

PRIMARY RESEARCH

Maqāṣid al-Sharī'ah Index for Islamic Banking Institutions

Sajjad Zaheer ^{1*}, Warda Rasool ²

¹ Joint Director at the Monetary Policy Department, State Bank of Pakistan, Pakistan

² Assistant Director at Islamic Banking Department, State Bank of Pakistan, Pakistan

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Abstract. The main aim of the study is to provide an index for the Islamic banking industry through which the performance of the Islamic banks can be gauged on the *maqāṣid al-Sharī'ah*. Accordingly, we suggest an index for the Islamic banking industry based on the *maqāṣid al-Sharī'ah* through which the Islamic banks' performance can be appraised from the *maqāṣid al-Sharī'ah* perspective. The index incorporates quantitative and qualitative information of the Islamic banks and assigns the ratings accordingly. We also applied the criteria to 5 Islamic banks in Pakistan and computed their *maqāṣid al-Sharī'ah* index using detailed information. The index is used to have a relative evaluation of the Islamic banks regarding their advancement towards achieving the *maqāṣid al-Sharī'ah*. To construct an index, we evaluate the Islamic banking services by the four *maqāṣid* namely *ḥifẓ al-māl*, *ḥifẓ al-īmān*, *ḥifẓ al-'aql*, and *ḥifẓ al-nafs*. Using the quantitative and qualitative information, the index shows each bank's rating. The paper finds that the banks with more prudent practices regarding the financial performance and Sharī'ah compliance fulfil the *maqāṣid al-Sharī'ah* in a better manner and accordingly get a higher index ranking. The stakeholders of the Islamic banking would prefer to have the industry evaluated as per *maqāṣid al-Sharī'ah*. This study has directly related the Islamic banking services with the objectives of Sharī'ah and provided a measurable index for the Islamic banking industry. The suggested index can be used mainly by the regulatory bodies. Future studies may focus more on the aspect and level of Sharī'ah compliance of the products and services offered by various banks with a dual objective to encourage the banks to raise their Sharī'ah compliance level and rating, and also guide the stakeholders in the selection of the banks.

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*Corresponding author: Sajjad Zaheer

†Email: sajjad.zaheer@sbp.org.pk



INTRODUCTION

The science of the *maqāṣid al-Sharī‘ah* (objectives of the Islamic law) focuses on determining the precise meaning and underlying wisdom of the specific laws in Sharī‘ah. Five fundamental *maqāṣid al-Sharī‘ah* are mentioned in the books of Islamic Jurisprudence (*Fiqh*), namely to protect faith, life, intellect, family (offspring), and wealth or property of the human beings. The general objective of Sharī‘ah is mentioned as to create ease and to remove hardships from a human’s life, endorsed in the following verse of Qur’ān, “Allah wants ease for you, and He does not want for you hardship (2:185).”

The banking sector plays an important role in the economic development of the emerging countries, as financing to households and businesses are mainly extended through the banks. The objective of Islamic Economics, described as *falāḥ* (well-being) of human beings, is aligned with the *maqāṣid al-Sharī‘ah*. Islamic banking is Sharī‘ah-based banking which fulfills the objectives of Sharī‘ah directly or indirectly. These objectives are *ḥifẓ al-īmān* (protection of faith/ deen), *ḥifẓ al-māl* (protection of wealth), and to some extent, *ḥifẓ al-nafs* (protection of life), *ḥifẓ al-‘aql* (protection of intellect), and *ḥifẓ al-nasl* (protection of lineage/offspring). These objectives necessitate a quantifiable criterion according to which the progress of the Islamic banks could be evaluated. As the Islamic banking industry is progressing from niche to mainstream, it is imperative to analyze its improvements with respect to the *maqāṣid al-Sharī‘ah*. This thing can be done by way of developing an index based on the *maqāṣid al-Sharī‘ah* (we call it *maqāṣid al-Sharī‘ah* index-MSI), and that is the main objective and contribution of our study. We suggest an index for the Islamic banks through which the Islamic banks’ performance could be analysed. We shall also apply the same MSI criteria on the quantitative and qualitative information of the Islamic banks in Pakistan and assign the ratings accordingly. The model can be extended to a large number of banks and more comprehensive data set. Although there are certain limitations in the availability and richness of the publically available data, more information can be acquired using the modern statistical tools to construct a comprehensive Sharī‘ah compliance index. In this regard, the central banks can play a vital role.

