Faisal Islamic Bank of Egypt with amount of LE 500 and its multiplier, and the profit of this certificate is distributed regularly every three months.³⁷

2.1.2 Internal Resources

There is no difference in the internal resources between Islamic banks and conventional banks. The internal resources consist of the following items:

³⁴ A.L.M. Abdul Gafoor, Interest-free Commercial Banking. (1995)

³⁵ *ibid.*,

³⁶ Muhsen Al-Khodery, *op. cit.*, pp. 110-112.

³⁷ Faisal Islamic Bank of Egypt, Services guide, p. 6

- Paid Capital
- Different types of reserves
- Distributable profit

Since the internal resources of money are very important for an Islamic bank than their importance in the conventional bank as it gives the Islamic bank more power to participate actively in development of the economy and the society in a short or long-term investments. Due to this importance some Islamic banks is targeting to increase their capital to the extent that some of them is doubling their capital, or even more.³⁸

2.1.3 Zakat Fund and Charity Money Resources³⁹

Zakat fund and charity money are considered a very important resource of money for Islamic Banks, as this special resource is not available for the conventional banks. The bank collects this money from different way like the following:⁴⁰

- Zakat religiously due on the shareholders' equity
- zakat provided by owners of investment account
- zakat provided by individuals,
- Grants and donations
- yield of charitable investment accounts

Zakat as a source of money is used to support the social role of the bank, as it will be able to offer more services in different social fields like paying money for the following:

- Individuals
- Students
- Mosques
- Some Islamic activities like keeping by heart the holly Quran and Ahadeeth

³⁸ Abou Shady, op. cit., Volume 2, p. 72

³⁹ Muhsen Al-Khodery, op. cit., pp 114-115

- Registered charitable societies.
- Medical clinics at popular areas.

Islamic Banks includes a separate section for the financial statements of zakat fund as it has its resources as well as its ways to be paid as one of the eight ways set by the Islamic law.

2.2 Types of Financing Instruments under Islamic Banking

There are different types of financing instruments that gives Islamic banks the ability to cover different varieties of needs for individuals, groups, or organizations. These types cover financing the investment, trade, paying Loans and other types of operations, as we will show in the following section.

2.2.1 Investment Financing

All the investment-financing contracts are based on the Profit-Loss-Sharing principle (PLS) or called PLS mode. This is applied through three main ways, direct investment, **Musharaka**, which is the equity participation Contract, and finally **Mudaraba**, which is the trustee finance contract.

2.2.1.1 Direct Investment

By direct investment, the Islamic Bank will use its business units to asses a value and expected profits of a project that will be owned completely by the bank. The bank will use the direct investment to execute this project, and manage it. This project will be considered as one of the business units that follows the bank not as a separate legal entity. In this case, the finance is completely from the bank and so Islamic bank will be different from the conventional bank. The conventional bank cannot directly invest in any project, and this makes a conventional bank keep its money liquidated and not to be transferred into fixed assets⁴¹.

⁴⁰ Faisal Islamic Bank of Egypt, Annual Report 2003 p., 37.

⁴¹ Mohamed Ibrahim Abou Shady, op. cit., volume 3 pp 4-5

2.2.1.2 *Musharaka (Equity Participation Contract)*

In *Musharakah* two or more parties participate, in equal or variable proportions to setup a joint venture. Profit and loss are arranged in a predetermined fashion according to their respective capital. *Musharaka* is used in long-term investments, like industrial and agricultural projects.

Companies under this form of finance can raise funds by offering certificates, as transferable corporate instruments secured by the companies' assets, in the market, which would determine their price.⁴²

2.2.1.3 *Mudaraba (Trustee Finance Contract)*

This implies a contract between two parties whereby one party, the **rabb al-mal** (beneficial owner or the sleeping partner), entrusts money to the other party called the **mudarib** (entrepreneur or borrower). The mudarib is to utilize it in an agreed manner and then returns to the rabb al-mal the principal and the pre-agreed share of the profit. He keeps for himself what remains of such profits⁴³. For more elaboration on the last definition we need to highlight the following characteristics of Mudaraba:

- The division of profits between the two parties must necessarily be on a proportional basis and cannot be a lump-sum or guaranteed return.
- The investor is not liable for losses beyond the capital he has contributed.
- The entrepreneur does not share in the losses except for the loss of his time and efforts.
- The entrepreneur has the absolute freedom to manage the business.

We have two types of Mudaraba, unrestricted and restricted. In unrestricted Mudaraba, rabb-al-mal is neither restricting certain project, making business with certain partners, the place of investment project nor restricting a certain period of time for making the investment. In restricted Mudaraba it is the opposite in which rabb-al-mal may restrict some conditions on the entrepreneur and it is conditioned that these

⁴² Mahmoud Mohieldin, op.cit., p. 9.

⁴³ Nida'ul Islam magazine, Islamic Funding Structures and Financing Vehicles. 10th issue, November-December 1995

restrictions to be beneficial for the project. These restrictions must be stated in the contract of the Mudaraba⁴⁴

Under the One-Tier Mudaraba model, the bank provides the entire capital needed for financing a project, while the entrepreneur offers his labor and expertise. The profits from the project are shared between the bank and the entrepreneur at a certain fixed ratio. Financial losses are borne exclusively by the bank. The liability of the entrepreneur is limited only to his time and efforts. However, if the negligence or mismanagement of the entrepreneur can be proven, he may be held responsible for the financial losses incurred. Mudaraba is usually employed in investment projects with short gestation periods and in trade and commerce.⁴⁵

Under Two-Tier Mudaraba model, the assets and liabilities sides of a bank's balance sheet are fully integrated. On the liabilities side, depositors enter into an unrestricted Mudaraba contract (a trustee finance contract) with the bank to share the overall profits accruing to the bank's business. Thus, depositors act as financiers by providing funds, and the bank acts as an entrepreneur by accepting them. On the assets side, the bank, in turn, enters into restricted Mudaraba contracts with agent entrepreneurs who search for funds to invest and who agree to share profits with the bank according to a certain percentage set in the contract.

2.2.2 Trade Financing

The most important and profitable financial instrument that the Islamic Bank can use and it follows the Non-PLS mode as they have a predetermined and fixed rate of return and are associated with collateral.

In fact, banks add a certain percentage to the purchase price and/or additional costs associated with these transactions as a profit margin, and the purchased assets serve as a guarantee. Moreover, banks

⁴⁴ For more discussion about the different types of Mudaraba and its conditions refer to Muhsen Al-Khodery, op. cit., pp 134-140

⁴⁵, Iqbal Zubair. and Abbas Mirakhor, . Islamic Banking. Washington : IMF Occasional Paper No. 4, 1987

may require the client to offer collateral. They are considered to conform to Islamic principles because the rate of return is meant to be tied to each transaction, rather than to a time dimension.⁴⁶

There are four different types for the trade financing, **Murabaha** or Mark-up, **Ijara wa Iqtina'** or Leas Purchase, **Bai'Mua'jjal** or Deferred payment sales, and **Bai'Salam** or Purchase with deferred delivery

2.2.2.1 *Murabaha (Mark-up)*

This is the sale of a commodity at a price which includes a stated profit margin or Mark-up known to both the vendor and the purchaser. This can be called a cost plus profit contract. The buyer usually pays the price back in deferred payments.⁴⁷

Under Murabaha, an Importer or a buyer can go to the Islamic bank asking it to finance the purchasing of some goods. Islamic bank purchases these goods in its own name, and then sells them to the importer or the buyer at an agreed mark-up. This technique is usually used for financing trade, but because the bank buys the goods on its own name, this therefore engaged in buying and selling, its profit derives from a real service that entails a certain risk, and is thus seen as legitimate. That is the opposite of the role of conventional banks which simply advancing the money to the client at a fixed interest rate and this is not legitimate. It is important to note that only a legitimate profit in addition to the actual price is considered lawful under Islamic law. Any excessive addition because of deferred payments will be disallowed as it would amount to a payment based on the value of money over time i.e. interest.

2.2.2.2 *Ijara wa Iqtina' (Leas Purchase)*

It is a mix between a sale and leasing of a certain product. In it, a party leases a particular product for using it for a specific sum of money and a specific period of time this is called Ijara, but another form of this is in Ijara wa Iqtina'. In this case, this party can change his mind and decide to purchase this product. Therefore, he can pay the price of this product after deducting the money paid for using it.

⁴⁶ Iqbal and Mirakhor, op. cit.

⁴⁷ Nida'ul Islam magazine, op. cit.

2.2.2.3 *Bai'Mua'jjal (Deferred payment sales)*

The seller can sell a product and deliver it first to the buyer while the payment is deferred to a certain time later in installment or in a lump-sum and the price of the product is agreed upon between the seller and the buyer at the time of the sale.

It takes two forms. First form is with no extra charge for the deferred payment. The second one is to have two prices for the product, one for paying in cash and a higher one for the deferred payment. Both forms are lawful in the Islamic law.⁴⁸

2.2.2.4 *Bai'Salam (Purchase with deferred delivery)*

And also called Bai'Salaf. In this trade, a buyer pays in advance for a specified quantity and quality of a commodity, deliverable on a specific date, at an agreed price. This financing technique is particularly applicable to seasonal agricultural purchases, but it can also be used to buy other goods in cases where the seller needs working capital before he can deliver. In this case, the seller guaranties the delivery of the agreed quantity and quality of the product in the agreed time.⁴⁹

2.2.3 Lending

The main source of lending money is from Zakat fund, grants and donations, and yield of charitable investment accounts. Although these loans are not a source of profit for the bank, it supports the objectives of Islamic banks for the society. This mode of financing is a Non-PLS mode. The main way to work through lending for Islamic banks is using ***Al-Qard Al-Hassan*** or Beneficence Loans

⁴⁸ Mohamed Ibrahim Abou Shady, op., cit., Volume 3, pp 114-116

⁴⁹ ibid., pp 95-112 for more details about the conditions of Bai'Salam and also for the evidence about the lawful of it from Quran and Sunnah.

2.2.3.1 *Al-Qard Al-Hassan (Beneficence Loans)*

These are zero-return loans that the Qur'an exhorts Muslims to make to "those who need them." Banks are allowed to charge the borrowers a service fee to cover the administrative expenses of handling the loan, provided that the fee is not related to the amount or maturity of the loan.⁵⁰

2.2.4 Other Financing Instruments

There are some other financing instruments that are supported in Islamic banking and are considered new instruments for financing projects as opposed to those used in the conventional banks. In the following section, we will highlight, **Muzar'h** or agricultural contract, **Musaqat** or irrigation contract, and **Jo'alah** or service charge

2.2.4.1 *Muzar'h (Agricultural Contract)*

It is a contract between two parties, landowner and a farmer. The landowner will give the land to the farmer to cultivate the land in return of a share of the harvest of this land. Muzara'h is considered another type for a partnership. Islamic banks can use this to finance the landowner with the needed fund to cultivate his land in return of a percentage of the output harvest of the land not a fixed quantity of the harvest. This contract must include the period of time for financing the land owner, if it is to a fixed date or it is seasonal by the state of the harvest itself.

This is not a leasing type between the Bank and the landowner but it is a partnership between them based on the PLS mode. Therefore, for any reason if there are losses for this harvest then both of, the bank and the landowner, will share these losses.⁵¹

2.2.4.2 *Musaqat (Irrigation Contract)*

It is a special kind of partnership, which specialized in the agricultural projects. It is a contract between the landowner and a partner, so the partner will irrigate the harvest for the landowner in return of a

⁵⁰ Iqbal and Mirakhor, op. cit.

⁵¹ Muhsen Al-Khodery, op. cit., pp 147-148

percentage from the harvest of the land. This type of instruments is very important in the big irrigation projects in to cultivate the desert land in which the Islamic bank can play a very important role. Identifying exactly the harvest, which will be irrigated, is a conditioned to be added in the contract.⁵² This contract is also based on the PLS mode.

2.2.4.3 *Jo'alah (Service Charge)*

A party undertakes to pay another party a specified amount of money as a fee for rendering a specified service in accordance to the terms of the contract stipulated between the two parties. This mode usually applies to transactions such as consultations and professional services, fund placements, and trust services.⁵³ This is a Non-PLS mode instrument.

Islamic banks world-wide, offer a full spectrum of fee-paid retail services that do not involve interest payments, including checking accounts, spot foreign exchange transactions, fund transfers, letters of credit, travelers' cheques, safe-deposit boxes, securities safekeeping investment management and advice, and other normal services of modern banking.⁵⁴

From all the above we can summarize it as the following. There is a demand to operate through Islamic modes of financing, which affect both the assets and liabilities sides of bank balance sheets. These modes can be divided into two groups: those that are based on the PLS principle (which should, in principle, be viewed as core modes), and those that are not (which should, in principle, be viewed as marginal modes). PLS modes include: Mudaraba (trustee finance), Musharaka (equity participation), and direct investment. Non-PLS modes include: Qard al Hasanah (beneficence loans), Bai' Muajjal (deferred payments sales), Bai' Salam or Bai' Salaf (purchase with deferred delivery), Ijara and Ijara wa iqtiaa' (leasing and leasepurchase), Murabaha (mark-up), and Jo'alah (service charge).

⁵² *ibid.*, pp 149-150

⁵³ Iqbal and Mirakhor, *op. cit.*

⁵⁴ For more detailed description for these new types of services offered by the Islamic banks, refer to Muhsen Al-Khodery, *op. cit.*, pp 150-157

CHAPTER 3 ISLAMIC BANKING IN EGYPT

In Egypt, there are three Islamic banks, which are applying *Sharia* or Islamic law in all their business. These banks are, Faisal Islamic Bank of Egypt (FIBE), Egyptian Saudi Finance Bank (ESFB), and International Islamic Bank for Investment and Development (IIBID). To study the performance of these three Islamic banks we will go it in two directions, the first one is by comparing the performance of these Islamic banks with the rest of the Egyptian conventional banks. The second direction is by analyzing the different performance indicators of Islamic banks in Egypt.

We are depending on two sources of information in the study of the performance of Islamic banks. First source is the data collected from the annual reports of these banks for the period from 1998 until 2003. The collected financial statements will be found in the exhibits section of this research. The second source of information is the suggested financial performance indicators, which was published by the Islamic economics center, department of research in the IIBID. These indicators are used to monitor and measure the development of the financial position for Islamic banks.

IIBID and ESFB did not publish the annual report of 2003 yet. We used the data for first three quarters.

3.1 Islamic Banks under the Conventional Banking System of Egypt

In the late seventies and as a response to success of Islamic Banks in attracting customers from conventional banks, these conventional banks responded by establishing Islamic branches. Bank Misr was the first conventional bank to set up an Islamic branch, which started its operations in 1980.⁵⁵ Now, Bank Misr has 31 Islamic branches from total of 312 branches⁵⁶.

⁵⁵ Mahmoud Mohieldin, op. cit. pp. 23-24

⁵⁶ The information about Bank Misr is available on its site at <http://bankmisr.stocknetmisr.com/>

We could not classify these Islamic branches as a part of the Islamic banking in Egypt. This is due to two main reasons; first, they do not have separate balance sheets or accounts as the outcome of their operations. This means that the resources of these branches are mixed with the rest of the banks' funds and directed towards financing the bank's activities. As a result, these branches did not comply well with the Islamic law⁵⁷. Second reason is that they did not have a board of religious scholars to verify the banks' operations and assure their compliance with *Sharia*. We will study the performance of Islamic banks of Egypt compared with the rest of the conventional banks in the period of 1998-2003 to see if the Islamic banks are still a succeeded experience.

3.2 Islamic Banks verses Conventional Banks

To compare between the Islamic banks' performance verses the performance of the conventional banks in Egypt, we will use three ratios. First, the ratio of deposits to the total deposits of the banking system, second, the percentage of shareholder's equity to the total capital and reserves of the banking system. And third ratio, is total assets to the total assets of the banking system

3.2.1 Comparison of Total Deposits

The deposits for each Islamic bank as well as the rest of the conventional banks are listed in Table 2

Table 2
Total Deposits of the Islamic Banking

Type	1998	1999	2000	2001	2002	2003*
Conventional Banks	207,154	226,678	247,219	277,305	323,736	383,773
Islamic Banks						
FIBE	5,634	6,155	8,262	8,556	10,909	12,405
ESFB	1,262	1,566	1,801	1,997	2,503	2,911
IIBID	2,416	2,944	3,148	3,366	3,720	4,056
Total Islamic Banks	9,312	10,665	13,210	13,920	17,132	21,694
All Banks	216,466	237,343	260,429	291,225	340,868	403,144

* Note: The data for both ESFB and IIBID represents only 3 quarters of 2003

Source: Central Bank of Egypt, and the annual reports of the three banks

⁵⁷ In an interview with a responsible person in the research center of Bank Misr, he mentioned that there is no separate data or financial statements for the Islamic branches of the bank

We calculated the percentage of the deposits for each Islamic bank to the total deposits of all banks. We did the same with the deposits of the conventional banks. These calculations are summarized in Table 3.

