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Islamic Project Financing in Pakistan: Current Challenges and Opportunities Ahead

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Abstract

This study is related to an Islamic project financing with a major focus on investigating the role of Islamic finance in financing infrastructural development projects (toll roads, power plants, airports, and plants, as well as natural resource exploitation projects, such as hydroelectric dams, mining projects, oil and gas assets, and paper mills), especially in the context of Pakistan. Infrastructural development being a significant indicator of stability and growth, most countries attempt to develop their infrastructure to a competitive level in their respective regions. Considering this critical aspect of economic development, Islamic project financing can be beneficial to developing economies like Pakistan as it would be able to compensate for a lack of domestic infrastructural development. New and innovative financial solutions are required to cater to the needs of infrastructural investment. Islamic project is an area which can open new channels for this purpose and this area is also under-explored. Islamic banks in Pakistan and across the globe need to be involved in huge infrastructural financing.[1] However, their growth rate and efficiency is higher than in conventional financing. Focusing on this aspect, this research study is based on a review of project financing in Pakistan. The study portrayed the current scene of project financing in Pakistan, and investigated the involvement and challenges faced by Islamic modes of financing in infrastructural projects in Pakistan. Fourteen in depth interviews were conducted with public and private sector professionals to investigate the issues and prospects. The main challenges faced by Islamic financial institutions (IFIs) are a lack of regulation and investment avenues, and non-coherent standards and practices. However, these IFIs have opportunities with respect to the Islamic market and fund development.

Keywords

Co-financing, Islamic finance, Islamic modes of financing, Islamic project financing, Project financing.

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1. J. Collins, "The road ahead for Islamic Finance", *in* "Integrating Islamic Finance into the Mainstream: Regulation, standardization and Transparency", *Islamic Finance Project*, Harvard University, 2007, p. 133.

Introduction

Considerable progress has been made by the Islamic finance sector during the last 30 years, particularly in the last 10 years this sector has shown a robust growth of between 15 to 20 percent annually (IBD bulletin, Dec, 2011). Islamic financial services are also expanding across the globe (Ali A., 2002; Archer S. and Ahmed T., 2003). This proves the Islamic finance sector is one of the fastest growing segments of the financial system. The worldwide number of Islamic financial institutions has risen to above 500 in more than 75 countries with total combined assets in excess of US$ 1.6 trillion (Global Islamic Finance magazine February, 2012). To get the most out of this potential market, a number of global financial institutions have established Shariah compliance services (Sundararajan and Errico, 2002). Despite all this growth, Islamic financing and banking are quite limited in most of these countries because of their small size compared to conventional financing.

Modern project financing brings numerous participants from the world together and now it has truly become an international undertaking (Niehuss, 2010). Large infrastructural projects need a large amount of capital which involves different parties participating. Sometimes it is hard for the government to finance projects from its own resources; hence it involves the private sector in financing infrastructural projects. Most countries across the globe use project financing techniques for their projects but Muslim countries have only been in this scene for the last two decades. For many years Islamic finance has been the source of funding for Middle Eastern countries but in the last few years Islamic financial institutions (IFIs) have developed their product range to apply to project financing.

The reason behind the late entry is due to the conflicts between Islamic and Western conventional project financing principles. Investors who look to Islamic financial products want to comply with Shariah[1], which prohibits the collecting of interest[2]; the real economic activity of an Islamic financial system forbids investment in sectors like alcohol, tobacco, gambling etc. These Islamic financial

1. Islamic body of law which determines how Muslims should live and behave.
2. Earning profit on exchange of money for money is considered as immoral in Islam.

institutions (IFIs) provide a wide variety of products and services[1] and these comply with Shariah principles.

Islamic divine Shariah law is derived from four sources: the Holy Quran, the Sunnah of the Holy Prophet (Peace be upon Him), the consensus of the Ummah (Ijma) and analogies made by Muslim scholars (Qiyas). Islamic financial businesses are based on four main principles: materiality (there should be a real economic transaction), risk sharing (a risk return distribution for parties involved in it), no exploitation of any party in the financial transactions and no investment in the prohibited businesses mentioned before.