Section 2 of the paper reviews the literature on Islamic banking, while Section 3 discusses the contemporary Islamic banking and its structure in Pakistan. We discuss the methodology of the *maqāṣid al-Sharī‘ah* index in section 4. Section 5 presents the application of the methodology on the data and information on the Islamic banks in Pakistan and shows the results. Finally, Section 6 presents the conclusion and findings of the paper.

LITERATURE REVIEW

Earlier studies on the MSI use concepts derived from the theory of *maqāṣid al-Sharī‘ah* where specific goals are classified into broad areas. Similarly, there are papers which examine the performance of the Islamic banking institutions in the light of objectives but are not particularly aimed at developing any index.

Our paper draws inspiration from the work done by Abdul Razak, Mohamed, and Md Taib (2008) who also address the need to have Islamic banking performance measures that

complement the traditional financial measures. The authors have derived the objectives of Islamic banking from the theory of *maqāṣid al-Sharī'ah* using Sekaran's (2000) method which breaks down the abstract notions or concepts into dimensions which are further broken down into measurable behaviors referred to as the elements. Three ideal objectives identified in their study are i) educating individuals, ii) establishing justice, and iii) public interest. Based on these objectives, a model of Islamic banks' performance measures is developed and is applied on a sample of six Islamic banks using Simple Additive Weighting Method (SAWM) (Hwang & Yoon, 2012).

Bedoui and Mansour (2015) developed a new approach linking the Islamic banks' performance to the vision of Islam and came up with a quantitative measure of performance by studying the interplay between religion and performance. Based on *maqāṣid al-Sharī'ah*, a Pentagon-shaped performance scheme is structured via five pillars, namely wealth, posterity, intellect, faith, and human self. Global Performance is measured by using a proxy for the performance corresponding to each of the *maqāṣid al-Sharī'ah* objectives. The authors believe that the devised scheme would be ensuring that the Islamic banks could contribute to the promotion of human welfare, prevention of corruption, and enhancement of social and economic stability.

Our study adds to the existing literature as we explore a direct relationship between pillars and performance. Hence, it provides a solid grounding for the development of an index. This step is very much imperative, as the compliance of the Islamic banks can directly be observed through their individual MSI. The selection of the *Sharī'ah* objectives in our study is based on the performance indicators of the Islamic banks which are identifiable, quantifiable, and measurable. Our study thus contributes to the existing literature on Islamic banking by providing a measurable MSI which is directly related to the *maqāṣid* of *Sharī'ah*.

Contemporary Islamic Banking and its Structure in Pakistan

The theoretical model of Islamic banking presented by Uzair (1955), worked under two-tier *muḍārabah* (agency/trustee) contract. In a classical *muḍārabah* agreement, the owner of the capital (*rabb al-māl*) transfers the capital to the user of the capital (*muḍārib*), to utilize the proceeds in some profitable venture. Both the parties to *muḍārabah* share profit and loss, as the case may be, of the business whereby the *muḍārib* manages the funds and the capital owner acts as a sleeping partner. Financial loss is borne solely by the capital owner, while the loss of the *muḍārib* is a kind of unrewarded time and efforts s/he exerts. When applying *muḍārabah* to Islamic banking, the contract implies that the depositors invest their money in PLS, Saving and Investment (S&I) deposits. The Islamic bank acts as a *muḍārib* (fund manager) for these deposits. On their asset side, theoretically, the Islamic banks act as an investor and their clients (borrower in the conventional banking) act as a *muḍārib*. In practice, however, the Islamic banks mainly employ *muḍārabah* for the collection of deposits, but not for financing (Baele, Farooq, & Ongena, 2010; Chong & Liu, 2009; Zaheer, Ongena, & Van Wijnbergen, 2013). Mostly, the Islamic banks use asset-backed debt creating contracts for financing to avoid moral hazard problem (Aggarwal & Yousef, 2000; Usmani, 1998). Main financing products of the Islamic banks are *muḍārabah* and *ijārah*, whereas the former has

a resemblance with a financial lease and the latter is equivalent to an operating lease in the conventional banking (Beck, Demirguc-Kunt, & Merrouche, 2013).¹