By comparing the numbers through the shown period, it is noticed that the percentage is almost constant for the last six years. The highest percentage is for FIBE, which is the oldest among the Islamic banks in Egypt. On the other hand, the lowest percentage is for ESFB, which is the newest established Islamic bank in Egypt as it was established in 1989.

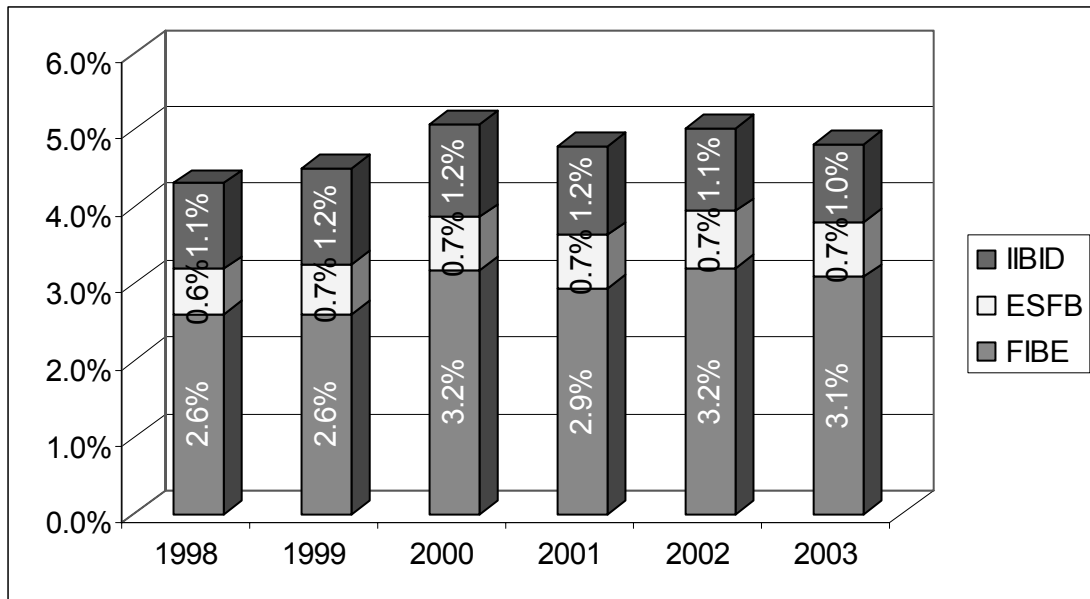
Table 3
Calculated Percentages of Deposits for Islamic Banks

	1998	1999	2000	2001	2002	2003	Average
Conventional Banks	95.7%	95.5%	94.9%	95.2%	95.0%	95.2%	95.3%
Islamic Banks							
FIBE	2.6%	2.6%	3.2%	2.9%	3.2%	3.1%	2.9%
ESFB	0.6%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%
IIBID	1.1%	1.2%	1.2%	1.2%	1.1%	1.0%	1.1%
Islamic Banks Percentage	4.3%	4.5%	5.1%	4.8%	5.0%	4.8%	4.7%

* Note: The data for both ESFB and IIBID represents only 3 quarters of 2003

Source: Central Bank of Egypt, and the annual reports of the 3 banks

The average of total deposits for the Islamic banks is about 4.7% for the six-year period. The highest percentage of 5.1% was in year 2000 (see Figure 2).



* Note: The data for both ESFB and IIBID represents only 3 quarters of 2003

Figure 2 Calculated Percentages of Deposits for Islamic Banks in Egypt

The banking system in Egypt, based on the annual report of 2003 from the Central Bank of Egypt (CBE), contains 62 banks with total number of 2582 branches. That gives us an idea about the banking system in Egypt so we can evaluate the performance of the Islamic banks. These banks contain only three Islamic banks with 35 branches⁵⁸. That means that 4.8% from the total number of banks in Egypt are receiving 4.7% from the total deposits to the banking system. Also means that 1.4% of Islamic branches are accepting 4.7% of the total deposits to the banking system.

3.2.2 Comparison of shareholder's equity

The other way of comparing the Islamic banks to the conventional banks is by comparing the shareholder's equity of both Islamic banks and conventional banks to the total capital and reserves of the banking system.

It is the ratio of the total shareholders' equity and net profit for each Islamic bank from the annual reports of Islamic banks to the total of (Capital + Reserves) for all banking system from the CBE annual report of

⁵⁸ FIBE has 16 branches, IIBID has 8 branches, and ESFB has 11

2003. This will give us an idea about the capabilities of the Islamic banks compared with the conventional banks. These data are collected in Table 4.

Table 4
Shareholders' Equity in Conventional and Islamic Banks

							(LE mn)
Type	1998	1999	2000	2001	2002	2003*	
Conventional Banks	13,043	17,155	18,893	20,415	21,596	22,887	
Islamic Banks							
FIBE	299	302	373	344	374	569	
ESFB	121	132	149	156	168	191	
IIBID	108	108	91	74	56	122	
Total Islamic Banks	529	543	612	575	598	882	
All Banks	13,572	17,698	19,505	20,990	22,194	23,769	

* Note: The data for both ESFB and IIBID represents only 3 quarters of 2003

Source: Central Bank of Egypt, and the annual reports of the 3 banks

These percentages are calculated and listed In Table 5. The average percentage for shareholders across the six-year period is 3.2% of the total banking system.

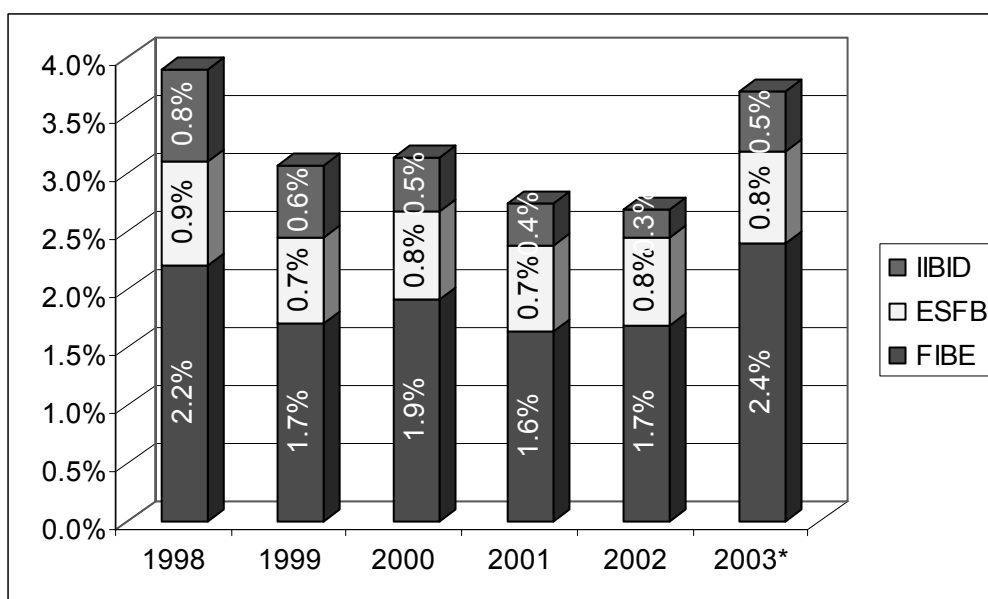
Table 5
Calculated Percentages of Shareholders' Equity in Islamic Banks

	1998	1999	2000	2001	2002	2003*	Average
Conventional Banks	96.1%	96.9%	96.9%	97.3%	97.3%	96.3%	96.8%
Islamic Banks							
FIBE	2.2%	1.7%	1.9%	1.6%	1.7%	2.4%	1.9%
ESFB	0.9%	0.7%	0.8%	0.7%	0.8%	0.8%	0.8%
IIBID	0.8%	0.6%	0.5%	0.4%	0.3%	0.5%	0.5%
Islamic banks percentage	3.9%	3.1%	3.1%	2.7%	2.7%	3.7%	3.2%

* Note: The data for both ESFB and IIBID represents only 3 quarters of 2003

Source: Calculated from Central Bank of Egypt, and annual reports of the 3 banks

The highest percentage is always for the FIBE with average of 1.9% while the highest percentage was in the year 2003 (see Figure 3) due to retained profits of LE 17.25 million plus net profit of LE 128.42 million added to the shareholders equity for this year.



* Note: The data for both ESFB and IIBID represents only 3 quarters of 2003

Figure 3 Calculated Percentages of Shareholders' Equity for Islamic Banks in Egypt

The percentage of ESFB is almost constant for the six-year period with average of 8%. Which means that the increase percentage in the shareholders' equity for ESFB is almost equals the increase percentage of the banking system. Finally, it was clear that IIBID has a continuous decrease in its shareholders' equity since 1998 until 2002. This is due to low income from the bank's investment operations that was not enough to cover the return on saving accounts. On the other hand, the value for 2003 is only for 3 quarters of this year as we stated before, which means that there may be a lot of final settlements by the end of the year which may ends up with losses as well.

3.2.3 Comparison of Total Assets

The last comparison is to compare between total assets for total Islamic banks to the total assets of the banking system in Egypt.

It is the ratio of the total assets for each Islamic bank from the annual reports of Islamic banks to the total assets for all banking system from the CBE annual report of year 2003. This will give us an idea about the capabilities of the Islamic banks compared with the conventional banks. These data are collected in Table 6

Table 6
Total Assets of Conventional and Islamic Banks

							(LE mn)
Type	1998	1999	2000	2001	2002	2003	
Conventional Banks	290,759	317,022	336,189	366,424	409,102	473,956	
Islamic Banks							
FIBE	6,868	7,505	9,893	10,011	12,600	13,946	
ESFB	1,699	1,813	2,060	2,289	2,781	3,263	
IIBID	2,693	3,223	3,485	3,615	3,878	4,298	
Total Islamic Banks	11,260	12,540	15,437	15,914	19,260	21,508	
All Banks	302,019	329,562	351,626	382,338	428,362	495,464	

* Note: The data for both ESFB and IIBID represents only 3 quarters of 2003

Source: Calculated from Central Bank of Egypt, and annual reports of the 3 banks

These percentages are calculated and listed in Table 7. The average percentage for shareholders across the six-year period is 4.2% of the total banking system.

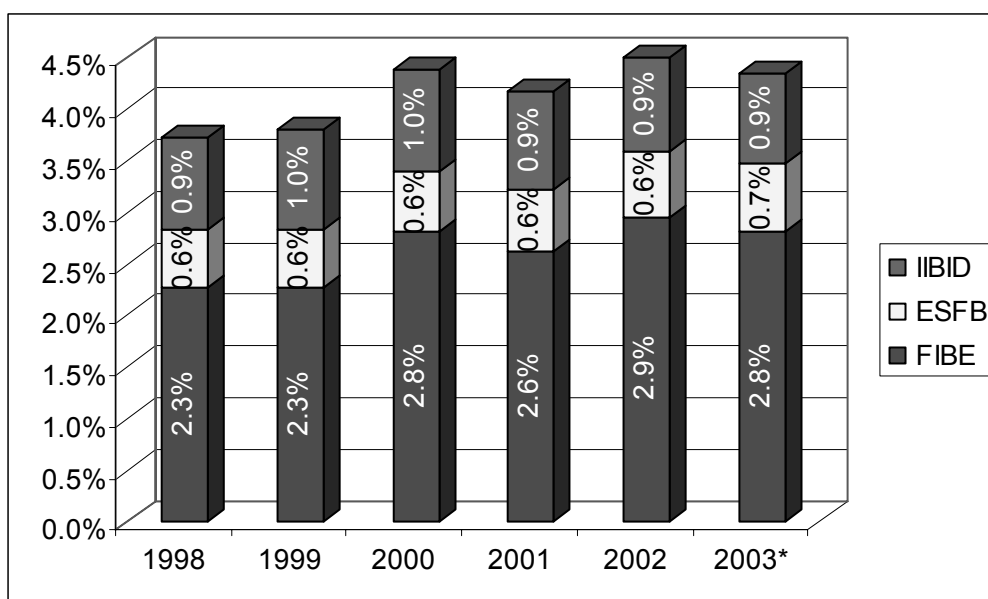
Table 7
Calculated Percentage of Total Assets for Islamic Banks

	1998	1999	2000	2001	2002	2003*	Average
Conventional Banks	96.3%	96.2%	95.6%	95.8%	95.5%	95.7%	95.8%
Islamic Banks							
FIBE	2.3%	2.3%	2.8%	2.6%	2.9%	2.8%	2.6%
ESFB	0.6%	0.6%	0.6%	0.6%	0.6%	0.7%	0.6%
IIBID	0.9%	1.0%	1.0%	0.9%	0.9%	0.9%	0.9%
Islamic banks percentage	3.7%	3.8%	4.4%	4.2%	4.5%	4.3%	4.2%

* Note: The data for both ESFB and IIBID represents only 3 quarters of 2003

Source: Calculated from Central Bank of Egypt, and annual reports of the 3 banks

From the calculated percentage and by comparing it with the percentage for deposits we can see the amount of deposits is in the normal percentage taking into consideration the capabilities of these banks.



* Note: The data for both ESFB and IIBID represents only 3 quarters of 2003

Figure 4 Calculated Percentage of Total Assets for Islamic Banks

It is clear that FIBE has the highest capabilities in Islamic banks as it has assets equals almost four time the assets of ESFB and about three times the assets of IIBID.

3.3 Financial Performance Indicators for Islamic Banks in Egypt

The Islamic economics center, department of research in the IIBID published a set of fourteen financial performance indicators, which Islamic banks use it to monitor and measure the development of their financial position.

These published indicators are: increase rate in total assets, shareholders' equity to total assets, total deposits to total assets, investment accounts to total assets, investment accounts to total deposits, current accounts to total deposits, total operating investment to total deposits, total long and medium term investment to total operating investment, short term investments to total operating investment, fixed assets to total shareholder's equity, total cash to total deposits, return on assets, return on saving accounts to total deposits, and the dividends to the paid up capital.

In the following analysis, we will not cover three of these indicators. The research will not cover the ratio of long and medium term investment to total operating investment, as well as the ratio of short-term

investments to total operating investment due to the lack of detailed information about the operating investment classified into long-term (Musharaka), medium-term (Mudaraba) and short-term (Murabaha) investments in their annual reports. The research will not cover the ratio of dividends to the paid up capital due to missing data for some years.

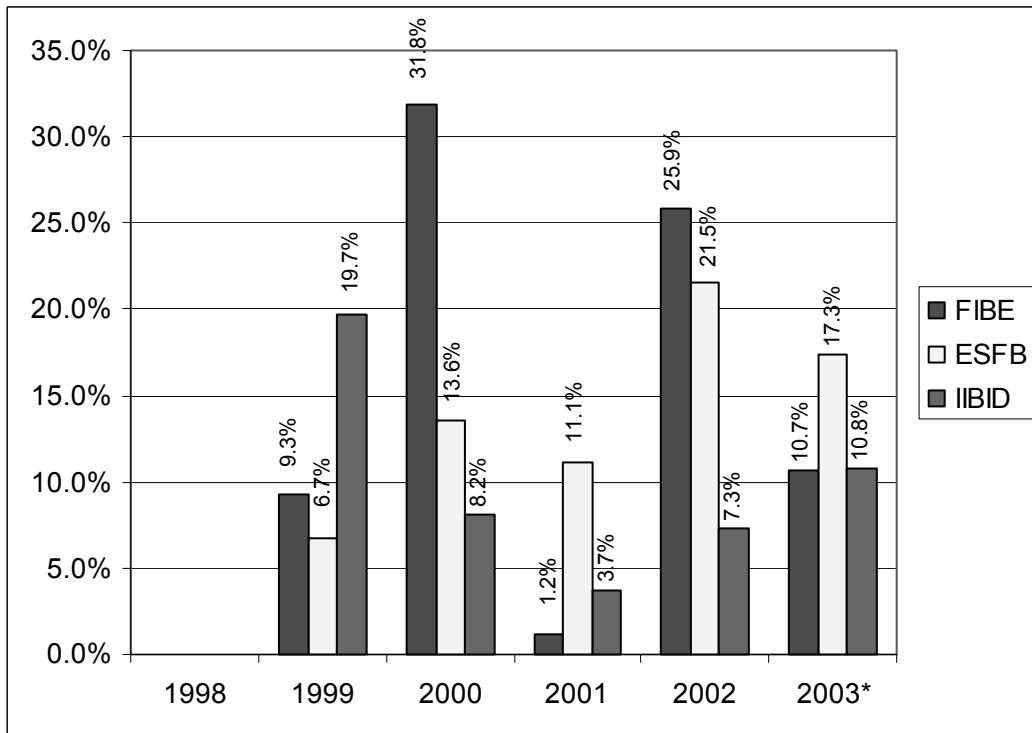
All financial indicators for each of the three Islamic banks in Egypt are listed in the Exhibits section of this research as Exhibit F, Exhibit H, and Exhibit J.