This research is based on the realism perspective which states that reality exists independent of the filters and beliefs of the human mind, and is critical to our ability to know reality with certainty (Bhaskar, 1978). A qualitative approach is used to address the research objectives, which is based on the following questions. What are the different sources of (conventional and Islamic) financing available in Pakistan? What is the magnitude of Islamic project financing in Pakistan? What are the current challenges and the prospects of the Islamic project financing in Pakistan?

The research design in this realism perspective is relatively exploratory. The literature is unfolded step by step around the basic phenomenon and we seek to answer the first question mentioned above. The second question is addressed through the descriptive statistics of project financing reviews in Pakistan. Then interviews are used to provide answers related to the third question regarding the current challenges and future prospects.

Literature Review

Two basic principles are provided by Shariah in Islamic finance: risk sharing and promoting the welfare of the society (Ibrahim, 2008). On the basis of these basic principles, five rules are extracted for Islamic finance: Riba, used in two senses; fixing the return in advance on a loan as a compensation for waiting (Riba-an-nasi'ah) and (Riba-alfadl) the manipulated hand to hand sale and purchase of a commodity

1. Services include the mobilization of funds, the leasing and allocation of assets, payment, exchange and settlement services and risk mitigation.

(Zaher and Kabir Hassan, 2001). Gharar is a contract involving deception (Islahi, 1998). The sharing of profit and losses arising out of any legal Shariah compliant business, Islamic transaction must be asset-backed, as money itself has no intrinsic value, and investment should be in those businesses which are not prohibited by Shariah (Rehman, 2008).

These five rules created a hindrance both for conventional project financiers to undertaking Islamic projects in the Muslim world and for Muslim project financiers to invest their capital in different countries, which limits the potential of Islamic project financing in Muslim countries as well as in other parts of the world. Huge potential and numerous possibilities are available in the Islamic world to finance projects in oil and gas production, power projects, and the construction of roads and dams (Richardson, 2006). Throughout the world, knowledge about Islamic finance increases along with the understanding of Islamic financial practices, which will surely increase the domain of Islamic project financing across the world.

Efforts towards the elimination of Riba from the economic system of Pakistan began in the early 1970s, but were not very significant in terms of Shariah compliance. However, in the 1980s some significant steps were taken to promote Islamic finance in Pakistan. The most important role played in this regard was by the Pakistan Islamic ideology council, which has been a significant contributor to the provision of a systematic way to eliminate Riba from a modern economy.

Before 1980s the focus was more on interest free financing and banking but in the mid-1980s these efforts shifted towards the development of Islamic financial institutions. These institutions also mainly focused on interest free transactions but they also exercised principles of Islamic finance related to property rights, the sanctity of contracts and the rules of sharing risk (Alee, 2011). In the late 1980s, Takaful and Islamic insurance were introduced and endorsed as Shariah compliant by the Organization of the Islamic Conference (OIC) that opened a door for Islamic finance to capital market investment and other financial intermediaries.

In early 1990s the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) developed Islamic finance

standards and later on these standards were supported by other institutions like the Islamic Financial Services Board (IFSB).

Contracts in Islamic Finance

The activities of Islamic finance can be categorized into two sets of contracts (D. El-Hawary *et al.,* 2004), transactional contracts (comprising economic transactions between parties), and intermediation contracts (serving the role of intermediary to assist and finance contracts based on financial transactions) as shown in Figure 1. Transactional contracts are based on sales, exchanges and trade. Transactional contracts are on the risk spectrum, in which on one end there are less risk asset-backed securities and on the other end there is equity-based participation under Musharaka (Khan, 1994). Within these two risk extremes, Ijara and Istisna contracts are included based on collateral securities. Both of these are linked to real assets and fall under the medium- term maturity risk category (D. El-Hawary *et al.,* 2004). This system also promotes social welfare by offering grants contracts like Zakat and Qard-e-Hassna (return free loans).