In Pakistan, early efforts were made to Islamize the entire financial system during the early 1980s. Around 1985, the banks were instructed to make all their products interest-free. However, after going through lengthy courts' proceedings regarding Sharī'ah compliance of the banking products, in 1999, Sharī'ah Appellate Bench (SAB) of the Supreme Court of Pakistan declared the banking system as un-Islamic due to some contracts, mainly the *bai' al-ṭinah* (buy-back) which were repugnant to the Islamic jurisprudence. Subsequently, to reintroduce Islamic banking, State Bank of Pakistan (SBP) issued detailed criteria for the establishment of Islamic banks in the private sector in 2001. This new three-pronged strategy approach permitted the financial industry to establish either full-fledged Islamic banks in the private sector or Islamic Banking subsidiaries or stand-alone Islamic banking branches of the existing commercial banks. The new strategy is much different from the initial one according to which all the banks were directed to Islamize all their operations invariably within a certain timeframe.² The approach to allow the co-existence of both banking systems has resulted in slow creeping of the new system into the existing conventional system. Over last 15 years, Islamic banking has been growing in double digits. Currently, there are 5 exclusive Islamic banks and 17 conventional banks which have Islamic branches with a market share of about 11 percent. The asset portfolio of the Islamic banking institutions shows their significant reliance on debt-based instrument, namely *murābahah*, and *ijārah*.

METHODOLOGY OF THE MAQĀṢID AL-SHARĪ'AH INDEX

In this study, we relate the services of the Islamic banks to four objectives of Islamic jurisprudence (*maqāṣid al-Sharī'ah*) namely *ḥifẓ al-māl*, *ḥifẓ al-īmān*, *ḥifẓ al-'aql* and *ḥifẓ al-nafs*.³ Accordingly these objectives (*maqāṣid*) have been employed to construct the index for the Islamic banks according to which their performance can be evaluated. Table 1 explains the methodology we adopt in this study. Each objective (*maqāṣid*) is given a specific weight in the index based on its importance, linkage and relevance with the Islamic banking operations. The weights assigned are acquired through a survey from the experts on the subject. Thus 50 percent weight is assigned to *ḥifẓ al-māl*, 35 percent to *ḥifẓ al-īmān*, 20 percent to *ḥifẓ al-nafs*, and 5 percent to *ḥifẓ al-'aql*. The formula for the index is as following, MS Index = $\sum_{i=1}^n \alpha_i X_i$, where α_i is the weight assigned to each rating (X_i) with

¹For details of Islamic financing products see El-Hawary, Grais and Iqbal (2004); a change has been witnessed in Pakistan since 2012 as the share of *mushārīks* in financing by IBIs in Pakistan had apparently increased to 15% by the end of December, 2015. But, actually it is also a fixed return technique innovated by IBIs to replicate the conventional Over Draft (OD) facility and cannot be termed as *mushārah* in real sense, see for details JIBM Editorial, "Running *mushārah* by Islamic Banks in Pakistan: Running from *mushārah* or Moving back to Square One", Vol.6 No.1, 2016. Further, for this study, we have covered the data up to the year 2010.

²State Bank of Pakistan, BCD Circular No. 13 dated October 12, 1984.

³Since *ḥifẓ al-nafs* has very less importance regarding the banking industry, we have not included this objective into the index. However, this can also be considered for the MSI provided one can identify some quantifiable indicators for this objective.

respect to individual objective (*maqāṣid*).

In our case, *maqāṣid al-Sharī'ah* index is defined as $MSI = 0.5 * \text{ḥifz al-māl rating} + 0.35 * \text{ḥifz al-īmān rating} + 0.10 * \text{ḥifz al-naḥs rating} + 0.05 * \text{ḥifz al-'aql rating}$.