3.3.1 Increase Rate of the Total Balance Sheet (IRTBS)

This indicator is to measure the increase rate of the total balance sheet (IRTBS) for the three Islamic banks. This indicator equals

$$IRTBS = \frac{(Total\ Balance\ Sheet\ of\ current\ year - Total\ Balance\ Sheet\ of\ previous\ year)}{Total\ Balance\ Sheet\ of\ previous\ year}$$

The calculated data for this indicator are shown in Figure 5



* Note: The data for both ESFB and IIBID represents only 3 quarters of 2003

Figure 5 Increase Rate in Total Balance Sheet

The highest increase rate was 31.8% for FIBE in 2000. This is due to the increase of investments in Musharaka, Modaraba, Morabaha, and real estate from LE 6,270 million to LE 8,253 million with an increase ratio of 31.6% while this ratio dropped in the next to only 0.97% which leads to the lowest increase rate for the total balance sheet of 1.2%. FIBE has the highest average of 13.1%

For ESFB, although the drop in the Morabaha and investment operations from LE 1,157 in 1998 to LE 1,125 million 1999, that was covered by the very high increase in the balances with banks from LE 27 million in 1998 to LE 179 million in 1999. The increase in the balances with banks is to meet the cash reserve ratio set by the CBE as the deposits increased from LE 1,262 million to LE 1,566 million. After that, there was a continuous increase in the Morabaha and investments operations but not with the same rate as this rate decreased in 2003. Taking into consideration that, our data for 2003 represents only 3 quarters of the year. The average of IRTBS for ESFB is 11.7%.

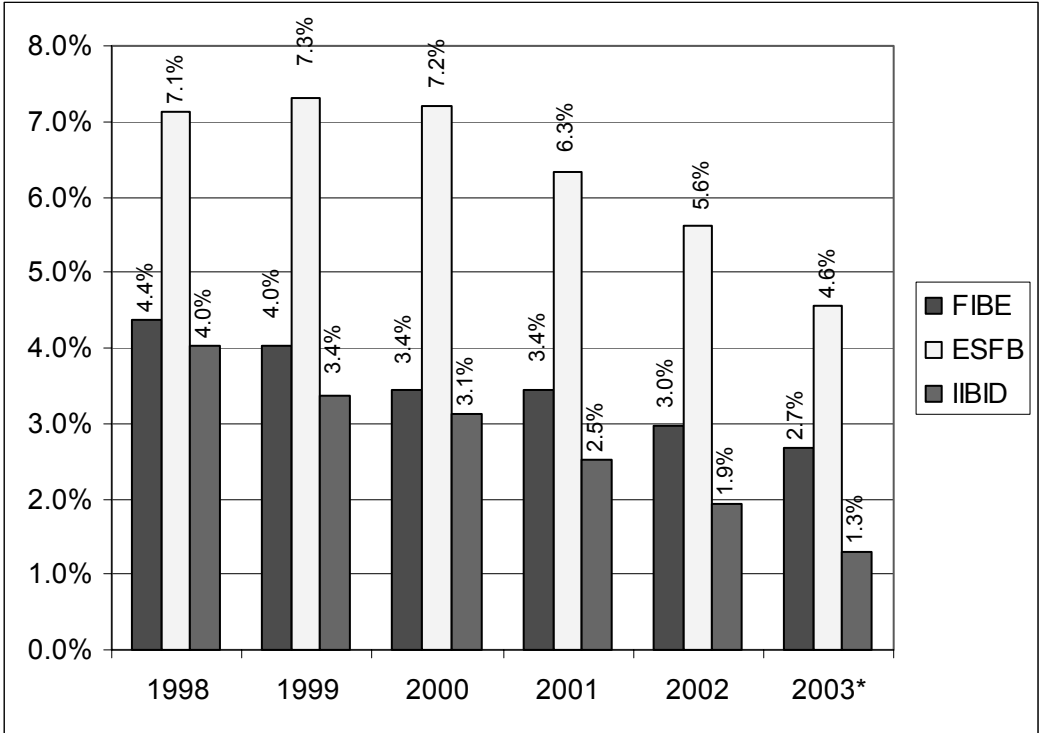
In IIBID there was a continuous drop starting 2001 through 2002 in the Morabaha and Investment operations that was covered again by the high increase in the balances with banks to meet the cash reserve ratio due to the increase in deposits. IIBID made the lowest average for IRTBS of 8.3%

3.3.2 Ratio of Shareholders' Equity to Total Assets (RSETA)

This indicator is to measure the Ratio of Shareholders' Equity to Total Assets (RSETA) for the three Islamic banks. This indicator equals

$$RSETA = (Paid\ up\ Capital + Reserves + Retained\ Profits) / Total\ Assets$$

The calculated data for this indicator are shown in Figure 6



* Note: The data for both ESFB and IIBID represents only 3 quarters of 2003

Figure 6 Ratio of Shareholders' Equity to Total Assets

The highest average for RSETA was by ESFB with value of 6.4% while the lowest average was by IIBID with value of 2.7%. FIBE made an average of 3.5%. These are low values, which means that the ability of these banks to make Musharaka and long term investments will be high as the biggest part of the

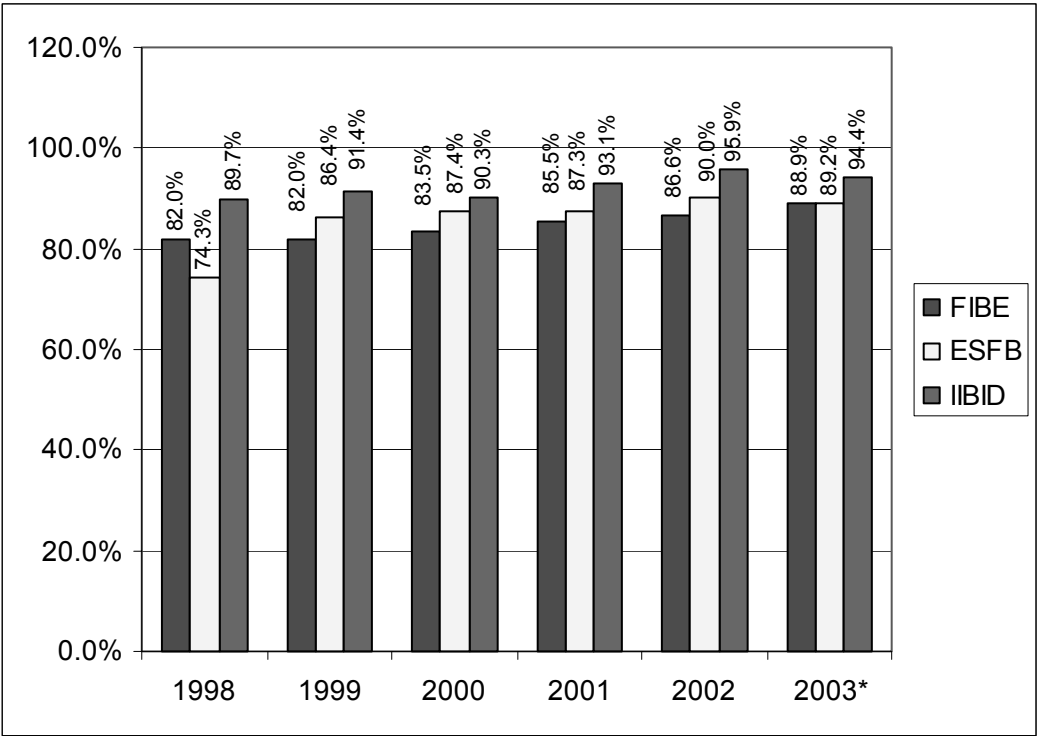
shareholders equity is used in fixed assets and if this indicator is high, this leave a low percentage of total assets to be used in the long term investments.

3.3.3 Ratio of Total Deposits to Total Assets (RTDTA)

This indicator is to measure the Ratio of Total Deposits to Total Assets (RTDTA) for the three Islamic banks. This indicator equals

$$RTDTA = \text{Total Deposits (Investment, Saving, and Current)} / \text{Total Assets}$$

The calculated data for this indicator are shown in



* Note: The data for both ESFB and IIBID represents only 3 quarters of 2003

Figure 7 Ratio of Total Deposits to Total Assets

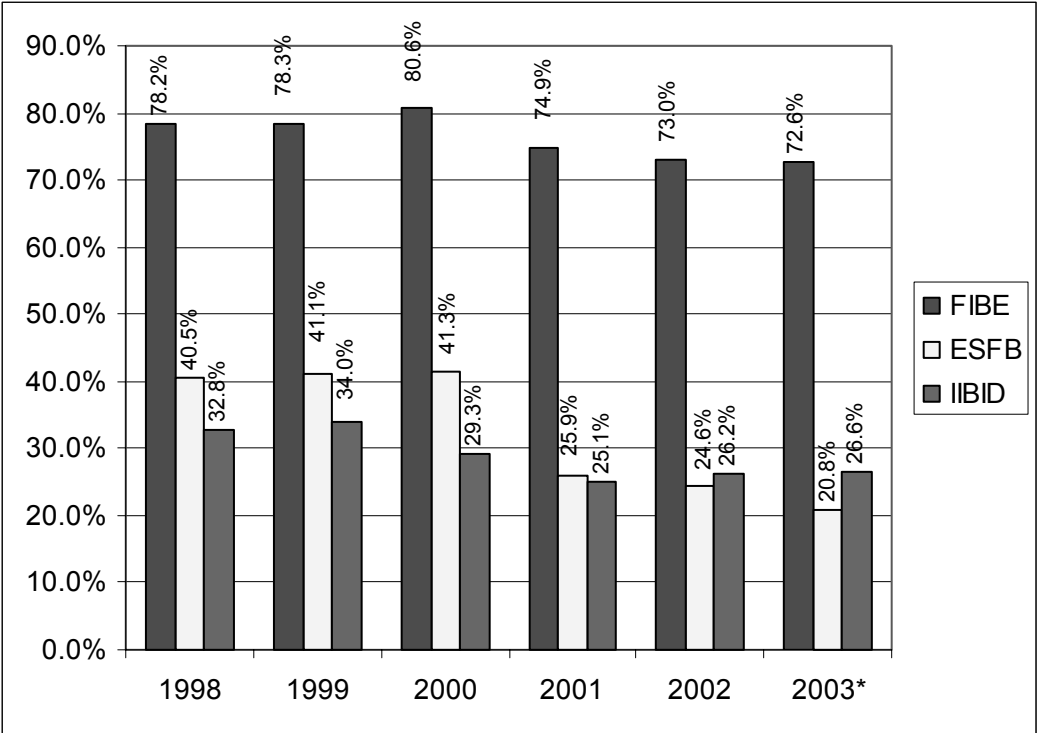
IIBID made the highest average for RTDTA with average ratio of 92.5% then ESFB with average ratio of 85.8%, then FIBE with the lowest average ratio of 84.8%. These measures reflects the high trust (specially for IIBID) from customers to Islamic Banks in Egypt. Thus, such trust made Islamic banks to depend more on the deposits from their clients in their operations

3.3.4 Ratio of Investment Accounts to Total Assets (RIATA)

This indicator is to measure the Ratio of Investment Accounts to Total Assets (RIATA) for the three Islamic banks. This indicator equals

$$RIATA = \text{Total Investment Accounts} / \text{Total Assets}$$

The calculated data for this indicator are shown in



* Note: The data for both ESFB and IIBID represents only 3 quarters of 2003

Figure 8 Ratio of Investment Accounts to Total Assets

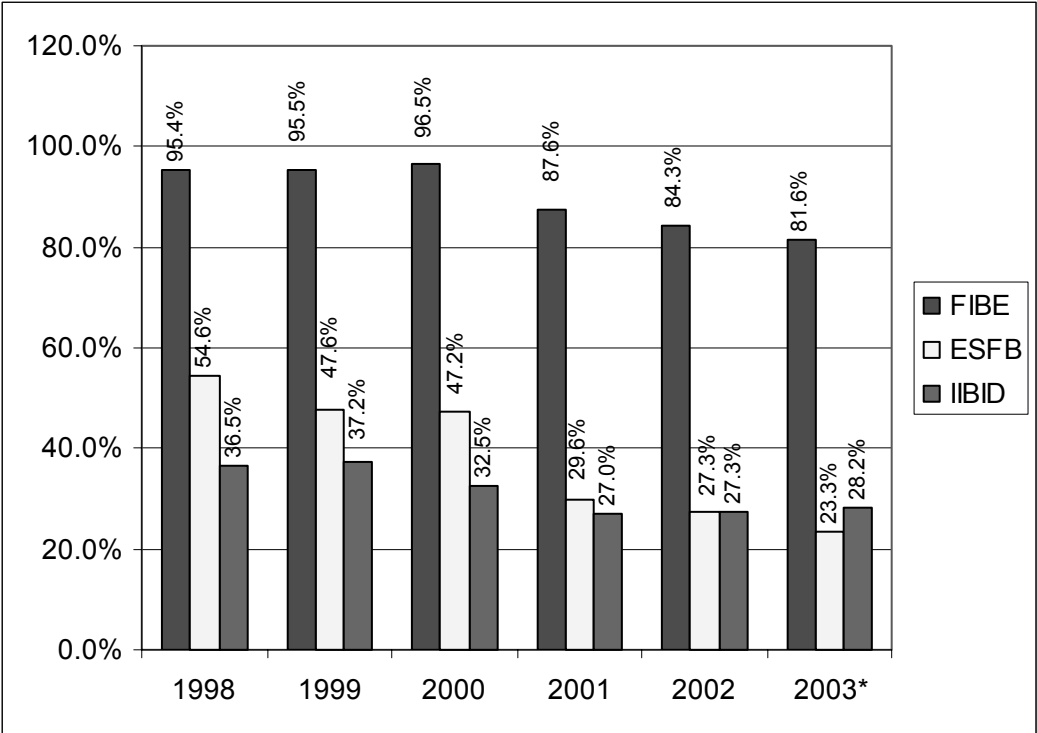
FIBE made the highest average for RIATA with average ratio of 76.3%, followed by ESFB with average ratio of 32.4% and finally IIBID with average ratio of 29%. The high value of this indicator for FIBE is mainly due to high ratio of Investment accounts and there was no saving certificate for years 1998, 1999, and 2000. Starting 2001 FIBE starts to depends on the deposits of saving certificates but still investment accounts represents the highest ratio of total assets. On the other hand, both ESFB and IIBID are highly depending on the saving certificates and represent a high ratio in the total assets.

3.3.5 Ratio of Investment Accounts to Total Deposits (RIATD)

This indicator is to measure the Ratio of Investment Accounts to Total Deposits (RIATD) for the three Islamic banks. This indicator equals

$$RIATA = \text{Total Investment Accounts} / \text{Total Accounts (Investment, Saving, and Current)}$$

The calculated data for this indicator are shown in Figure 9



* Note: The data for both ESFB and IIBID represents only 3 quarters of 2003

Figure 9 Ratio of Investment Account to Total Deposits

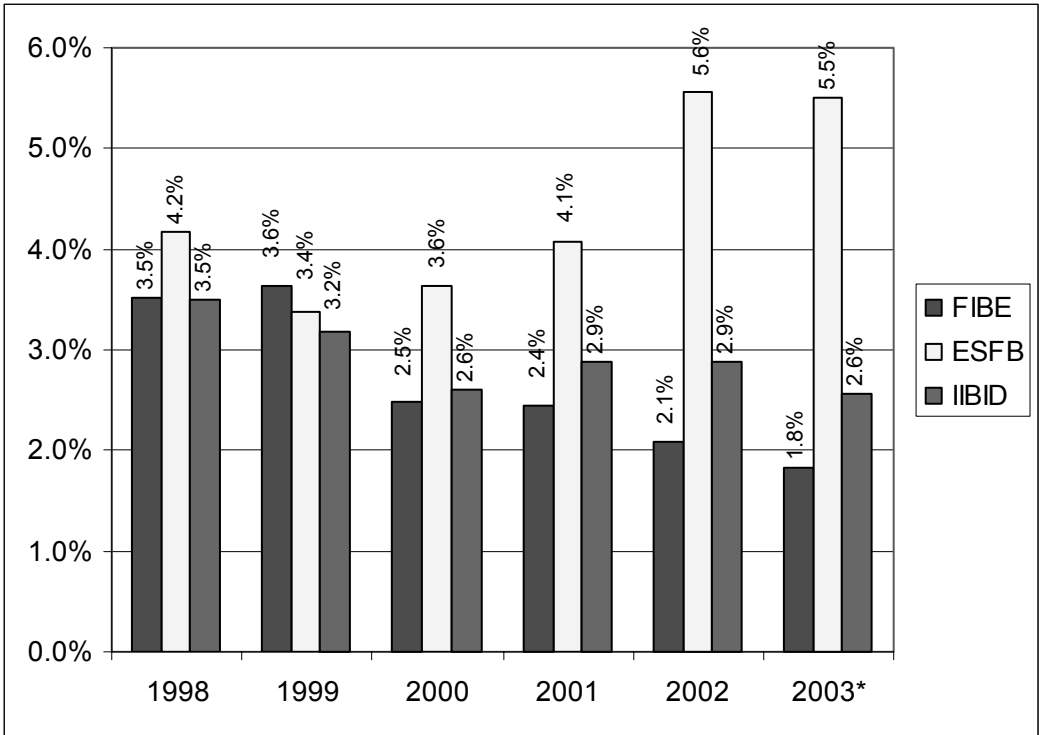
FIBE made the highest average for RIATD with average ratio of 90.1%, followed by ESFB with average ratio of 38.3% and finally IIBID with average ratio of 31.5%. As explained in previous indicator, both of ESFB and IIBID are highly depending on the saving certificates and represents a high ratio in the total deposits.