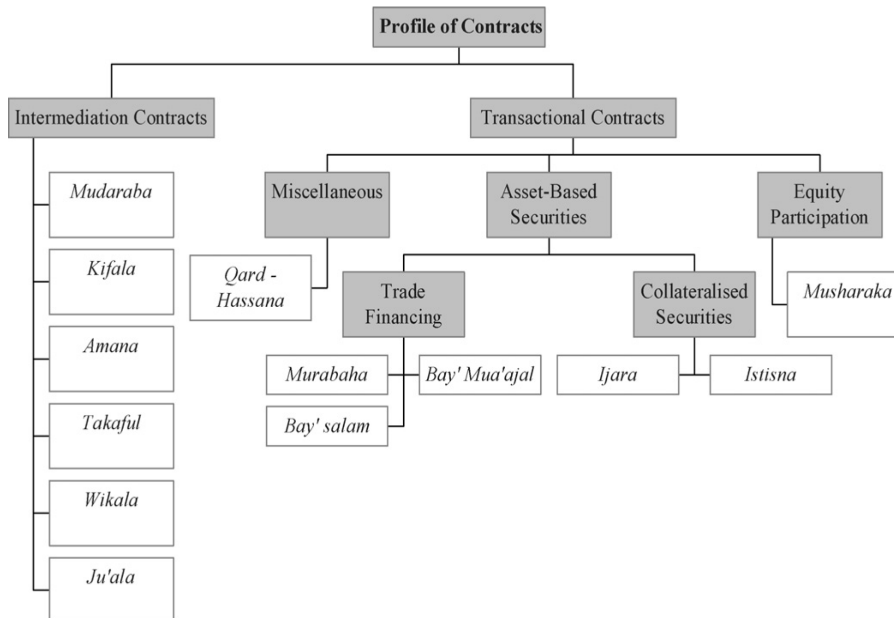

Fig. 1. Islamic financial contracts
Source D. El-Hawary et al. / The Quarterly Review of Economics and Finance 46 (2007) 778–800

Trade financing consists of Murabaha, Bay Salam and Bay Mu'aja[1] (includes deferred payments and pre delivery). Murabaha[2] contracts engage Islamic banks making a physical purchase of a finished/completed asset and then re-selling it on at a higher price. The payment can be made to the bank in instalments or in a lump sum during the maturity of the contract. The profit collected by the bank in these contracts covers the risk that they face while holding the asset (Esty Benjamin, 2000). Bay Salam[3] (prepayment, deferred delivery) is commonly used in the agriculture sector whereby the financial institution acts as a buyer making a contract with the seller to fix the price for the goods delivered on a fixed future date (Mannan, 1993).

Collateral securities include Ijara[4] (lease contract) and Istisna[5] (deferred payment, deferred delivery). In an Ijara agreement, the Islamic financial institution buys an asset and then rents it for an amount that is determined and can be adjusted. Giving the leaser the option to purchase the asset at the end of the lease rentals is unlawful, because this incorporates vagueness into the contract. These Ijara agreements are generally used in the funding preparations of huge companies for high value professional devices (Al Zawya, 2009). In an Istisna contract one party agrees to purchase goods from another party and makes payments at some future date. Islamic banks are the end users in most cases of Islamic project finance. In construction phases, Istisna is extensively used. Most of the time Istisna involves a sales contract (in which a buyer agrees to purchase the product/asset

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1. The seller can sell a product on a deferred payment, the sale can be in instalments or on a lump sum basis. At the time of the sale of the product the price of the product is mutually agreed between the parties based on some market factors. This sale price cannot include any charges for deferred payment.
2. The seller expressly mentioned his cost of purchasing (acquiring) or manufacturing a specified product. Then both parties negotiated the profit margin between them. The total cost is paid either in a lump sum or in instalments.
3. In Salam the buyer pays the full price of the asset/product in advance that the seller will provide at some future date, the sale can be in instalments or on a lump sum basis. At the time of the sale of the product the price of the product is mutually agreed between the parties. This sale price cannot include any charges of deferred payment.
4. A product is leased for a particular time period and at some specific sum (lease payments). Each payment in Ijara includes a portion which goes toward the transfer of ownership and the final purchase of that product.
5. In *Istisna* a contractor or manufacturer manufactures (build) and delivers a product at a given price on a given future date. In contrast to Salam the price does not have to be paid in advance. The payment can be made in instalments or some part in advance and remains at some later stages based on the mutual consent of the parties.