Ḥifz al-māl is given a larger weight in this index due to its explicit relation with the banking industry. Since the banks convert short-term liabilities and deposits into long-term financing, i.e. maturity transformation, therefore, by the very nature of their business, they are exposed to liquidity mismatch risk which, in turn, might lead to the bank runs and insolvency (Diamond & Dybvig, 1983). Moreover, if the funds are not invested in a wise manner, the asset quality of the banks would deteriorate as happened in the 2007-09 sub-prime mortgage crises. Eventually this scenario affects the profitability, capital, and stability of the individual banks and of the financial sector as a whole. Likewise, cost efficiency also has a significant impact on the performance of a bank.

Accordingly, we included all the aforesaid factors in the index with relevant weights in the *ḥifz al-māl* which has 50 percent share in the MSI. We evaluated the performance of each Islamic bank regarding Sharī'ah objectives through certain factors which could be examined through various observable elements such as financial indicators and ratios.

We assigned individual weights to the indicators within an objective. The first objective, *ḥifz al-māl* (protection of wealth), is directly related to the operations of the Islamic banks and can be assessed objectively through various ratios and indicators of their financial accounts. Although the Islamic banks mostly raise non-remunerative current accounts using a loan (*qard*) contract, these accounts are generally held by the depositors for security purpose and convenience in day to day transactions. Thus it is the responsibility of the Islamic banks to ensure the protection of these deposits and to facilitate these account holders through providing the best services. The Islamic banks keep a fraction of these accounts as cash to meet the cash reserve requirement of the central banks. The remaining portion is amalgamated in a pool together with equity and other accounts.⁴ The funds from this pool are then used for financing and investment activities. Being non-remunerative in nature, these accounts are, therefore, a main source of seigniorage, a profit that comes from creating money,⁵ for the Islamic banks. On the other hand, S&I deposits are opened with the Islamic banks on PLS basis. Hence, neither return nor principle amount of these deposits is guaranteed by the bank. The main purpose of the depositors here is to seek a Sharī'ah-compliant return on their funds. Every Islamic bank is under an obligation to invest these funds profitably as well as prudently to prevent them from depletion and to distribute the income so received among the financiers /depositors justly.

To quantify the Islamic banks' observance of *ḥifz al-māl*, we included all those indicators through which the financial performance, stability, asset quality, and cost efficiency of a bank could be measured. Specifically, we included Return on Assets (ROA), Capital Asset Ratio (CAR), stability index (z-score), Non-Performing Financing (NPF) to total financing,

⁴However, if an Islamic bank offers a facility such as free check books or free ATM cards, the same facility should also be provided to saving and investment account holder free of cost as otherwise it may be considered as paying interest in kind.

⁵In the form of profits on the financing they make with the money they create because of fractional reserve system.

provisioning to NPF, cost-income ratio, and liquidity ratio. The z -score is constructed as the sum of the mean rate of return on assets (μ) and the mean equity-to-assets ratio (k) divided by the standard deviation of the return on assets (σ) i.e. z -score. It measures the risk of insolvency or distance to default. While combining accounting measures of profitability, leverage, and volatility, it exhibits the probability of loss surmounting the equity capital. Since a higher z -score means more stability, the same increases the value of the index. We used NPF to total financing and provisioning to NPF to include the asset quality of the banks in the index. NPF contributes negatively, whereas provisioning contributes positively to the index. We have constructed the index in such a way that a lower value of the index means better compliance with *maqāṣid al-Sharī'ah*. So for all those indicators which improve the compliance of an Islamic bank with an objective of Sharī'ah, we took reciprocal of that indicator to make it aligned with our design of the index. For example, the higher value of ROA means that the Islamic bank is more profitable and thus fulfils *ḥifẓ al-māl* objective better than the others. Therefore, we took its reciprocal to get an inverse relationship meaning that the higher value of ROA produces a lower value of the index for that bank.

The second objective, *ḥifẓ al-īmān* (protection of faith), is directly related to the performance of the Islamic banks and can be assessed objectively through analyzing Sharī'ah compliance level, service quality, funding structure, interest-free lending capacity, and interest-free financing.