3.3.6 Ratio of Current Accounts to Total Deposits (RCATD)

This indicator is to measure the Ratio of Current Accounts to Total Deposits (RCATD) for the three Islamic banks. This indicator equals

$$RCATD = \text{Total Current Accounts} / \text{Total Accounts (Investment, Saving, and Current)}$$

The calculated data for this indicator are shown in Figure 10



* Note: The data for both ESFB and IIBID represents only 3 quarters of 2003

Figure 10 Ratio of Current Accounts to Total Deposits

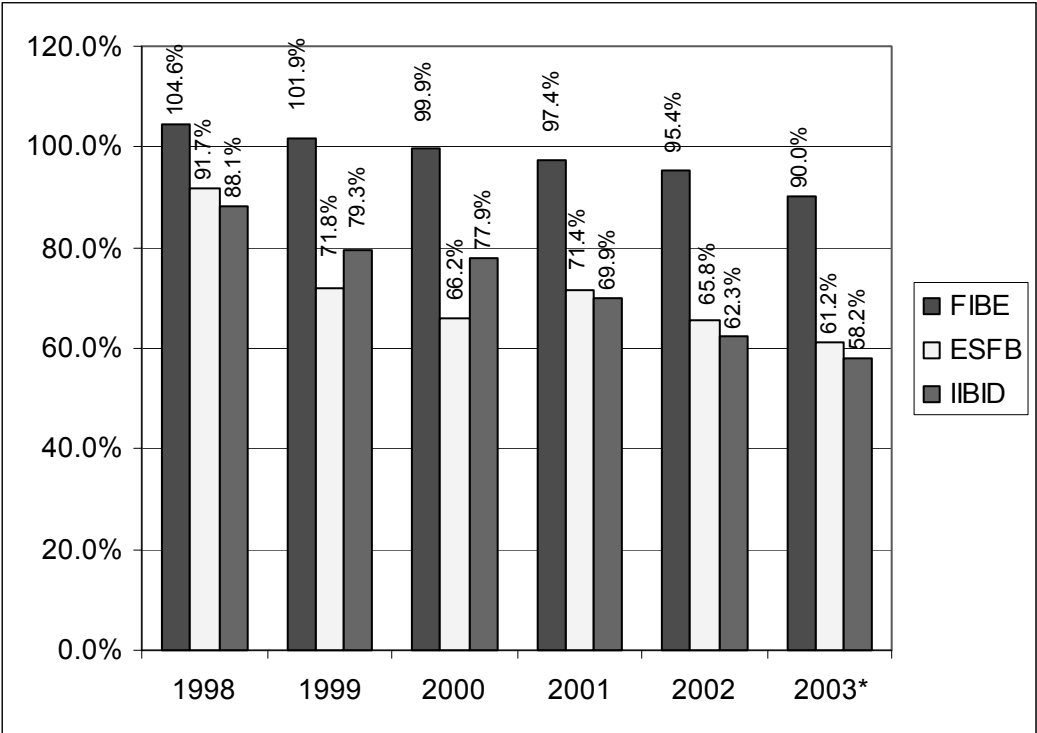
ESFB made the highest average for RCATD with average ratio of 4.4%, followed by IIBID with average ratio of 2.9% and finally FIBE with average ratio of 2.7%. The low percentage of RCATD is due to the increase of investment accounts and saving certificates deposits in the 3 banks. The high average in RCATD for the ESFB is mainly due to its new establishment as well as the new type of accounts which is called current saving accounts with low return on these accounts.

3.3.7 Ratio of Operating Investment to Total Deposits (ROITD)

This indicator is to measure the Ratio of Operating Investment to Total Deposits (ROITD) for the three Islamic banks. This indicator equals

$$ROITD = \frac{\text{Total Operating Investment (Long, Medium, and Short-term)}}{\text{Total Accounts (Investment, Saving, and Current)}}$$

The calculated data for this indicator are shown in Figure 11



* Note: The data for both ESFB and IIBID represents only 3 quarters of 2003

Figure 11 Ratio of Operating Investment to Total Deposits

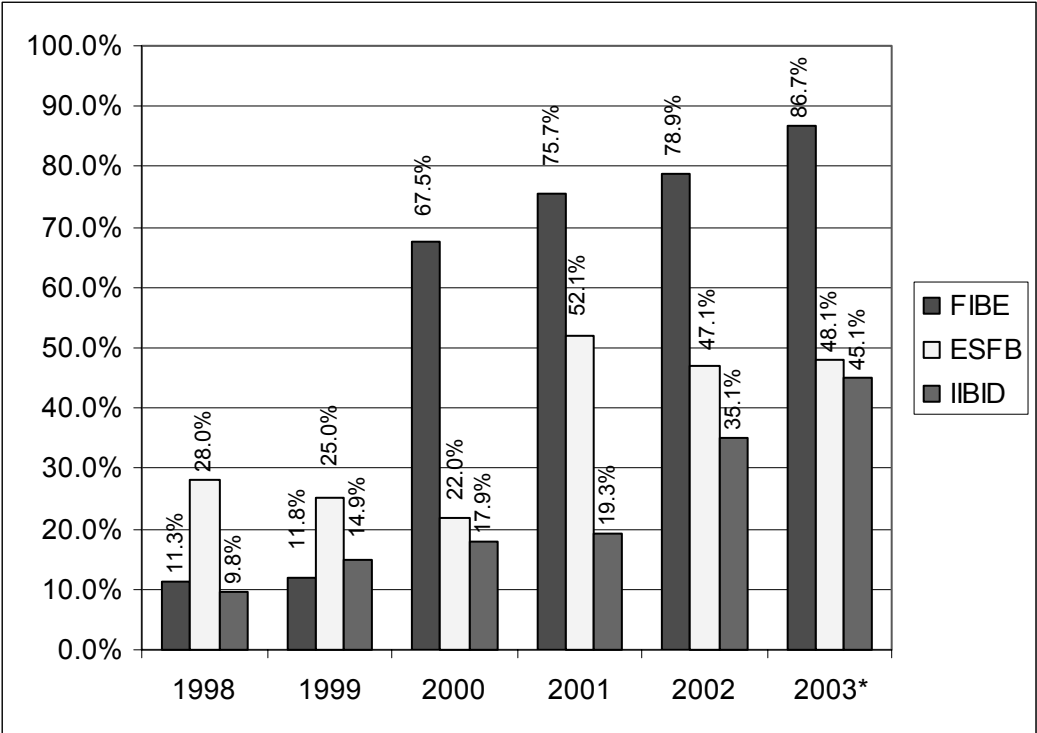
FIBE made the highest average for ROITD with average ratio of 98.2%, followed by IIBID with average ratio of 72.6% and finally ESFB with average ratio of 71.3%. There is a continuous drop in the value for ROITD in the three banks. For FIBE it is dropped from 104% in 1998 to 90.0% in 2003. This is also valid in case of IIBID as it is dropped from 88.1% in 1998 to be 58.2%. This drop is due to the higher increase rate in the Total Deposits than the increase rate in the Total Operating Investment.

3.3.8 Ratio of Fixed Assets to Total Shareholders' Equity (RFASE)

This indicator is to measure the Ratio of Fixed Assets to Total Shareholders' Equity (RFASE) for the three Islamic banks. This indicator equals

$$RFASE = \text{Total Fixed Assets} / (\text{Paid up Capital} + \text{Reserves} + \text{Retained Profits})$$

The calculated data for this indicator are shown in Figure 12



* Note: The data for both ESFB and IIBID represents only 3 quarters of 2003

Figure 12 Ratio of Fixed Assets to Total Shareholders' Equity

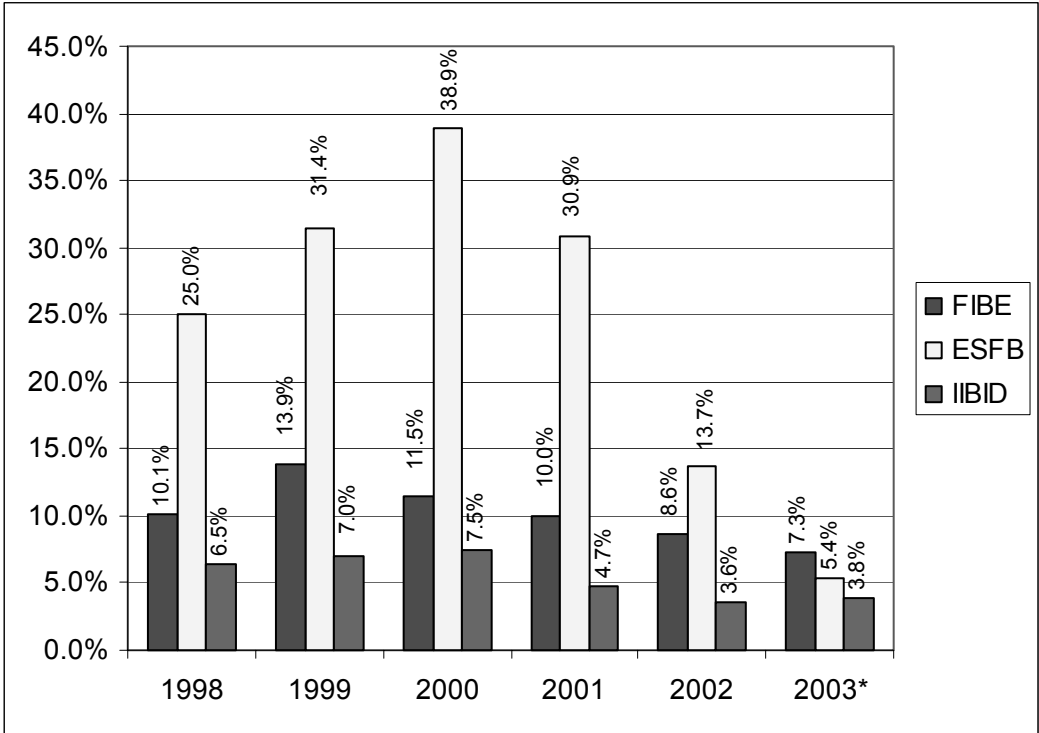
FIBE made the highest average for RFASE with average ratio of 55.3%, followed by ESFB with average ratio of 37.1% and finally IBID with average ratio of 23.7%. These are high values, which give an indication for high payment in fixed assets especially by FIBE as there is a huge increase in payment for purchasing lands and buildings from LE 26 million in 1999 to LE 219 million in 2000. This increase continued in the following years. The increase in fixed assets in 2001 for ESFB was due to the opening of the new building as headquarter and the opening of three new branches.

3.3.9 Ratio of Total Cash to Total Deposits (RTCTD)

This indicator is to measure the Ratio of Total Cash to Total Deposits (RTCTD) for the three Islamic banks. This indicator equals

$$RTCTD = \frac{\text{Total Cash (In CBE, and Banks)}}{\text{Total Accounts (Investment, Saving, and Current)}}$$

The calculated data for this indicator are shown in Figure 13



* Note: The data for both ESFB and IIBID represents only 3 quarters of 2003

Figure 13 Ratio of Total Cash to Total Deposits

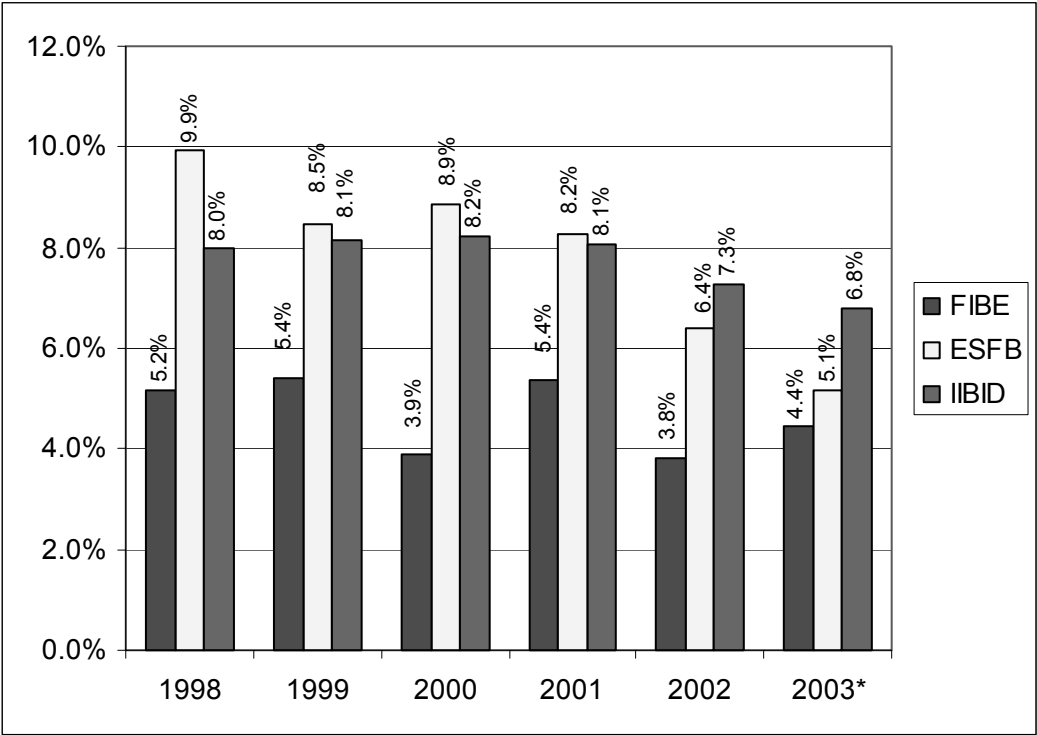
ESFB made the highest average of RTCTD with average ratio of 24.2%, followed by FIBE with average ratio of 10.2% and finally IIBID with average ratio of 5.5%. The high average of RTCTD for ESFB is due to the high percentage of cash allocated for treasury bonds. The high value of RTCTD means low operating investments.

3.3.10 Return on Assets (ROA)

This indicator is to measure the Return on Total Assets (ROA) for the three Islamic banks. This indicator equals

$$ROA = \frac{\text{Net Profit before deduction of return on saving accounts and zakat}}{\text{Total Assets}}$$

The calculated data for this indicator are shown in Figure 14



* Note: The data for both ESFB and IIBID represents only 3 quarters of 2003

Figure 14 Return on Total Assets

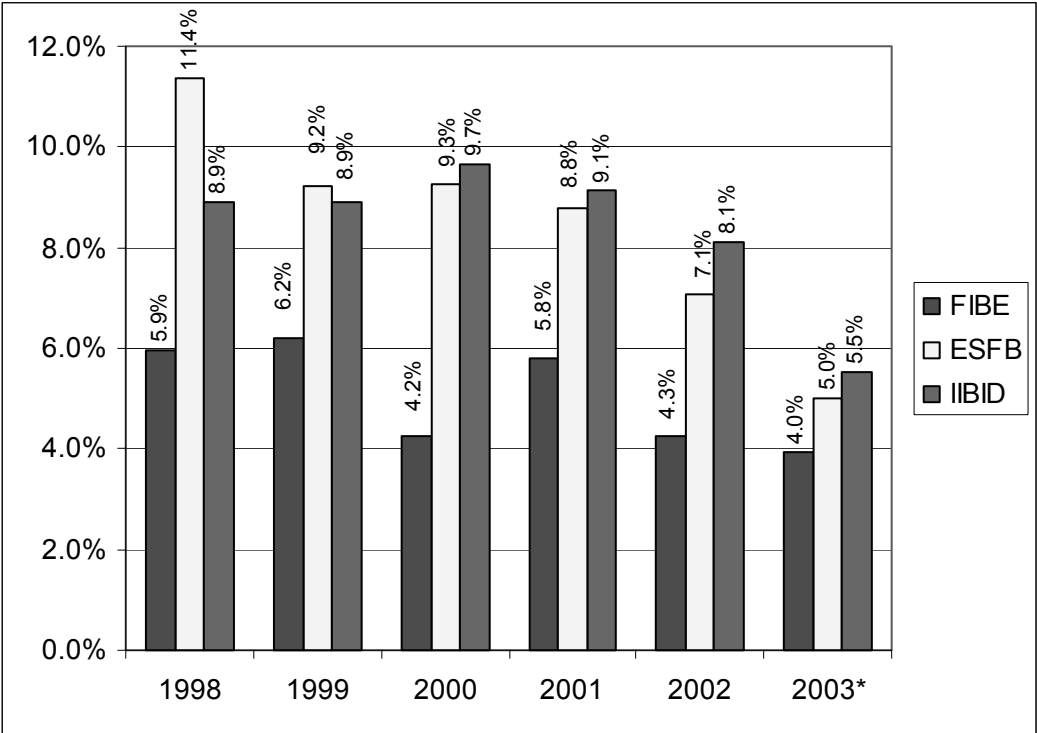
ESFB made the highest average of ROA with average ratio of 7.8%, followed by IIBID with average ratio of 7.7% and finally FIBE with average ratio of 4.7%. As explained in the Comparison of Total Assets (see section 3.2.3) FIBE has total assets almost four times the assets of ESFB and about three time total assets of IIBID. That gives us an indication that the profits of FIBE is not as it should be if we compare it with its capabilities while the other two banks are performing fairly comparing with their capabilities.