from the bank on its completion) and then a manufacturing contract (in which the bank pays an amount to the manufacturer to build an asset), so this can be seen as a "back to back" contract. Equity participation includes the term, Musharka,[1] Shirkah in Arabic, which is a partnership in a venture (Chapra, 1986; Siddiqi, 2005; Aggarwal and Yousef, 2000). Qard Hasana[2] (beneficence loans) is a risk-free asset allowed in Islam and which falls on the other end of the risk spectrum (Ebrahim, 1999).

In Figure 1 financial intermediation agreements execute features of testing and tracking, and financial commitment. They involve Mudaraba,[3] Kefalas,[4] Amana,[5] Takaful,[6] Wakulla[7] and Ju'ala.[8] In a Mudaraba agreement, a party with financial resources (Rabb-ul-mal) makes a profit-sharing relationship with an agent (Mudarib) who has expertise in business. The losses are carried only by the financial commitment company. The Mudarib is responsible for a loss in case of wrong doings or carelessness. However, under a Mudaraba agreement, the finance provider company does not get involved in the control of the resources and these controls are exercised by the agent only (the Mudarib) (Fadeel, M. 2002).

Islamic finance and traditional project financing

The term project finance is generally used for complex, new, standalone and massive undertakings. It is the creation of legally

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1. An equity partnership agreement takes place between the Islamic bank and one or more parties to jointly finance the project. Profit and loss distribution is done on a pro-rata basis.
2. Qard Hasana is zero return loans. Quran and Shariah encourage Muslims to provide this loan to needy people. To cover the administrative expenses for handling this loan banks charge borrowers a service fee. The fee is not subject to the loan amount or maturity.
3. Rabb-ul-mal (the owner of the capital) provides the capital to finance the whole project while the Mudarib (acting as entrepreneur) provides his expertise and labour. Profits are shared at a fixed ratio of the actual profit earned in the project. The financial losses are borne by Rabb-ul-mal only and the Mudarib is only liable for his time and effort.
4. Kifala is a guarantee contract; a surety for a payment of a debt is provided by a third party, if the original liable person is unable to pay. It is a commitment given to a creditor that the person will pay the debts, excellent or any other liability.
5. Amana is a trust deposit in which one party deposits its resources for the purpose of safe keeping with another party on a trust basis.
6. Takaful is a mutual insurance contract based on the nature of a mutual guarantee.
7. An agency contract is used to give power of attorney to some other person to represent his/her interest. The agent charges his fee for the contract.
8. The contract in which a party offers a professional service for a predetermined fee. These services include trust services and fund placements.

independent projects combining equity from various sponsoring firms and non-recourse debt for the purpose of investing in a capital asset (Esty, 2007).

Islamic and conventional finance have profound differences in their nature from the point of view of their origin and from a legal perspective. However, in the field of project finance there are some points of convergence as well. Similarities exist between the field of project financing and classical Islamic financing techniques. These similarities arise from the conceptual basis and nature of project finance (Khan, 1997).

In the Ottoman Empire, Muslims financed their project through Mudaraba, while in the thirteenth century, the Italian bankers, Frescobaldi, used a quasi-equity structure to finance the silver mines in the area of Devon. They exploited the mine for two years and repaid their loans from the income generated from the mine (Klarmann, 2003). Islamic finance is based on some prohibitions and is the most important component of Islamic economics. Trading any Haram good is prohibited in Islam. In addition, Shariah provides a basic set of principles which provide the basic framework for financing. These principles are based on a profit and loss sharing basis. Islamic finance also endorses the Western financial concept of ethical standards, such as justice, fair dealing, transparent dealing, paying liabilities in time and mutual cooperation (Ayub, 2007).

Riba is also prohibited in some other religions, such as Judaism and Christianity, but gradually Riba was accepted by different stakeholders with the growth of economic systems. The rationale behind the prohibition of Riba in different religions is to prevent injustice, promote work, and encourage productivity and the equitable distribution of wealth. In Islamic finance a valid contract should be lawful, clearly defined on all the terms at the time of contract and should be Shariah compliant. Quantities should be clearly defined and the delivery of the product should be possible and certain.