Sharī'ah compliance has been assessed by quantifying Sharī'ah-related issues highlighted by external evaluators and bank's own Sharī'ah advisor in the annual report. The reported issues are grouped into seven broad categories which are;

- i) Sharī'ah committee composition and relations with the management,
- ii) Training programs / understanding of the products,
- iii) Treatment of non-Sharī'ah income / Funds Utilization / Charity Account,
- iv) Compliance of the banking products / agreements with the Sharī'ah-approved documents,
- v) Disclosure of relevant information,
- vi) Internal Sharī'ah Audit / Product Development & Sharī'ah Compliance, and
- vii) Review of policies by bank's Sharī'ah Advisor / Missing Sharī'ah guidelines. Issues pertaining to each category are summed up and weighted according to their importance in the overall functioning of the bank. Due to their complementary nature, the assigned weights do not vary significantly.

The second measure of this section is service quality for which consumer complaints are taken into account. The nature and frequency of consumer complaints against a variety of functions provide an insight into the bank's performance. The major categories of complaints are:

- i) Account Operations and Deposits,
- ii) ATMs,
- iii) Auto Finance,
- iv) Fraud and Forgeries,
- v) House / Mortgage Finance,

- vi) Misbehaviour / Misconduct,
- vii) Miscellaneous Complaints, and
- viii) Remittances.

We also included three other measures of evaluating *ḥifẓ al-īmān*, i.e., funding structure, interest-free lending capacity, and actual interest-free financing. If the funding structure of a bank shows more reliance on profit and loss sharing deposit instead of debt, it means that the Islamic bank is more inclined toward equity financing which increases adherence to the said objective. Next, we included non-loan earning assets relative to the total portfolio. Higher ratios mean that the bank has less capacity to extend interest-free financing. Thus higher values of these ratios contribute negatively to the index.

The third measure is the non-loan earning assets which show the non-financing business of the Islamic banks, while the fixed assets represent the opportunity cost of having unproductive assets. A lower value of each of these indicators improves the quality of the index for the respective bank. Lastly, for this objective, we incorporated the actual interest-free financing by an Islamic bank represented by financing to assets ratio, which contributed positively to the index.

For *ḥifẓ al-naḥs* (protection of life), we used equity financing, *qard al-ḥasan*, and charitable activities as main basis for the objective. For that purpose, we employed equity products plus *qard al-ḥasan*, the core products of Islamic banking and finance in principle, standardized by total financing. We also included the utilization ratio of charitable funds of the banks to the total available funds. The banks are instructed to use the funds within a year so that the needy people could get benefit of those funds as early as possible. Higher values of both indicators mean better performance of the bank. Detailed methodology of the study has been summarized in Table 1, as follows:

TABLE 1
Methodology

Objectives	Weight	Basis	Factors	Data Sources	Indicator/ Observables	Weight
<i>Ḥifẓ al-māl</i>	0.50	Financial performance and stability	Profitability	Quarterly/Annual	ROA	0.10
			Capital	financial accounts of	CAR	0.10
			Financial Stability	the Islamic Banks.	z-Score	0.10
			Asset Quality	Customer	NPF	0.20
			Liquidity	satisfaction (survey, complaints with	Provisioning to NPF	0.10
			Cost Efficiency	regulatory bodies, if available)	Liquidity Ratio	0.20
					Cost-Income Ratio	0.20