3.3.11 Ratio of Return on Saving Accounts to Total Deposits (RRSATD)

This indicator is to measure the Ratio of Return on Saving Accounts to Total Deposits (RRSATD) for the three Islamic banks. This indicator equals

$$RRSATD = \text{Return on Saving Accounts} / \text{Total Accounts (Investment, Saving, and Current)}$$

The calculated data for this indicator are shown in Figure 15



* Note: The data for both ESFB and IIBID represents only 3 quarters of 2003

Figure 15 Ratio of Return on Saving Accounts to Total Deposits

ESFB made the highest average of RRSATD with average ratio of 8.5%, followed by IIBID with average ratio of 8.4% and finally FIBE with average ratio of 5.1%. Return on saving accounts for FIBE is not as it should be comparing with its huge deposits specially those for investments. The types of investments that bank participating in need to be reconsidered. ESFB and IIBID are doing fine. There may be a reason for this as FIBE is investing more in long-term investments, while ESFB IIBID are depending

more on the short-term investments which are mostly Morabaha or others of Non-PLS based instruments.

CHAPTER 4

PROBLEMS OF ISLAMIC BANKING

There are problems for Islamic banking in Egypt. Some of these problems are general problems that we can find in any other country including Egypt that have Islamic banks, and some of them are specific with Islamic banks in Egypt. This chapter is to highlight each of them.

4.1 General Problems of Islamic Banking

Islamic banks are suffering from different problems that may be general problems for all of them. These are internal problems and external problems.

4.1.1 Internal Problems

The main internal problems are lack of management, inability of Islamic banks to develop new instruments that attract new customers, and the surplus in cash.

4.1.1.1 Lack of qualified management

Islamic banks, based on their objectives, will have varieties of operations in different areas which need a wide range of skills to cover most of these areas. Such management needs to be a believer, in the same time, in the role of Islamic banks. Since that most of Islamic banks are new and established in a conventional banking systems that means that the available bankers to work in them mostly have conventional banking background. Thus it is normal to find that management in Islamic banks contains three types, those who are believers in Islamic banking with limited banking skills, those are professional bankers with poor or no interest in Islamic banking, and finally those who are skilful and convicted and such type are, unfortunately, very few in the banking field. And due to the lack of skilful believers, Islamic banks are suffering from mismanagement problems which most of the time leads to the violation of Islamic law.

4.1.1.2 Poor development of new investment instruments

Islamic banks failed in developing new instruments to meet the new needs of the customers these days. This is a very serious problem as it means that Islamic banking is no more able to be a replacement for conventional banking. Not only that, but this problem made some Islamic banks to follow some ways and techniques that looks like those used in the conventional banks and leads to bad image for them.

4.1.1.3 Investing the surplus in cash

Most of Islamic banks are suffering from surplus in cash due to their success to attract a lot of deposits more than expected and more than the planned investment projects. That makes the cash-in flow much higher than the cash-out flow. Which means lost of opportunities for profitable investment and decrease in the value of such cash due to inflation which will defiantly affect the return on such investments from one side and the inability to use such capital in the economical development of the society in the other side. This problem forced some Islamic banks to speculate on Gold and foreign currencies or deposit the surplus cash in conventional banks with a fixed interest rate.

4.1.2 External Environmental Problems

The external environment, in which the Islamic banks are working, is very important. In countries that have a conventional banking system is dominant, will have some regulations and rules that will be problems for the Islamic banks. Egypt is an example for such conventional banking system.

We can summarize these problems in the following:

4.1.2.1 Problems with conventional Central Banks

In most of the cases, Islamic banks are working within a conventional banking system which is controlled by the central bank. Due to the absence of Islamic central banks, Islamic banks face the following problems:

1. Central banks apply the reserve ratio policy. This means that the bank will keep certain percentage of the customers' deposits with the central bank with no return on it, which will lead to have a great part of the investment accounts, which represents more than 90% of the total deposits in Islamic

banks, not working. This will decrease the return on these investment accounts. The conventional banks do not face such a problem as the current accounts (with no interest) represents about 40% of the total deposits so the reserve ratio will be easily covered.

2. The policy of applying credit ceilings controls the maximum limit of finance that Islamic banks can use in projects of certain sectors. This maximum limit is a ratio from the total deposits. By this, Islamic banks find no other way but to deposit the rest of their deposits in the conventional banks with interest, which breaks the Islamic law.
3. Central banks occasionally put some restrictions like controlling the acceptance of more investment deposits, which is applied on all banks and protect the conventional banks from the high competition of Islamic banks.
4. Central banks are not approving any more establishments of new Islamic banks or even opening new branches for the existing ones.

4.1.2.2 Problems in dealing with clients

Islamic banks are suffering from, what we can call, a non-Islamic thinking and mentality for their clients; either they are depositors or investors. We can classify Islamic banks' clients into three categories based on such mentality:

1. Clients who don't understand the meaning or the nature of Islamic banks' operations as they used to deal with conventional banks. Those clients made comparisons between Islamic banks and the conventional banks, and due to their mentality, the results are against Islamic banks most of the time.
2. Clients who are afraid from dealing with the instruments of Islamic banks specially those instruments, which depends on the profit and loss sharing. So they seek for quick and guaranteed profit from Islamic banks and not understanding the profit and loss sharing concept.
3. Dishonest clients who are establishing incorrect accounts to show losses in their operations or by a lot of other ways to swindle their partners of Islamic banks. This is one of the reasons that forced most of Islamic banks to shrink their investment by Musharaka, or Modaraba, and depends more and more on Morabaha

4.1.2.3 *Missing of coordination and cooperation among Islamic Banks*

There is no established and well functional network to connect all the Islamic banks together. By the existence of such network, those Islamic banks with surplus will be able to direct such surplus to other Islamic banks. Not only that, but these Islamic banks are missing for an international organization that have authorities to establish policies to be applied on all Islamic banks and protect the industry from all these institutions which are using the word "Islam" without respecting it, just to benefit from the Islamic resurgence

4.2 Problems of Islamic Banking in Egypt

The general problems that are discussed are applied on Islamic banks in Egypt as well. In additions to that, Islamic banks in Egypt are suffering from problems that are specific in their case. The dominance of short-term Murabaha finance over the rest of financial instruments specially Musharaka and Mudaraba is an important problem. Services offered by conventional banks are much better and more consistent than services offered by the three Islamic banks in Egypt. We can also say that there is a problem in marketing the different instruments available for the customers. There is a huge problem in providing data in the three Islamic banks in Egypt and only one bank of them starts to use the internet to offer services and marketing its investments instruments to its clients. There are some violations of Islamic law in Islamic banks. Finally, the role of Islamic banks in Egyptian economy is limited.

4.2.1 The dominance of short-term Murabaha finance

As mentioned in the introduction of section 3.3 that we could not calculate three indicators, one of them was to get the percentage of long and medium-term investments to the total deposits and second one was to get the percentage of short-term investments to total deposits. This is mainly due to the lake of information about each type separately in their financial statements. FIBE used to aggregate all their funding operations under one item in the assets side of its balance sheet called "Musharaka, Modaraba, Commercial and Productive Morabaha, and Real estate Investments" so it is difficult to know the relative importance of these different forms of funding from reading the balance sheet. ESFB called the same item as "Murabaha and investment operations", with no indication for Musharaka or Modaraba. IIBID named the same item as "Investment Operations" with no indication for the type of these funds.

Our enquiry within the banks gives us an indication that Murabaha dominated the portfolios of Islamic banks. Not only that, but we can say that Musharaka is completely absent and that Mudaraba has a very limited presence in the portfolios of Islamic banks in Egypt.

4.2.2 Poor service quality

Services offered by the three Islamic banks are limited and offered in a poor quality. While most of the conventional banks are offering the debit cards, which are lawful in Islamic law, only FIBE is offering such service. FIBE is supporting its clients of the debt cardholders with only three ATM machines two of them in Cairo and the third one in Alexandria, while a conventional bank like HSBC in Egypt has 79 ATM machines distributed all over Egypt⁵⁹.

Most of big conventional banks in Egypt like Bank Misr or Citibank are now offering online banking services through the internet. These services include checking the account balance, request a credit card or make transactions from an account to another account. FIBE was offering such a service on its internet site but this site, at the time of submitting this research, was closed and had a sign that it is under construction⁶⁰. IIBID has an internet site that has just little information about its locations and the different services offered⁶¹. ESFB has plans for establishing such an internet site but no news about the launch date of it.

FIBE offers the voice bank, which enables the customer to use the phone to ask about the balance of his account or make transactions from account to another and more other services. This service is not reliable and the client finds busy lines most of the time. While such a service in Citibank Egypt is very reliable and available 24 hours a day, 7 days a week. Such service is not available in both ESFB and IIBID.

⁵⁹ HSBC has 64 ATM machines in Cairo, 9 in Alexandria, 4 in Sharm El-Shiekh, and 2 in Hurghada. For more information about the online services of HSBC is available on its site <http://www.egypt.hsbc.com/>

⁶⁰ The internet address for FIBE site is: <http://www.faisalbank.com.eg/>

⁶¹ The internet address for IIBID site is: <http://www.iibid.org/>

4.2.3 Poor Marketing

Most of Islamic banks are poor in marketing for their services. Most of people do not know any Islamic banks except FIBE, while most of them did not know that ESFB is applying the Islamic law. Moreover, the clients for FIBE do not know the different services available in the bank. This is due to very poor marketing strategy if ever existing.

4.2.4 Lack of information

Only FIBE had printed issues of the annual reports for the years covered by this research (1998 – 2003). These reports were available in both English and Arabic languages and in very expensive printout and was easily available. In ESFB, the annual report for 2003 was under preparation and is not published until the time of submitting this research but the annual reports of the rest of the years were available in Arabic language only and they need some efforts to get them. IIBID did not publish the annual report of 2003 until now as well, but the annual reports for the rest of the years were not available at all and were only available on personal bases.

FIBE published its financial statements for the last year 2003 on its internet site. IIBID published only the balance sheet of 2002 while ESFB has no internet site yet. On the other side Bank Misr published the financial statements of the last three years on its internet site.

4.2.5 Violation of Islamic law

Both of ESFB and IIBID mentioned two items as assets in their balance sheets. First item is treasury bonds, which they bought with fixed interest rate from the government, and the other item is the deposits with banks - conventional banks - that give fixed interest rate on these deposits. It is clear that this is a violation for the Sharia or Islamic law and contradiction with main principles behind the establishment of these banks.

4.2.6 Limited role of Islamic Banks in the economy

The domination of short-term operations on the portfolios of Islamic banks results in an unfavorable effect on investment and growth. This is also the reason for Islamic banks to be biased against the

agricultural and industrial projects due to their nature to be long-term projects. The Murabaha as a short-term instrument is mainly used to import durable consumption products, which not help the society to be a productive society.

Most of the branches of Islamic banks exist in urban areas, which exclude a high ratio of depositors by geographic filtering. Moreover, setting a minimum limit for deposits excludes further number of depositors by income filtering.

Such a limited role in the economy makes the government not to consider the existence of Islamic banks while putting the new banks law.

CONCLUSIONS

Throughout the conclusion, the research hypotheses, which were listed in the introduction of the research, will be assessed to validate them. The research hypotheses, just as a reminder for them, are as follows:

1. Islamic banks are following the Islamic law in all their operations and services.
2. Clients are trusting Islamic banks more than conventional banks to save or invest their money
3. Islamic banks put more concentration on the long-term investment projects, which are more beneficial for the society than the short-term investment projects
4. The central bank of Egypt gives a great understanding for the special nature of Islamic banks and gives them the needed facilities, which supports their operations.

Islamic banks have the needed sources of funds that can supply the planned projects and even make a surplus in money entered to Islamic banks. These sources of funds are external like current accounts, investment accounts, savings accounts, and Islamic finance certificates; and internal resources like paid capital, different types of reserves and distributable profit, and finally Zakat fund and charity money resources which is used to support the social role of the bank. From all the external sources of funds, only the current accounts are guaranteed, while the rest of these sources are applying the concept of Profit-and-Loss sharing. Internal resources are the same as conventional banks while Zakat fund and charity money are not available for conventional banks.

Islamic banks are equipped with wide range of financial instruments that give great flexibility to finance different investments as well as, trade, paying loans and other types of operations. For financing investments, Islamic banks has the option to use direct investment, Musharaka, or Mudaraba. To finance trade, Islamic banks can use any of Murabaha, Ijara wa Iqtina', Bai'Muajjal, or BaiSalam. Islamic banks can only pay Qard Hassan which mainly has no return. There are also other instruments like Muzar'h and Musaqqat which is targeting the agricultural projects and Jo'alah as a service charge.

Financial performance of Islamic banks is measured by average percentage of deposits, assets and shareholders' equity to the total of these values of all Egyptian banking system for the last six years. While Islamic banks has an average of 4.2% of total assets of the banking system, the average of shareholders' equity was only 3.2% but on the other hand they made a good percentage of 4.7% of total deposits of the banking system. It is clear that Islamic banks has more trust from depositors than conventional bank. This result assures the second hypothesis. It also indicates that there is a great opportunity for Islamic banks to grow.

FIBE made the following results for financial performance indicators during the six-year period of the research:

- FIBE had assets of 2.6% of total assets of banking system with shareholder's equity of 1.9% and average deposits of 2.9% of the total deposits of banking system.
- FIBE made an average increase rate of 15.8% of total balance sheet mainly because an equivalent increase rate in the total deposits in the liabilities side was met by an increase in the investments using its different financial instruments in the assets side of the balance sheet.
- The average of shareholder's equity was about 3.5% of the total assets while fixed assets had an average of 55.3% of the total shareholders' equity with the highest percentage of 86.7% in 2003. This gives an indication to the high ability of FIBE to finance big investment projects. This result makes the third hypothesis applicable but with no evidence on it. This result also indicates high expenses on fixed assets to purchase lands for the bank in the last three years.
- FIBE had average deposits of 84.8% of total assets with 76.3% for investment accounts of total assets. Based on this we will find that average investment accounts were 90.1% of total deposits, while the current accounts were only 2.7%. That means that all the clients of FIBE is more interested in investment accounts than in the current accounts.
- The average of cash was about 10.2% of total deposits. This ratio of cash represents a threat for Islamic banks as it does not cover the reserve ratio of 14% of the deposits, which is set by CBE⁶². This means that a part of the deposits, which were actually allocated for investment, must be kept

⁶² Central Bank of Egypt, op. cit., p. 91

with no operation as a reserve for the bank. Such a reserve ratio condition will decrease the return on the saving accounts. This result made the fourth hypothesis not valid.

- FIBE has average investment operations of 98.2% of total deposits, which means good usage of these deposits in investment operations. On the other hand, the average return on assets is 4.7% and never exceeds 5.4%. In addition, the average return on saving accounts is 5.1% from the total deposits. This is a low return compared with the huge capabilities that FIBE has to invest

ESFB is the second - and the newest - Islamic bank in Egypt based on its financial performance. Its financial performance indicators during the six-year period of the research is summarized in the following:

- ESFB has average assets of 0.9% of total assets of banking system with shareholder's equity of 0.8% and average deposits of 0.7% of the total deposits of banking system. This low percentage of deposits is mainly due to the recent establishment of the bank compared with the other two old banks as well as its poor marketing strategy.
- ESFB had an average increase rate of 14.1% of total balance sheet mainly because an equivalent increase rate in the total deposits in the liabilities side was met by a normal increase in the investments using its different financial instruments and high increase in the cash deposited with banks and treasury bonds in the assets side of the balance sheet.
- The average of shareholder's equity was about 6.4% of the total assets while fixed assets had an average of 37.1% of the total shareholders' equity with the highest percentage of 86.7% in 2003. This gives an indication to the high ability of ESFB as well to finance big investment projects. Again this result makes the third hypothesis applicable but with no evidence on it. However, in fact ESFB does not mention anything about Musharaka or Modaraba, but only the use for Murabaha, which is the short-term investment.
- ESFB had average deposits of 85.8% of total assets with 32.4% of total assets were investment accounts. Based on this, we find that average investment accounts were 38.3% of total deposits, while the current accounts were only 4.4%. ESFB is offering saving certificates and saving accounts, which are getting high demand from the clients. That means that all the clients of ESFB are interested in investment accounts and saving certificates more than current accounts.