Furthermore, IFIs can contribute to achieving the major socio-economical goals of Islamic society through project financing (Chapra, 1985). The most significant goals among them are economic welfare, the equitable distribution of wealth, high economic growth, mobilizing and the stability of money, and fair profit sharing among

the parties involved in projects (Hassan and Levis, 2007). These ethical goals are close to the requirements of sustainable development which is set by the World Commission on Environment and Development of the United Nations.

Islamic project finance is the areas which are conceptually conducive to Islamic finance and adhere to the basic economic philosophy of Islam. Islamic finance can configure itself as an ideal solution and be capable of meeting the economic needs of projects. The remuneration of Islamic lenders is not based on the time lapse but on the actual revenue generated from the project. The lenders will act as a partner and also be liable for risk as well, which resembles the philosophy of Islamic project finance as well.

A variety of arrangements are used in project financing on the basis of financial and contractual obligations. In order to fund specific projects, different sectors are involved in different environments. Real, useful and beneficial assets are involved in project financing. This seems to be completely relevant with the asset backing principle of Islamic law. Different contracts and financial structures are used to finance industrial, natural, construction and infrastructural development (Wood, 1995) which is quite similar to Islamic financial contracts (Ebrahim, 1999). The profit and risk logic of project finance is also similar to the Islamic concept. Similarly, conventional and Islamic project financing encourages infrastructural development in emerging economies. This allows different actors to participate actively and makes sure that the risk involved in projects is identified and properly mitigated.

Cases of modern Islamic projects (co-financing)

Blending Islamic finance trenches with conventional finance is another innovative product, which is also called co-financing. With co-financing the capital pool increases which would otherwise be limited to only one form of financing. A brief overview of the few modern infrastructure projects that integrate some sort of Islamic project finance innovation is given below.

Equate Petrochemicals Company[1] (December 1995)

PIC (Kuwaiti State Controlled Petrochemicals Company) was involved in building and operating a USD $2 billion petrochemical plant. The early construction process was financed through an Istisna contract while the post constructions phase was financed using Ijara financing. This venture involved US $ 400 million from regional banks and US $ 600 million from international bank financing.

The deal became a demonstration that conventional and Islamic financing could indeed be put together while fulfilling the needs of the activities involved. It is interesting to note that this project looked to Islamic financing only because there was a shortfall of conventional funds.

Jimah Energy Ventures[2]

Jimah Energy Ventures (JEV) is a royal family-owned Malaysian state company, which is now closed. In order to raise capital to fund the construction of a 1400 MW Greenfield IPP in Malaysia, most of the $1.6 billion required was generated by an Islamic bond issue (known as a Sukuk). However, this deal also includes a significant amount of conventional finance in the form of bank guarantees and standby letters of credit.

Dolphin Gas Project

Dolphin Gas Project involved gas extraction and processing in Qatar, and the construction of a pipeline to the United Arab Emirates, which secured a $1 billion Ijara and Istisna bridge financing for four years. The deal was blended with a $2.45 billion conventional tranche.[3] By using co-financing, $3.5 billion was raised, the largest amount to be raised for an oil and gas project in the Middle East Gulf.[4]

Thuraya Satellite[5]

This was a $1.1 billion project for a satellite in which Islamic

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1. International investor Islamic finance and the equate project, Harvard Business Review. October 1999.
2. “Jimah Energy: Upfront Equity”, Project Finance, London: June 2005.
3. “Islamic Blending”, Project Finance, London: September 2005.
4. “Dolphin Finalizes Finance”, International Petroleum Finance, New York: August 8, 2005.
5. November Nelthorpe, Tom, “The Making of Thuraya”, Project Finance, London 1999, Issue 199.

financing was used along with other equity investments. The Islamic tranche covered $100 million for the ground station of the satellite and at that time it was the largest Islamic financing investment done in any project.