TABLE 1 continue

Objectives	Weight	Basis	Factors	Data Sources	Indicator/ Observables	Weight	
<i>Hifz al-īmān</i>	0.35	Sharī'ah compliance	Compliance of banking products/agreements with Sharī'ah approved documents, Disclosure of relevant information, Review of policies by bank's Sharī'ah Advisor.	Internal Sharī'ah compliance report prepared by (Sharī'ah) auditors, and information acquired from other sources, regulatory authorities, surveys etc.	Number and intensity of violations in different areas	0.40	
			Stakeholders concerns and grievances	Complaints data	Number of complaints per 100 branches	0.20	
			Funding Structure	Preference given to PLS deposits	Quarterly/Annual accounts	PLS deposits to total deposits	0.10
			Interest Free Lending Capacity	Business Model		Fixed Assets	0.10
<i>Hifz al-'aql</i>	0.05	Interest-free financing Research and New Product Development, Training and Development, Stakeholders Engagement	Financial Intermediation		Non-Loan Earning Assets	0.05	
			Development and launch of new products, Training to the staff, general awareness programs	Quarterly/Annual accounts	Financing to assets ratio Expenditure on training to total expenditure ratio	0.15	
<i>Hifz al-nafs</i>	0.10	Equity Financing, <i>qard al-ḥasan</i> , Micro and SME financing Charitable activities performance	Percentage of financing in equity, micro, SME and small agriculture loans.	Quarterly/Annual accounts	Equity products Plus <i>qard al-ḥasan</i> to total financing ratio.	0.5	
			Policy for Charity Fund. Utilization and disclosure of amount/transactions related to Charity Fund	Quarterly/Annual Accounts	Utilization ratio of Charity fund, i.e.	0.5	

Application of the Index to the Islamic Banks in Pakistan

We tested the performance of five Islamic banks in Pakistan by constructing the index through using the information and data acquired from their financial accounts and other sources. We used individual quarterly financial accounts of all commercial banks. The data contain very detailed information of all the balance sheet items and income statements of the commercial banks. We then computed the indicators for the business model, efficiency, asset quality, and stability to evaluate the performance of the Islamic banks. The data cover 32 quarters starting from June 2002 to March 2010. Although there are 21 Conventional

Banks (CBs), 5 exclusive Islamic Banks (IBs), and 16 mixed banks with Islamic Banking Branches (IBBs) in Pakistan, we used the data of 5 Islamic banks only to have more vivid figures of the index. Currently, we used dummy names for the Islamic banks.

Due to the unavailability of the data on training, we could not evaluate the banks for compliance with respect to *ḥifẓ al-‘aql*. For the other three objectives of Sharī‘ah, we collected the information mainly from annual accounts of the banks, Sharī‘ah compliance reports of the banks, and complaints to the central bank. We first indicated the share of *ḥifẓ al-māl* in the overall *maqāṣid al-Sharī‘ah* index (see Table 2). The lower the index, the better would be the performance of the Islamic bank in achieving the respective objective of Sharī‘ah. As mentioned earlier, we took the reciprocal ROA, to align the results with the design of our index. Similarly, we took the reciprocal of z-score, CAR, provisioning, and liquidity ratio. For ROA, Muslim Bank Ltd. is far better than all other banks securing a score of 0.0196. In the last column of the table, we have indicated the total share of the respective objective for a bank in overall *maqāṣid al-Sharī‘ah* index. For *ḥifẓ al-māl* objective, Dunia bank shows the least observance and Muslim bank shows the best achievement of this objective. Similarly, we have indicated the results for *ḥifẓ al-īmān* and *ḥifẓ al-nafs*.

TABLE 2
Share of indicators related to the specific objectives in overall *maqāṣid al-Sharī‘ah* index

	Bank/Indicator	ROA	z_Score	CAR	Cost Income Ratio	NPF	Provisioning	Liquidity Ratio	Objective Share
<i>Ḥifẓ al-māl</i>	Amana Bank	0.0251	0.0028	0.0039	7.9523	0.4199	0.0208	0.0968	8.5215
	Bank Iman Ltd.	0.0444	0.0007	0.0015	11.2353	0.1892	0.0493	0.0512	11.5715
	Bank Ahtimad Ltd.	0.0748	0.0010	0.0012	10.3949	0.3639	0.0412	0.0780	10.9550
	Dunia Bank Ltd.	0.1194	0.0030	0.0017	17.2770	0.1041	0.0497	0.0907	17.6457
	Muslim Bank Ltd.	0.0196	0.0028	0.0041	6.9956	0.2943	0.0218	0.1606	7.4989
<i>Ḥifẓ al-īmān</i>		Sharī‘ah Compliance	Complaints	Gross Loans	Non-Loan Earning Assets	Fixed Assets	Investment Deposits		Objective Share
	Amana Bank	0.0720	0.0059	0.0008	0.4440	0.0166	0.0406		0.5799
	Bank Iman Ltd.	0.0540	0.0357	0.0015	0.8834	0.2623	0.0408		1.2777
	Bank Ahtimad Ltd.	0.0774	0.0072	0.0010	0.7009	0.2356	0.0247		1.0468
	Dunia Bank Ltd.	0.0648	0.0089	0.0009	0.6000	0.2181	0.0410		0.9337
	Muslim Bank Ltd.	0.0360	0.0163	0.0008	0.4955	0.0368	0.0399		0.6254
		Equity Financing	Charity Fund						
<i>Ḥifẓ al-nafs</i>	Amana Bank	0.1131	0.0055						0.1186
	Bank Iman Ltd.	0.0422	0.0007						0.0429
	Bank Ahtimad Ltd.	4.7356	0.0005						4.7361
	Dunia Bank Ltd.	0.0184	0.0006						0.0190
	Muslim Bank Ltd.	0.0073	0.0008						0.0081