- The average of cash was about 24.2% of total deposits. By this very high ratio, we can see that ESFB is covering the reserve ratio and is having surplus in cash
- ESFB had average investment operations of 71.3% of total deposits, which means fair usage of these deposits in investment operations. On the other hand, the average return on assets is 7.8%. In addition, the average return on saving accounts is 8.5% of the total deposits. These are high percentages comparing with the high percentage of cash. The only explanation for this is that ESFB is using only short-term investments, which have a quicker profit.

IIBID is the third Islamic bank in Egypt based on its financial performance. Its financial performance indicators during the six-year period of the research is summarized in the following:

- IIBID had average assets of 0.9% of total assets of banking system with shareholder's equity of 0.5% and average deposits of 1.1% of the total deposits of banking system. This is a good percentage of deposits comparing with the percentage of assets and shareholder's equity.
- IIBID made an average increase rate of 9.9% of total balance sheet mainly because an equivalent increase rate in the total deposits in the liabilities side. In the assets side of the balance sheet there was a normal increase in the investments using its different financial instruments, increase in the cash deposited with banks, and decrease in treasury bonds.
- The average of shareholder's equity was about 2.7% of the total assets while fixed assets had an average of 23.7% of total shareholders' equity with the highest percentage of 45.1% in 2003. This gives an indication to the high ability of IIBID as well to finance big investment projects. Again this result makes the third hypothesis applicable but with no evidence on it. However, in fact IIBID do not mention anything about Musharaka or Modaraba, or even Murabaha in its financial statements.
- IIBID had average deposits of 92.5% of total assets with 29% of total assets are investment accounts. Based on this, the average investment accounts were 31.5% of total deposits, while the current accounts were only 2.9%. IIBID is offering saving certificates, which are getting high demand from the clients. That means that all the clients of IIBID are interested in investment accounts and saving certificates more than the current accounts.
- The average of cash is about 5.5% of total deposits. IIBID as same as FIBE is suffering from this cash ratio as it represents a threat for not covering the reserve ratio. This means that part of the

deposits, which were actually allocated for investment, must be kept with no operation as a reserve for the bank. As we explained before, such a reserve ratio condition will decrease the return on the saving accounts.

- IIBID had average investment operations of 72.6% of total deposits, which means fair usage of these deposits in investment operations. On the other hand, the average return on assets was 7.7%. In addition, the average return on saving accounts was 8.4% of the total deposits. These are high return percentages comparing with the high percentage of cash. The only explanation for this, as it was explained before, is that IIBID is using only short-term investments that have a quicker profit.

Islamic Banks did violate Islamic law by depositing the cash with conventional banks and by buying treasury bonds, in fixed return rates. Unfortunately, this means a violation for the first hypothesis.

We could see that the first hypothesis, which did assume that Islamic banks are following the Islamic law in all their operations and services, is not a valid assumption. On the other hand, the hypothesis that clients trust Islamic banks more than conventional banks to save or invest their money is a valid hypothesis. That was clear as the percentages of the investment accounts as well as saving accounts were high compared with the assets of these banks. We can also conclude that the third hypothesis that Islamic banks are concentrating on the long-term investments was also invalid. Finally, CBE was giving some facilities for Islamic banks but due to their total low performance, these facilities were withdrawn and that means that the fourth hypothesis is also not a valid hypothesis.

Islamic banking may suffer from problems in its application in the reality, but this does not mean that Islamic banking is not applicable. Realizing the fact that Islamic banking is compatible with Islamic law and Islamic thinking should lead us to trust Islamic banking and encourage it. It is also clear by now that Islamic banking is the only way for Islamic countries to develop and unify their economies, especially at these days where the attack on Islam and Muslims became a normal policy.

Islamic banking in Egypt needs a lot of effort to develop as it is still far beyond the real objectives of Islamic banking and it is too early for these banks to saturate at this level of financial performance.

RECOMMENDATIONS

Based on the study of the problems of Islamic banks in general and Islamic banks in Egypt specifically, this chapter will demonstrate the recommendations in two parts general recommendations for Islamic banking, and recommendations for Islamic banks in Egypt

General Recommendations for Islamic Banking

Islamic banks need a lot of effort to arrange the work among them. The following are some recommendations to arrange such effort:

1. There must be an international organization or authority, to provide an international standard certificate for the financial institutions and assess them if they are complying with its standards, which are based on the Islamic law. This organization must renew this certificate yearly for all certified institutes to make sure that all operations executed through the year are lawful in Islamic law and following the Islamic standards for financial investments. If these certified institutes, found to be violating these standards in the yearly assessment, that result in expiring the certification for this year and to apply for it again from the beginning.
2. Establish an international Islamic capital market for all Islamic banks, which gives them the chance to offer shares in their capitals based on forces of supply and demand away from the conventional international capital markets, which are not based on Musharaka. This will give Islamic banks the sources for long-term funds that will encourage them to direct their funds to long-term financial investments. This will also enable Islamic banks to establish companies, subscribe partly in their capitals, and offer the rest of shares of these companies in this Islamic capital market for subscription by other Islamic banks. This capital market will help to invest the surplus in cash which most of the Islamic banks are suffering from across the different Islamic countries through other Islamic banks.
3. International information center for all Islamic banks becomes mandatory in the era of electronic commerce. This information center will be the central database for all the financial statements as well as the financial operations. It is necessary for the International Organization for supervision on

the Islamic banks and must be included in its standards for Islamic operations, as well as for the Islamic capital market as it will be the database for all its operations.

4. Establish an Islamic banking institute with a main task to offer studies and researches about the Islamic law related to the banking operations and the different details about applying it through different financial instruments, as well as new methodologies, and techniques that improve the banking operations. This institute will be a way to prepare qualified and skilled management. It will also help to develop the current financial instruments as well as new instruments that will help in establishing new ways of investments. This institute could be an international one with locale branches in different countries which have Islamic banks in it. This will help to exchange the different experiences from different countries.
5. Central banks need to issue special arrangements and tools to supervise the Islamic banks. These tools must take into consideration the special financial instruments, which are used by the Islamic banks.

Recommendations for Islamic Banking in Egypt

Islamic banking in Egypt needs mainly to unify the efforts to give it the power that would provide it with the needed respect and weight in the economy. We are recommending the following:

1. Unify the religious supervisory boards of the different Islamic banks into one High religious supervisory board, which will establish a central authority to supervise Islamic banks. The approval of this board will be a mandatory for accepting the annual reports of Islamic banks. This board will follow Dar Al-Efta' and will complete central bank's role in supervising all banks in Egypt.
2. Encourage establishment of more Islamic branches for the conventional bank but with the condition of having a separate aggregate financial statements for all Islamic branches of one conventional bank. These branches will be under the supervision of the high religious supervisory board.
3. Launch a marketing campaign funded by all the Islamic banks in Egypt to introduce Islamic banking concepts and the benefits that clients and society will have by applying these concepts.
4. Islamic banks in Egypt could start accepting current accounts based on profit and loss share by Musharaka or Modaraba not based on Qard Hassan. ESFB started this by accepting a new type of

accounts called current investment account, which was the reason for increase in current accounts at 2003 for almost double its value at 2001.

5. The dependence of Islamic banks only on the religious sense for the clients is not enough to attract more clients and increase market share. It needs more enhancements for the services offered to the clients. This enhancement must include the latest banking technologies like ATM machines, on-line banking through the internet, customer call centers and any other services that already exist at the competitors from conventional banks.

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EXHIBITS

EXHIBIT E
FINANCIAL STATEMENTS OF FISAL ISLAMIC BANK OF EGYPT

Table 8
Fisal Islamic Bank of Egypt - Balance Sheet

(Amounts LE thousands)

as at December 31	1998	1999	2000	2001	2002	2003
Assets						
Cash and balances with the Central Bank of Egypt	281,938	647,118	770,151	664,167	676,723	686,730
Balances with banks	288,043	206,158	178,006	198,118	265,777	215,077
Financial investments for trading purpose	121,979	160,586	243,407	73,022	73,241	172,727
Financial Investments available for sale	---	---	---	172,482	185,904	313,057
Musharaka, Modaraba, Commercial and Productive Morabaha, and Real estate Investments (Net)	5,892,008	6,269,793	8,252,904	8,332,642	10,403,530	11,164,216
Financial investments held to maturity date	122,490	71,802	84,330	---	322,066	651,000
Financial investments in Subsidiaries & mutual interests companies	---	---	---	161,295	171,401	204,602
Debit balances and other assets	127,337	113,634	133,538	148,378	206,443	215,006
Fixed assets (after depreciation)	33,988	35,579	230,175	260,453	294,948	324,071
Total Assets	6,867,783	7,504,670	9,892,512	10,010,557	12,600,033	13,946,486
Liabilities and Shareholders Equity						
Liabilities						
Due to banks	467,222	589,110	717,685	652,320	791,042	475,077
Saving Instruments						
Current accounts	198,565	224,355	204,821	209,155	227,467	226,193
Investment accounts	5,373,340	5,874,932	7,975,366	7,493,494	9,192,095	10,122,944
Saving certificates	---	---	---	778,495	1,398,441	1,975,199
Other deposits	62,453	55,492	81,992	75,276	90,612	80,308
Total Saving instruments	5,634,358	6,154,779	8,262,179	8,556,420	10,908,615	12,404,644
Credit balances and other liabilities	449,787	437,890	539,384	457,562	466,738	437,660
Subordinated loan	---	---	---	---	60,000	60,000
Divideends payable	16,922	21,058	---	---	---	---
Total Liabilities	6,568,289	7,202,837	9,519,248	9,666,302	12,226,395	13,377,381
Shareholders' Equity						
Paid up capital	263,698	263,698	263,698	263,698	263,698	263,698
Reserves	35,796	38,135	77,334	80,557	92,689	92,689
Retained Profits	---	---	---	---	17,251	17,251
Total	299,494	301,833	341,032	344,255	373,638	373,638
Special Reserve (for Financial Investments)	---	---	---	---	---	69,043
Total Shareholders' Equity	299,494	301,833	341,032	344,255	373,638	442,681

Net Profit of The Year	---	---	32,231	---	---	126,424
Total Shareholders' Equity & Net Profit of The Year	299,494	301,833	373,264	344,255	373,638	569,105
Total Liabilities and Shareholders' Equity	6,867,783	7,504,670	9,892,512	10,010,557	12,600,033	13,946,486
Contingent Liabilities and commitments						
Commitments for letters of guarantee, letters of credit & others	263,922	242,915	572,318	319,199	206,588	185,293

Source: Annual reports of FIBE for periods (1998 – 2003)

Table 9
Income Statement of Faisal Islamic Bank of Egypt

(Amounts in LE. thousands)

For the year ending December 31,	1998	1999	2000	2001	2002	2003
Income from Musharaka, Modaraba, Commercial and Productive Morabaha, Real estate Investments, and others	396,935	433,716	376,195	520,053	495,522	494,537
Less:						
Return on saving Accounts.	(335,067)	(380,958)	(350,914)	(497,938)	(465,091)	(490,387)
Net income	61,868	52,758	25,281	22,115	30,431	4,150
Commissions and banking services fees	36,008	36,465	68,848	100,614	28,907	22,428
Shares dividends	38,818	27,854	26,345	7,670	19,048	41,827
Profits of foreign currency operations.	---	---	---	4,726	2,181	113,208
Profits of financial investments sales	---	---	---	---	50,000	44,897
Valuation differences of financial investments for trading purpose	---	---	---	---	(146)	(16)
Valuation differences of other financial investments	---	---	---	5,765	---	47,561
Net Operating Revenue	136,694	117,077	120,474	140,890	130,421	274,055
Less:						
Zakat due	(1,146)	(2,154)	(262)	(1,031)	(695)	(1,343)
Provisions	(55,000)	(30,307)	(33,000)	(25,105)	(31,575)	(60,121)
General and Managerial expenses depreciation	(61,746)	(61,218)	(54,980)	(75,556)	(80,900)	(86,167)
Net profit of the year	18,803	23,398	32,231	39,198	17,251	126,424

Source: Annual reports of FIBE for periods (1998 – 2003)

Table 10
Fisal Islamic Bank of Egypt - Statement of Cash Flows

(Amounts in LE thousands)

For the year ending December 31	1998	1999	2000	2001	2002	2003
Cash flows from operating activities						
Net profit of the year before Taxes	18,803	23,397	32,231	39,198	17,251	126,424
	18,803	23,397	32,231	39,198	17,251	126,424
Adjustments to settle net income with cash flows from operating activities:						
Depreciation	3,850	3,137	3,220	3,320	3,707	4,625
Provisions	55,000	30,307	33,000	25,105	31,575	60,121
Operating income before the change in Assets & Liabilities used in operating activities	77,653	56,841	68,451	67,623	52,533	191,170
Net Decrease (Increase) in assets						
Financial investments for trading purpose	(20,941)	3,609	(27,341)	(7,504)	(219)	(99,486)
Financial investment available for sale			---	(17,762)	(13,422)	(127,153)
Musharaka, Modaraba, commercial and productive Morabaha, and Real estate investments	(545,848)	(396,562)	(1,031,511)	(141,823)	(755,561)	(805,807)
Debit balances and other Assets	(13,321)	13,811	(18,655)	(16,403)	(53,982)	(23,563)
Net Increase (Decrease) in liabilities						
Due to banks	101,519	121,743	43,063	(65,997)	123,989	(315,965)
Customer's deposits	495,949	517,668	1,137,465	(520,054)	361,869	919,271
Three years saving certificates				778,495	619,946	576,758
Credit balances and other liabilities	(94,351)	(20,595)	(79,731)	(122,421)	(79,492)	(29,078)
Net cash flows provided by operating activities (1)	660	296,515	91,741	(45,846)	255,661	286,147
Cash flows from investing activities						
Purchase of financial investments held till maturity date	(19,466)	8,471	---	---	(242,116)	(328,934)
Purchase of financial investments in subsidiaries & mutual interests companies .	---	---	---	---	(10,106)	(33,201)
Financial investments'sales	---	---	(9,473)	17,618	---	---
Purchase of fixed assets and branches improvements	(5,827)	(4,728)	(3,292)	(33,598)	(38,203)	(33,748)
Net cash flows (used in) investing activities (2)	(25,293)	3,743	(12,765)	(15,980)	(290,425)	(395,883)
Cash flows from financing activities						
Increase in Reserves	108,736	---	36,264	3,223	12,131	69,043
Increase in Subordinated loan	---	---	---	---	60,000	---
Dividends paid	---	(16,922)	(26,412)	(32,231)	(35,278)	---
Net cash flows provided by financing activities (3)	108,736	(16,922)	9,852	(29,008)	36,853	69,043
Net (decrease) in cash and cash equivalent during the year (1) + (2) + (3)	84,103	283,336	88,828	(90,834)	2,089	(40,693)
Cash & cash equivalent opening balance	485,878	569,981	859,329	948,157	949,120	942,500

Cash & cash equivalent closing balance	569,981	853,317	948,157	857,323	951,209	901,807
Cash & cash equivalent represented in the following:						
Cash and balances with the Central Bank of Egypt	281,938	647,211	770,151	661,610	676,723	686,730
Balances with banks	288,043	206,106	178,006	195,713	265,777	215,077
Total Cash & cash equivalent	569,981	853,317	948,157	857,323	942,500	901,807

Source: Annual reports of FIBE for years 1999-2003

EXHIBIT F
FINANCIAL PERFORMANCE INDICATORS OF FISAL ISLAMIC BANK OF EGYPT

Table 11
 Financial Performance Indicators of FIBE

Ratio	1998	1999	2000	2001	2002	2003	Average
Increase Rate in Total Balance Sheet		9.3%	31.8%	1.2%	25.9%	10.7%	15.8%
Shareholders' to Equity Total Assets	4.4%	4.0%	3.4%	3.4%	3.0%	2.7%	3.5%
Total deposits to Total Assets	82.0%	82.0%	83.5%	85.5%	86.6%	88.9%	84.8%
Investment Accounts to Total Assets	78.2%	78.3%	80.6%	74.9%	73.0%	72.6%	76.3%
Investment Accounts to Total Deposits	95.4%	95.5%	96.5%	87.6%	84.3%	81.6%	90.1%
Current Accounts to Total Deposits	3.5%	3.6%	2.5%	2.4%	2.1%	1.8%	2.7%
Total Operating Investment to Total Deposits	104.6%	101.9%	99.9%	97.4%	95.4%	90.0%	98.2%
Fixed Assets to Total Shareholder's Equity	11.3%	11.8%	67.5%	75.7%	78.9%	86.7%	55.3%
Total Cash to Total Deposits	10.1%	13.9%	11.5%	10.0%	8.6%	7.3%	10.2%
Return on Assets	5.2%	5.4%	3.9%	5.4%	3.8%	4.4%	4.7%
Return on Saving Accounts to Total Deposits	5.9%	6.2%	4.2%	5.8%	4.3%	4.0%	5.1%

Source: Calculated from Annual reports of FIBE for periods (1998 – 2003)