Method

This research is based on the realism perspective which states that reality exists independent of the human mind's filters and beliefs, and is critical of our ability to know reality with certainty (Bhaskar, 1978). A qualitative approach is used to address the research objectives. The research design in this realism perspective was relatively exploratory, whereby the literature was explored step by step around the basic phenomenon, and attempts were made to answer the questions. Interviews were also used to provide answers regarding the current challenges and future prospects.

The main goal of the interviews was to obtain a broad a range of different viewpoints as possible. For this, purposive sampling (Patton, 2002) was used to ensure variation, since the prime goal was to have a spectrum of opinions on this matter. The samples selected were public sector Islamic finance professionals (PSP) working in SBP, Islamic banking professionals with expertise in Islamic finance (IBD), professionals from the Islamic insurance industry (IIP), academic experts of Islamic finance working in universities (UIS), and Islamic religious scholar (IRS).

Variation was sought through the inclusion of a variety of participants within the population from different organizations and positions. Purposive sampling is commonly used to select interview participants. In this method, researchers select their sample based on the purpose of the research and who in the population of interest would be the most informed or experienced in the topic area (Babbie, 2001). A total of 14 in-depth interviews were conducted. Interviews were conducted in an in-depth format with a few basic questions kept in mind. The advantage of this format was that it provides sufficient flexibility for the respondents to focus on what is important to them as it pertains to the research topic (Patton, 2002; Robson, 2002; Rubin & Rubin, 2005).

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- Academic experts of Islamic finance working in universities (UIS)
- Islamic religious scholars (IRS).

Project financing prospects in Pakistan

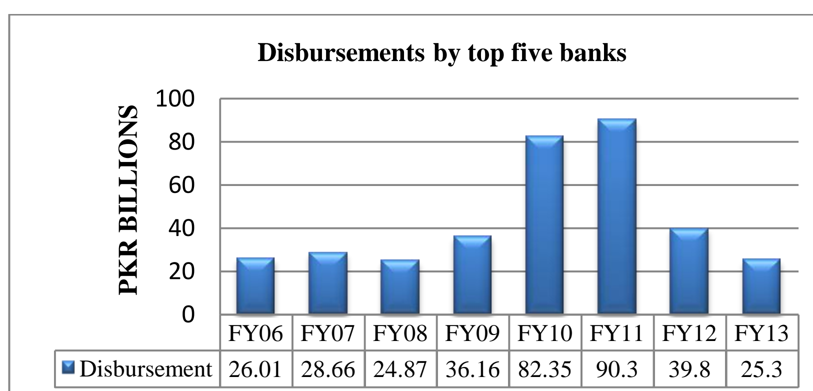
The social and economic development of a country mainly relies on infrastructure development. Countries which are better equipped with a developed infrastructure have better chances of prosperity and stability. Improving the quality and coverage of services in crucial sectors like power, water supply, sewerage treatment, transport and logistics are critical to Pakistan's economy and to improving the quality of life of its citizens. To have a clearer view of infrastructure and projects in Pakistan, this section provides some tables and figures representing project financing statistics during FY06 to FY13.

In FY06, disbursements by five top banks, Allied Bank Limited (ABL), United Bank limited (UBL), MCB Bank limited, the National Bank of Pakistan (NBP) and the Habib Bank Limited (HBL) totalled about Rs. 26 billion (Fig. 2), which then rose to Rs. 36.16 billion in FY09. The volume of disbursements reached Rs. 90.3 billion in FY11, which indicates that the banking sector has left behind seeking financing from the consumer section and felt that Islamic project financing was a viable option for its financing. In FY08, consumer financing decreased by 78% while in FY011 it further decreased by 380%. In FY 2012 and 2013 the disbursement by the five top banks were on a declining trend and decreased to Rs. 39.8 and Rs. 25.3 billion.

The decrease in disbursements in FY12 and FY13 was due to the low number of new projects initiated in these years. Less than 20 new

projects received a financial close in both these years, compared to 53 projects in FY11 alone. The majority of the initiatives were in the power generation sector. The private sector only participates in infrastructural projects when they have clear assurance of government support. The role of financial development institutions was also very disappointing (below 3%) during these years. There was very low (less than 2%) involvement of IFIs in project financing during these fiscal years.