The overall rating of the banks for observing *maqāṣid al-Sharī‘ah* is shown in Table 3. In the total index based on *maqāṣid al-Sharī‘ah*, Muslim bank shows the best performance.

TABLE 3
***Maqāṣid al-Sharī‘ah* index for 5 banks from Pakistan**

Amana Bank	Bank Iman Ltd.	Bank Ahtimad Ltd.	Dunia Bank Ltd.	Muslim Bank Ltd.
9.2200	12.8920	16.7379	18.5984	8.1323

CONCLUSION

The objective of Islamic Economics, as mentioned in the literature, is *falāḥ* which is also aligned with the *maqāṣid al-Sharī‘ah*. Islamic banking is Sharī‘ah-based financial intermediation and has to meet the objectives of Sharī‘ah directly or indirectly, namely *ḥifẓ al-māl*, *ḥifẓ al-īmān* and up to some extent *ḥifẓ al-nafs*, and *ḥifẓ al-‘aql*. For evaluating the performance of Islamic banking institutions, a quantifiable criterion has to be developed according to which the progress of the Islamic banks can be appraised. As the Islamic banking industry is moving from niche to a mainstream, it is imperative to analyze its progress with respect to the *maqāṣid al-Sharī‘ah*. This thing can be done through developing an index based on the *maqāṣid al-Sharī‘ah* Index (we call it MSI) and that is the aim and contribution of our study. In this article, we suggest an index for Islamic banking based on the *maqāṣid al-Sharī‘ah* through which the Islamic banks’ performance can be judged. Accordingly, we also applied the index criteria on the quantitative and qualitative information of the Islamic banks in Pakistan and assigned the ratings accordingly. From the brief survey from Sharī‘ah scholars, we find that the highest weight is given to *ḥifẓ al-māl* by the Islamic banking industry. The bank with higher financial soundness would be able to get better rate on the *maqāṣid al-Sharī‘ah* index. In our case, Muslim Bank got the highest relative ranking among five Islamic banks due to its better financial health.

Thus the paper finds that the most important objective of Sharī‘ah in MSI construction is *ḥifẓ al-māl*. Profound and prudent banking would lead to strengthening the quantifiable measures used in MSI and thus improving the relative scoring of the banks. In this regard, a special role needs to be played by the stakeholders and the policy makers to improve the overall ranking of the Islamic banking industry according to MSI criteria. Since Islamic banking came into existence because of its compliance with Sharī‘ah, *ḥifẓ al-īmān* also should play a major role in MSI with measurable indicators. MSI, therefore, incorporates all the available information related to *maqāṣid*. Use of this kind of indicators would hopefully improve the performance of the Islamic banking industry.

While constructing this index, we encountered certain issues; the main issue was the unavailability of data, we faced difficulty even in accessing the data that existed but haphazardly. It implies that the banks need to improve their data presentation to make it useable by the researchers and regulators. While we mainly used annual/quarterly published accounts, the work can be extended through incorporating rich data from various sources including banks’ websites. Bank’s management response can be obtained through interviews and questionnaires. The central banks may sometimes withhold information due to the confidential nature of the data, but relevant surveys conducted on banks’ depositors and clients might prove to be very helpful in getting a feedback on the relevant bank.

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