EXHIBIT G
FINANCIAL STATEMENTS OF EGYPTIAN SAUDI FINANCE BANK

Table 12
Egyptian Saudi Finance Bank - Balance Sheet

(Amounts in LE thousands)

as at December 31	1998	1999	2000	2001	2002	2003*
Assets						
Cash and balances with the Central Bank of Egypt	197,311	221,017	376,271	111,704	161,830	133,900
Balances with banks	27,225	178,927	183,724	393,209	503,462	579,562
Treasury bonds	241,398	212,648	140,706	179,891	236,931	437,692
Financial investments for trading purpose	2,495	741	536	198	---	0
Financial Investments available for sale	---	---	---	---	4,405	4,399
Morababa, and Investment operations (Net)	1,157,244	1,125,088	1,191,197	1,426,823	1,645,944	1,781,686
Loans to customers (Net)	817	996	832	523	472	467
Financial investments held to maturity date	3,304	3,304	67,282	66,610	64,262	143,227
Financial investments in Subsidiaries & mutual interests companies	---	---	---	---	2,526	2,526
Debit balances and other assets	35,382	37,169	66,287	34,065	87,593	108,401
Fixed assets (after depreciation)	33,969	33,109	32,704	75,597	73,663	71,570
Total Assets	1,699,147	1,812,999	2,059,538	2,288,620	2,781,087	3,263,428
Liabilities and Shareholders Equity						
Liabilities						
Due to banks	255,417	61,020	45,322	67,022	55,748	92,541
Saving Instruments						
Current accounts	52,730	52,944	65,333	81,544	139,063	160,254
Investment accounts	688,489	745,785	850,258	591,932	683,179	678,387
Saving certificates	467,588	680,506	774,966	1,139,285	1,423,301	1,661,165
Saving accounts	25,513	54,562	87,316	141,600	217,185	320,821
Other deposits	27,694	32,310	22,748	43,071	40,442	90,151
Total Saving instruments	1,262,014	1,566,107	1,800,621	1,997,432	2,503,170	2,910,778
Credit balances and other liabilities	30,011	34,878	42,946	44,444	45,122	58,082
Dividends payable	21,435	10,899	14,145	15,358	---	---
Other provisions	9,083	7,704	7,918	8,292	8,552	11,181
Total Liabilities	1,577,959	1,680,608	1,910,953	2,132,547	2,612,592	3,072,582
Shareholders' Equity						
Paid up capital	100,000	103,500	119,139	119,139	130,188	130,188
Reserves	12,315	23,072	24,542	25,721	25,721	18,367
Retained Profits	8,872	5,819	4,904	163	374	374
Total	121,187	132,391	148,585	145,023	156,283	148,928
Paid under the account of increasing capital	---	---	---	11,050	12,213	19,812
Total Shareholders' Equity	121,187	132,391	148,585	156,073	168,495	168,740
Net Profit of The Year	---	---	---	---	---	22,105
Total Shareholders' Equity & Net Profit of The Year	121,187	132,391	148,585	156,073	168,495	190,846
Total Liabilities and Shareholders' Equity	1,699,146	1,812,999	2,059,538	2,288,620	2,781,087	3,263,428

Contingent Liabilities and commitments						
Commitments for letters of guarantee, letters of credit & others	130,817	117,743	134,019	170,333	210,593	179,333

* Note: The data represents only 3 quarters of 2003

Source: Annual reports of ESFB for periods (1998 – 2003)

Table 13
Egyptian Saudi Finance Bank - Statement of Income

(Amounts in LE. thousands)

For the Year ending December 31,	1998	1999	2000	2001	2002	2003*
Income from Morabaha and balances with banks	161,238	145,910	177,129	181,775	198,557	143,596
Income of Treasury bonds	22,829	22,887	16,361	26,334	20,454	31,336
Less:						
Return on saving Accounts.	(143,583)	(144,440)	(166,898)	(175,758)	(176,567)	(145,865)
Net income	40,484	24,357	26,591	32,352	42,444	29,067
Commissions and banking services fees	15,030	16,720	15,763	15,176	17,015	17,041
Shares dividends	327	179	1,098	377	71	42
Profits (losses) of financial investments sales	36	(286)	(253)	(249)	1,548	---
Profits of foreign currency operations.	3,162	3,108	9,315	20,384	2,539	37,391
Profits from sales of financial investments for holding			221	---	---	---
Valuation differences of other financial investments	1,058	2,527	2,856	964	824	538
Net Operating Revenue	60,097	46,604	55,591	69,003	64,441	84,080
Less:						
Commissions and banking services fees	(914)	(302)	(650)	(1,171)	(1,660)	(2,265)
Provisions	(12,814)	(14,344)	(17,665)	(27,007)	(30,024)	(31,900)
General and Managerial expenses depreciation	(20,993)	(22,963)	(21,584)	(28,092)	(31,232)	(27,411)
Zakat fund support	(1,751)	(1,433)	(1,004)	(1,178)	(915)	(1,005)
Other operations' expanses	---	---	---	---	(609)	(399)
Valuation differences of financial investments for holding	(35)	---	(9)	---	---	---
Net Operating Profit	23,590	7,562	14,680	11,556	0	21,100
Profit not related to operations	---	---	20	240	---	---
Net profit of the year	23,590	7,562	14,700	11,796	0	21,100

* Note: The data represents only 3 quarters of 2003

Source: Annual reports ESFB for periods (1998 – 2003)

Table 14
Egyptian Saudi Finance Bank - Statement of Cash Flows

(Amounts in LE .thousands)

For the year ending December 31	1998	1999	2000	2001	2002	2003*
Cash flows from operating activities						
Net profit of the year before Taxes	23,590	7,562	14,700	11,796	---	66,499
	23,590	7,562	14,700	11,796	0	66,499
Adjustments to settle net income with cash flows from operating activities:						
Depreciation	2,777	4,605	1,810	2,884	3,492	2,276
Provisions	12,814	14,344	17,665	27,007	30,024	---
Valuation differences of financial investments	---	---	---	---	221	---
Used from provisions and valuation differences of provisions in foreign currency	(10,375)	---	---	---	---	(4,009)
Profits from selling financial investments	---	---	(221)	(113)	(1,548)	---
Profits from selling fixed assets	---	---	(20)	(240)	---	(56)
Operating income before the change in Assets & Liabilities used in operating activities	28,807	26,511	33,934	41,334	32,189	64,710
Net Decrease (Increase) in assets						
Balances with banks	---	---	---	---	(104,165)	(368,707)
Treasury bonds to be deducted with central bank	(8,293)	29,984	120,373	(68,134)	(413)	16,263
Financial investments for trading purpose	(1,907)	1,759	143	483	198	---
Financial investment available for sale	(101,222)	---	---	---	(3,832)	---
Morabaha and investments operations	1,065	16,256	(83,911)	(263,154)	(248,916)	---
Loans to customers	9,882	(6)	579	1,058	81	(107,235)
Debit balances and other Assets	2,235	(1,787)	(29,118)	32,237	(53,529)	1,596
Net Increase (Decrease) in liabilities						
Due to banks	(136,062)	(194,397)	(15,698)	21,700	(10,625)	0
Customer's deposits	280,321	304,093	234,514	196,810	505,739	335,997
Credit balances and other liabilities	2,203	4,867	6,940	1,344	677	80,814
Net cash flows provided by operating activities (1)	77,030	187,280	267,756	(36,322)	117,405	23,437
Cash flows from investing activities						
Purchase of financial investments held till maturity date	---	---	(64,412)	(1,750)	(46,639)	0
Purchase of financial investments in subsidiaries & mutual interests companies .	---	---	---	---	(750)	0
Sales of financial investments held till maturity date	---	---	655	2,535	47,965	0
Purchase of fixed assets and branches improvements	(17,555)	(3,744)	(1,441)	(45,777)	(1,559)	(1,311)
Fixed assets' sales	---	---	55	240	2	56
Net cash flows (used in) investing activities (2)	(17,555)	(3,744)	(65,142)	(44,753)	(981)	(1,255)
Cash flows from financing activities						
Paid under the account of increasing capital	---	13,500	15,639	11,050	12,211	---
Dividends paid	(20,401)	(20,395)	(9,771)	(14,005)	(15,146)	---
Net cash flows provided by financing activities (3)	(20,401)	(6,895)	5,869	(2,955)	(2,935)	0
Net increase (decrease) in cash and cash equivalent during the year	39,074	176,641	208,483	(84,031)	113,489	22,182

Cash & cash equivalent opening balance	276,502	315,577	492,219	700,701	229,768	133,705
Cash & cash equivalent closing balance	315,576	492,219	700,701	616,670	343,257	155,888
Cash & cash equivalent represented in the following:						
Cash and balances with the Central Bank of Fgypt	197,311	221,017	376,271	111,704	161,830	115,896
Balances with banks	27,225	178,927	183,724	393,209	503,462	1,510,486
Treasury bonds to be deducted with central bank	241,398	212,648	140,706	179,891	236,931	70,000
Deposits with banks	(150,359)	---	---	---	(490,419)	(1,470,494)
Treasury bonds with maturity more than 3 months	---	(120,373)	---	(68,134)	(68,547)	(70,000)
Total Cash & cash equivalent	315,576	492,219	700,701	616,670	343,257	155,888

* Note: The data represents only 3 quarters of 2003

Source: Annual reports of ESFB for periods (1998 – 2003)

EXHIBIT H
FINANCIAL PERFORMANCE INDICATORS OF EGYPTIAN SAUDI FINANCE BANK

Table 15
 Financial Performance Indicators of ESFB

Ratio	1998	1999	2000	2001	2002	2003*	Average
Increase Rate in Total Balance Sheet		6.7%	13.6%	11.1%	21.5%	17.3%	14.1%
Shareholders' Equity to Total Assets	7.1%	7.3%	7.2%	6.3%	5.6%	4.6%	6.4%
Total deposits to Total Assets	74.3%	86.4%	87.4%	87.3%	90.0%	89.2%	85.8%
Investment Accounts to Total Assets	40.5%	41.1%	41.3%	25.9%	24.6%	20.8%	32.4%
Investment Accounts to Total Deposits	54.6%	47.6%	47.2%	29.6%	27.3%	23.3%	38.3%
Current Accounts to Total Deposits	4.2%	3.4%	3.6%	4.1%	5.6%	5.5%	4.4%
Total Operating Investment to Total Deposits	91.7%	71.8%	66.2%	71.4%	65.8%	61.2%	71.3%
Fixed Assets to Total Shareholder's Equity	28.0%	25.0%	22.0%	52.1%	47.1%	48.1%	37.1%
Total Cash to Total Deposits	25.0%	31.4%	38.9%	30.9%	13.7%	5.4%	24.2%
Return on Assets	9.9%	8.5%	8.9%	8.2%	6.4%	5.1%	7.8%
Return on Saving Accounts to Total Deposits	11.4%	9.2%	9.3%	8.8%	7.1%	5.0%	8.5%

* Note: The data represents only 3 quarters of 2003

Source: Calculated from the annual reports of ESFB for periods (1998 – 2003)

EXHIBIT I
FINANCIAL STATEMENTS OF ISLAMIC INTERNATIONAL BANK FOR INVESTMENT AND DEVELOPMENT

Table 16
Islamic International Bank of Investment and Development - Balance Sheet

(Amounts in LE thousands)

as at December 31	1998	1999	2000	2001	2002	2003*
Assets						
Cash and balances with the Central Bank of Egypt	99,786	149,754	199,748	109,857	101,333	115,896
Balances with banks	158,940	268,568	373,007	673,875	1,134,160	1,510,486
Treasury bonds	74,024	246,315	247,120	271,281	83,973	67,710
Investment operations (Net)	2,127,841	2,335,495	2,450,442	2,354,041	2,316,150	2,358,912
Financial investments held to maturity date	21,477	20,496	20,883	21,814	18,360	21,409
Financial investments in Subsidiaries & mutual interests companies	---	---	---	---	21,252	21,252
Debit balances and other assets	200,397	185,793	174,602	166,607	176,772	177,572
Fixed assets (after depreciation)	10,551	16,144	19,422	17,534	26,431	25,229
Total Assets	2,693,017	3,222,565	3,485,223	3,615,009	3,878,430	4,298,466
Liabilities and Shareholders Equity						
Liabilities						
Due to banks	18,712	39,908	120,093	75,364	---	---
Saving Instruments						
Current accounts	84,254	93,449	81,973	96,785	107,420	103,990
Investment accounts	882,599	1,096,258	1,022,651	908,625	1,014,506	1,143,539
Saving certificates	1,213,997	1,527,507	1,793,528	2,094,485	2,278,326	2,410,563
Saving accounts	67,377	97,553	139,413	199,794	264,858	332,630
Other deposits	167,682	129,416	110,009	65,983	54,946	65,329
Total Saving instruments	2,415,909	2,944,182	3,147,574	3,365,672	3,720,056	4,056,052
Credit balances and other liabilities	82,574	97,978	121,870	90,792	91,486	110,227
Long term Liabilities	62,000	26,000	---	---	---	---
Other provisions	5,733	6,048	5,068	8,814	10,995	9,738
Total Liabilities	2,584,928	3,114,117	3,394,604	3,540,642	3,822,536	4,176,017
Shareholders' Equity						
Paid up capital	133,820	133,820	133,820	133,820	133,820	133,820
Reserves	2,387	2,746	2,788	2,843	3,852	3,908
Retained Profits (Losses)	(28,118)	(28,118)	(28,118)	(45,990)	(62,297)	(81,778)
Total	108,089	108,448	108,490	90,674	75,376	55,950
Total Shareholders' Equity	108,089	108,448	108,490	90,674	75,376	55,950
Losses (Net Profit) of The Year	---	---	(17,872)	(16,306)	(19,482)	66,499
Total Shareholders' Equity & Net Profit of The Year	108,089	108,448	90,619	74,367	55,894	122,449
Total Liabilities and Shareholders' Equity	2,693,017	3,222,565	3,485,223	3,615,009	3,878,430	4,298,466

Contingent Liabilities and commitments						
Commitments for letters of guarantee, letters of credit & others	398,554	304,558	244,474	193,826	163,920	150,410

* Note: The data represents only 3 quarters of 2003

Source: Annual reports of IIBID for periods (1998 – 2003)

Table 17
Islamic International Bank for Investment and Development - Statement of Income

(Amounts in LE thousands)

For the Year ending December 31,	1998	1999	2000	2001	2002	2003*
Income from Investment and balances with banks	235,196	259,574	273,761	252,837	286,122	177,792
Income of Treasury bonds	5,149	17,167	21,743	22,342	9,436	7,340
Less:						
Return on saving Accounts.	(214,999)	(262,061)	(304,509)	(307,453)	(300,866)	(224,785)
Net income	25,346	14,680	(9,005)	(32,274)	(5,309)	(39,653)
Commissions and banking services fees	23,379	23,241	15,902	14,660	11,402	8,627
Shares dividends	1,082	183	359	201	518	418
Profits of foreign currency operations.	2,434	1,275	1,152	35,165	5,995	115,246
Revenue of other operations	6,167	4,515	4,722	3,626	3,006	5,306
Net Operating Revenue	58,409	43,895	13,130	21,378	15,612	89,945
Less:						
Commissions and banking services fees	(404)	(458)	(392)	(402)	(344)	(166)
Provisions	(26,401)	(10,287)	(50)	(5,435)		0
General and Managerial expenses depreciation	(27,167)	(29,874)	(30,559)	(31,848)	(27,016)	(23,280)
Other operations' expences	(4,434)	(3,275)				0
Loses from sales of financial investments	(3)					0
Valuation differences of financial investments					(7,734)	0
Net Operating Profit (Losses)	(0)	0	(17,872)	(16,306)	(19,482)	66,499
Profit not related to operations	15	359	42	55	1,008	56
Less:						
Profits from sales of fixed assets trasfered to capital reserves	(15)	(359)	(42)	(55)	(1,008)	(56)
Losses (Net profit) of the year	(0)	0	(17,872)	(16,306)	(19,482)	66,499

* Note: The data represents only 3 quarters of 2003

Source: Annual reports of IIBID for periods (1998 – 2003)

Table 18

Islamic International Bank for Investment and Development - Statement of Cash Flows

(Amounts in LE thousands)

For the year ending December 31	1998	1999	2000	2001	2002	2003*
Cash flows from operating activities						
Net profit (Losses) of the year before Taxes	15	359	(17,830)	(16,306)	(19,482)	66,499
	15	359	(17,830)	(16,306)	(19,482)	66,499
Adjustments to settle net income with cash flows from operating activities:						
Depreciation	1,801	2,100	2,490	2,368	2,431	2,276
Provisions	26,401	10,287	50	5,435	258	0
Valuation differences of financial investments	(18)	(8)	(304)	(731)	(54)	0
Used from provisions	(2,345)		(1,324)		(9,818)	(2,633)
Valuation differences of provisions in foreign currency	(25)	(15)	(293)	(848)	(43)	(1,376)
Profits (Losses) from selling financial investments	3					0
Profits from selling fixed assets	(15)	(359)	(42)	(55)	(1,008)	(56)
Operating income before the change in Assets & Liabilities used in operating activities	25,817	12,363	(17,253)	(10,137)	(27,716)	64,710
Net Decrease (Increase) in assets						
Balances with banks	(1,532)	(111,313)	(123,639)	(287,342)	(477,204)	(368,707)
Treasury bonds to be deducted with central bank	(74,024)	(172,291)	(806)	(24,160)	187,308	16,263
Loans to customers	(321,766)	(255,878)	(105,770)	33,089	41,979	(107,235)
Debit balances and other Assets	20,581	10,511	8,582	33,989	(40,147)	1,596
Net Increase (Decrease) in liabilities						
Due to banks	(31,561)	21,196	80,184	(44,729)	(75,364)	0
Customer's deposits	412,892	528,273	203,392	218,098	354,384	335,997
Credit balances and other liabilities	31,644	55,141	14,659	7,651	22,240	80,814
Net cash flows provided by operating activities (1)	62,049	88,003	59,351	(73,541)	(14,521)	23,437
Cash flows from investing activities						
Purchase of financial investments held till maturity date	(336)				(9,110)	0
Financial investments' sales	100					0
Purchase of fixed assets and branches improvements	(7,730)	(4,079)	(2,600)	(2,877)	(2,822)	(1,311)
Fixed assets' sales	15	359	42	55	1,008	56
Net cash flows (used in) investing activities (2)	(7,951)	(3,720)	(2,558)	(2,822)	(10,924)	(1,255)
Cash flows from financing activities						
Paid under the account of increasing capital	(36,000)	(36,000)	(26,000)			0
Net cash flows provided by financing activities (3)	(36,000)	(36,000)	(26,000)	0	0	0
Net increase (decrease) in cash and cash equivalent during the year	18,098	48,283	30,793	(76,364)	(25,444)	22,182
Cash & cash equivalent opening balance	138,340	156,438	204,720	235,513	159,150	178,274
Cash & cash equivalent closing balance	156,438	204,720	235,513	159,150	133,705	200,456
Cash & cash equivalent represented in the following:						
Cash and balances with the Central Bank of Egypt	99,786	149,754	199,748	109,857	101,333	115,896
Balances with banks	158,940	268,568	373,007	673,875	1,134,160	1,510,486

Treasury bonds to be deducted with central bank						70,000
Deposits with banks	(102,288)	(213,602)	(337,241)	(624,583)	(1,101,787)	(1,470,494)
Treasury bonds with maturity more than 3 months						(70,000)
Total Cash & cash equivalent	156,438	204,720	235,513	159,150	133,705	155,888

** Note: The data represents only 3 quarters of 2003*

Source: Annual reports of IIBID for periods (1998 – 2003)

EXHIBIT J
**FINANCIAL PERFORMANCE INDICATORS OF ISLAMIC INTERNATIONAL BANK FOR
INVESTMENT AND DEVELOPMENT**

Table 19
Financial Performance Indicators of IIBID

Ratio	1998	1999	2000	2001	2002	2003*	Average
Increase Rate in Total Balance Sheet		19.7%	8.2%	3.7%	7.3%	10.8%	9.9%
Shareholders' Equity to Total Assets	4.0%	3.4%	3.1%	2.5%	1.9%	1.3%	2.7%
Total deposits to Total Assets	89.7%	91.4%	90.3%	93.1%	95.9%	94.4%	92.5%
Investment Accounts to Total Assets	32.8%	34.0%	29.3%	25.1%	26.2%	26.6%	29.0%
Investment Accounts to Total Deposits	36.5%	37.2%	32.5%	27.0%	27.3%	28.2%	31.5%
Current Accounts to Total Deposits	3.5%	3.2%	2.6%	2.9%	2.9%	2.6%	2.9%
Total Operating Investment to Total Deposits	88.1%	79.3%	77.9%	69.9%	62.3%	58.2%	72.6%
Fixed Assets to Total Shareholder's Equity	9.8%	14.9%	17.9%	19.3%	35.1%	45.1%	23.7%
Total Cash to Total Deposits	6.5%	7.0%	7.5%	4.7%	3.6%	3.8%	5.5%
Return on Assets	8.0%	8.1%	8.2%	8.1%	7.3%	6.8%	7.7%
Return on Saving Accounts to Total Deposits	8.9%	8.9%	9.7%	9.1%	8.1%	5.5%	8.4%

* Note: The data represents only 3 quarters of 2003

Source: Calculated from the annual reports of IIBID for periods (1998 – 2003)

EXHIBIT K
FINANCIAL POSITION AND DEPOSITS BY MATURITY OF EGYPTIAN BANKS

Table 20
 Banks: Aggregate Financial Position

(LE mn)

END OF JUNE	1997	1998	1999	2000	2001	2002	2003
Assets							
Cash	3,210	3,121	3,220	3,431	3,485	4,453	5,557
Securities & investments of which:	53,088	65,148	60,114	60,818	71,142	87,726	111,337
Treasury bills	28,956	35,295	21,342	20,601	28,442	39,740	53,651
Other gov. securities	13,614	13,962	19,187	19,888	20,899	24,423	33,666
Balances with banks in Egypt	42,608	44,607	45,098	49,400	67,047	83,244	110,874
Balances with banks abroad	32,931	23,121	16,106	17,776	16,252	20,002	29,798
Loans and discounts	152,189	172,379	204,132	226,776	241,470	266,100	284,722
Other assets	17,993	21,186	22,956	24,137	28,966	33,939	35,650
Assets = Liabilities	302,019	329,562	351,626	382,338	428,362	495,464	577,938
Liabilities							
Capital	9,137	10,566	11,373	11,764	12,038	12,531	18,155
Reserves	4,435	7,132	8,132	9,226	10,156	11,238	11,805
Provisions	20,744	23,392	25,984	27,554	31,200	35,869	40,099
Long term loans & Bonds	4,807	7,354	9,147	10,579	11,922	14,057	14,866
Obligations to banks in Egypt	29,156	29,744	21,413	24,210	28,158	35,094	35,578
Obligations to banks abroad	6,814	11,121	11,306	9,970	11,486	11,830	16,248
Total deposits	200,574	216,466	237,343	260,429	291,225	340,868	403,144
Other liabilities	26,352	23,787	26,928	28,606	32,177	33,977	38,043

Source: Central Bank of Egypt

Table 21
Banks: Deposits by Maturity

(LE mn)

	END OF JUNE	1997	1998	1999	2000	2001	2002	2003
Total Deposits		200574	216466	237343	260429	291225	340868	403144
Demand deposits		23544	25016	26187	24541	26678	30913	37233
Time & Saving deposits		163342	176485	194006	217705	244858	286953	342535
Blocked or retained deposits		13688	14965	17150	18183	19689	23002	23376
Local Currency Deposits		151666	166206	184756	199619	218238	250106	278179
Demand deposits		17326	18999	20019	18131	18354	21063	22929
Time & Saving deposits		125149	137127	152305	168389	186545	213385	242058
Blocked or retained deposits		9191	10080	12432	13099	13339	15658	13192
Foreign Currencies Deposits		48908	50260	52587	60810	72987	90762	124965
Demand deposits		6218	6017	6168	6410	8324	9850	14304
Time & Saving deposits		38193	39358	41701	49316	58313	73568	100477
Blocked or retained deposits		4497	4885	4718	5084	6350	7344	10184

Source: Central Bank of Egypt

APPENDICES

APPENDIX A
VERSES OF RIBA IN QURAN

English Translation for Riba verses from <http://www.al-islam.com>

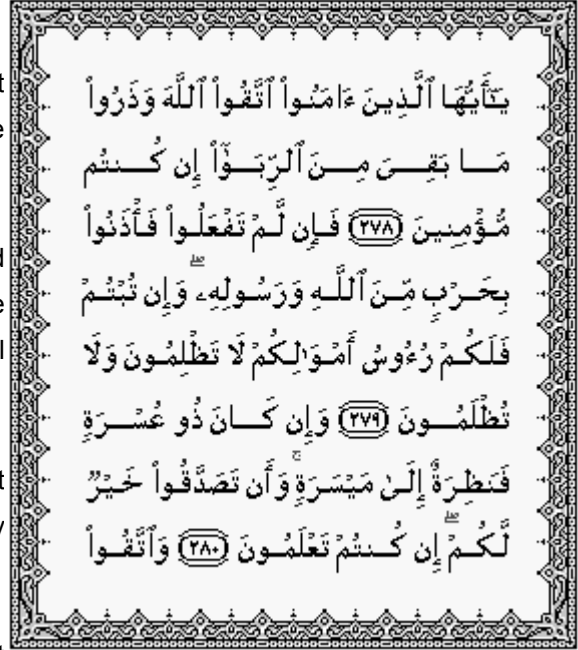
A.1 Surah 2: Al-Baqara, Verses: 278-281

[278] O ye who believe! Fear Allah, and give up what remains of your demand for usury, if ye are indeed believers.

[279] If ye 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 ye shall not be dealt with unjustly.

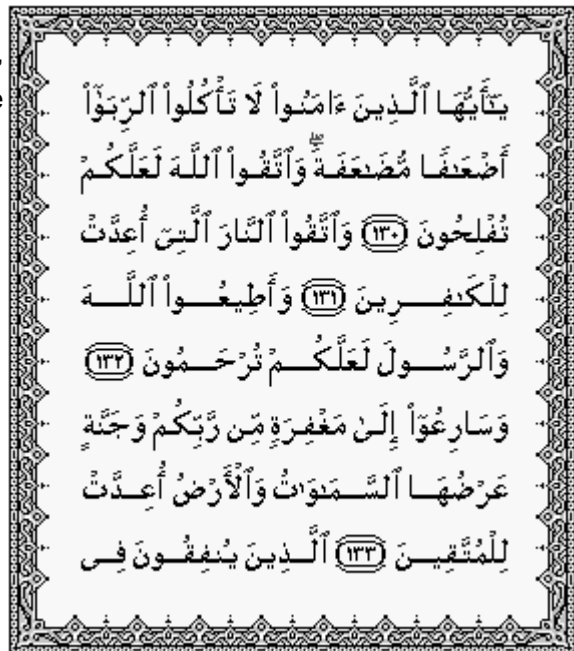
[280] If the debtor is in a difficulty, grant him time till it is easy for him to repay. But if ye remit it by way of charity, that is best for you if ye only knew.

[281] And fear the Day when ye shall be brought back to Allah. Then shall every soul be paid what it earned, and none shall be dealt with unjustly.



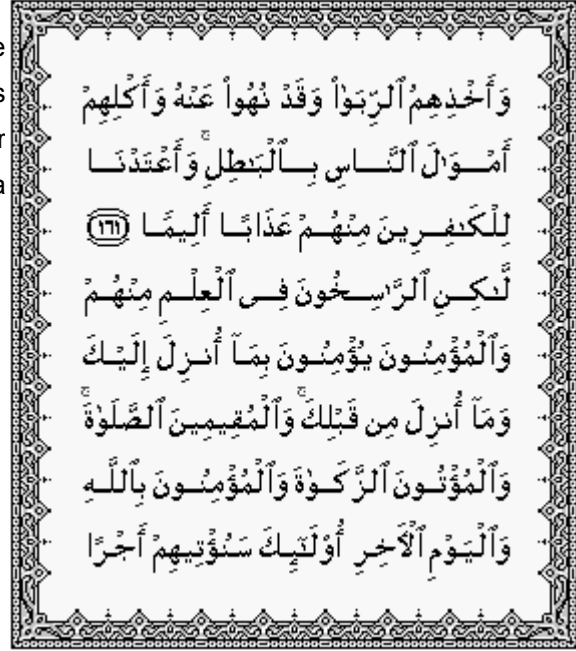
A.2 Surah 3: All-Emran, Verse 130

[130] O ye who believe! devour not Usury, doubled and multiplied; but fear Allah; that ye may (really) prosper.



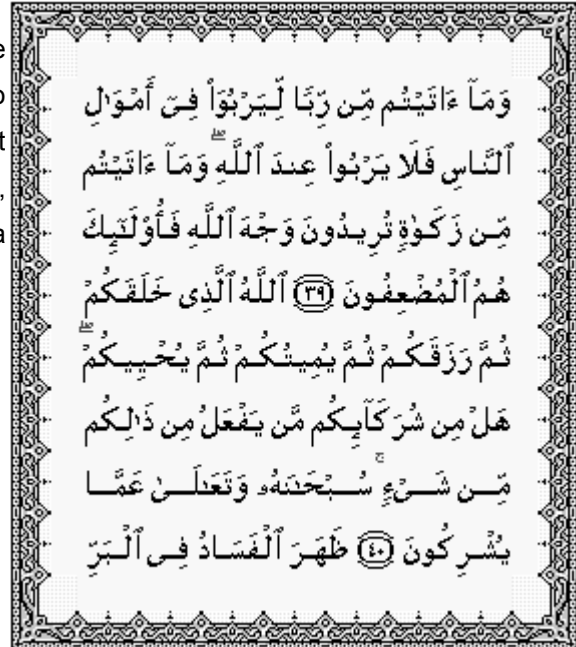
A.3 Surah 4: Al-Nisaa' Verse: 161

[161] That they took usury, though they were forbidden; and that they devoured men's substance wrongfully; We have prepared for those among them who reject Faith a grievous punishment.



A.4 Surah 30: Al-Roum, Verse 39

[39] That which ye lay out for increase through the property of (other) people, will have no increase with Allah: but that which ye lay out for charity, seeking the Countenance of Allah, (will increase): it is these who will get a recompense multiplied.



APPENDIX B
EXAMPLE FOR THE INCREASE OF MONEY SUPPLY

Let us assume for simplicity that the economic system has only one bank. This bank gives 5 per cent for the deposit rate and takes 10 per cent for the lending rate. The bank keeps only 10 per cent as reserves. Person "A" make a deposit of LE 1000 into the bank. The Balance Sheet entry of the bank would look as below:

Balance Sheet			
Deposit	1,000	Reserve	1,000

The Bank is required to keep on 10 per cent of this money, or increase the deposits to be 10 times this cash amount. Then the bank will make a Loan for Person "B". The Bank will give a loan to Person B with amount of 9000 LE. This Person will open an account with this money and in his name and get a check book for this new account. The balance sheet position after money creation would be as below:

Balance Sheet			
Deposit	1,0000	Reserve	1,000
		Loans	9,000

After money creation, the LE 1000 original deposit is now equivalent to 10 per cent of the current total deposits of LE 10,000.

Now, in the next period the amount deposit money would be LE 10,500. ($LE\ 10,000 + 0.05 \times LE\ 10,000$). The depositors would now be able to buy anything that is priced for LE 10,500 in the economy. On the other hand, the loan balance would become LE 9,900 ($LE\ 9,000 + 0.10 \times LE\ 9,000$). The extra LE 900 is simply the interest income to the bank. After paying depositors an interest of LE 500, the bank makes a profit of LE 400, which is 40 per cent of the original deposit. With this profit, the bank would pay salary to its employees, utility bills, etc., the remainder of which would comprise the bank's retained earnings. The current balance sheet position is as shown below:

Balance Sheet			
Deposit	10,500	Cash	1,000
Profit	400	Loans	9,900

Notice that the current reserve of 1,000 is now inadequate for a total deposit of 10,500.

This suggests that in a system as above, in the long run, the central bank would be forced to continually increase fiat money and/or the banks would continuously extend loans to the public and private sectors so that the reserve requirement can be met and thereby sustain the system. The implication of this is that the existence of interest rates would themselves force a continuous increase in both state money (fiat money) and bank money (loans) so they can cover the increase in the money created by the bank.

Hence, with the simple existence of interest rates alone, under normal circumstances, money supply in an economy will grow by default.

GLOSSARY

Bai Salam is purchasing a product with deferred delivery also called Bai'Salaf.

Hadeeth A saying from prophet Mohamed (prayers be upon him) as a teaching for us to follow.

Halal lawful, accepted actions in the Islamic law

Haram unlawful, forbidden actions in the Islamic law

Ijara wa Iqtina' Lease purchase.

Mudaraba is the trustee finance contract

Mudarib is the entrepreneur or borrower

Murabaha profit margin or markup

Musaqat is a contract between two parties so the first party will irrigate the other party's land in return of a percentage from the output harvest of the land.

Musharaka is the Equity Participation Contract

Muzara'h is a deal between two parties about farming a land in return of share in the harvest.

Rabb al-mal is the beneficial owner or the sleeping partner

Riba Is the interest

Sharia Is the Islamic law which has two main sources, Quran and Sunnah

Sunnah is the teachings and traditions of the Prophet Mohammed ((prayers be upon him)

Surah the Chapter in the Holy Quran

Zakat is the third of the five pillars of Islam. Zakat is a compulsory levy teed on all possessions, lure cash, agricultural products, gold and silver,..etc. The rate of such tax is 2.5% per annum on the accumulated wealth and net income that exceed the minimum exemptible level. The aim of zakat is to achieve social justice.