Projects are financed through different modes by banks. This includes demand finance, term finance, running finance, letters of credit, bank guarantees etc. Term and demand finance are used for financing green field projects and the capacity building of existing projects. The need for working capital in projects is achieved by running finance while letters of credit are used for importing equipment and machinery for the projects.



	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13
Disbursement	26.01	28.66	24.87	36.16	82.35	90.3	39.8	25.3

Fig. 2. Disbursement of the top five banks in the project financing
Source: SBP- Quarterly Review of Infrastructural Financing 2006-13

Figure 3 shows the shares of various modes of financing used by banks in project financing in Pakistan during FY06 to FY2013. The most widely used mode of project financing is demand financing, which has a share of 43%. Term finance with 21% was the second on the list. While the share of running finance and letters of credit was 17.1% and 10% respectively. The share of the Islamic mode of financing and other bonds in the infrastructure sectors were extremely marginal.

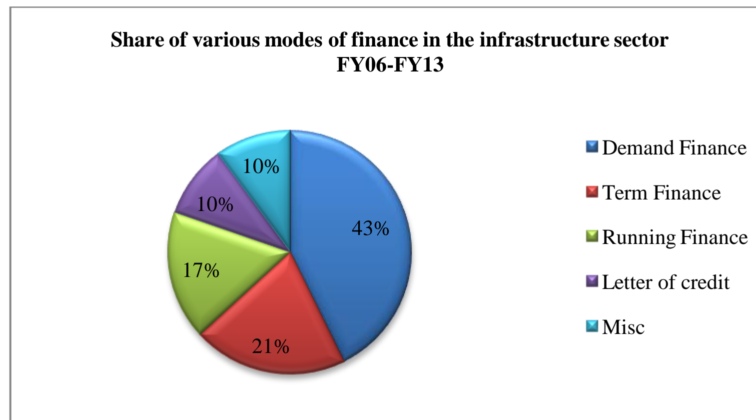


Fig. 3. Share of various modes of finance in the infrastructure sector FY06-FY13
Source: SBP- Quarterly Review of Infrastructural Financing 2006-13

Power, telecommunications and petroleum are the most vibrant sectors for project financing in Pakistan. Figure 4 shows that during FY06-13 these three sectors had the highest share in disbursements by banks. Power generation had the highest share with 44%. Petroleum and telecommunications were second and third with 20% and 16%, followed by power transmission, and the oil and gas sector with a less than 9% share. From FY06 to FY10, telecommunications and petroleum were the top two sectors financed by the banks. Due to the shortage of power supply in Pakistan, financing in the power sector was intensified and the share for power generation rose above 44% in FY13.

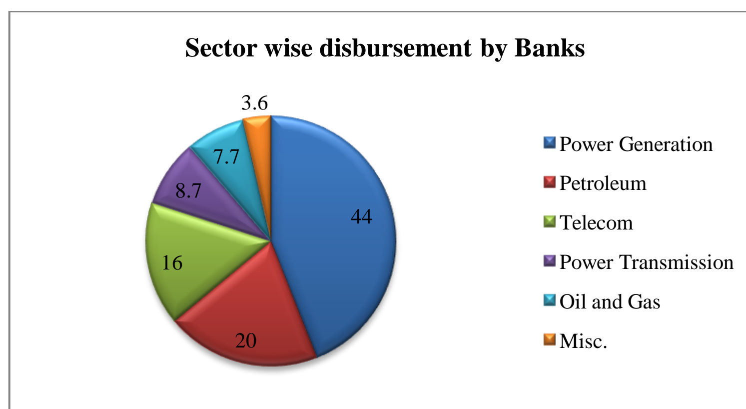


Fig. 4. Sector-wise disbursement by banks FY06-FY13
Source: SBP- Quarterly Review of Infrastructural Financing 2004-11

During FY06-13, as shown in Figure 5, the private sector banking share was 87% and was the major finance provider during all these years. The public sector banks' share was only 11% while DFI had an only 2% share of the total disbursement in spite of having a mandate for development finance. Islamic banks' share in this was almost negligible despite its growth in the last decade.

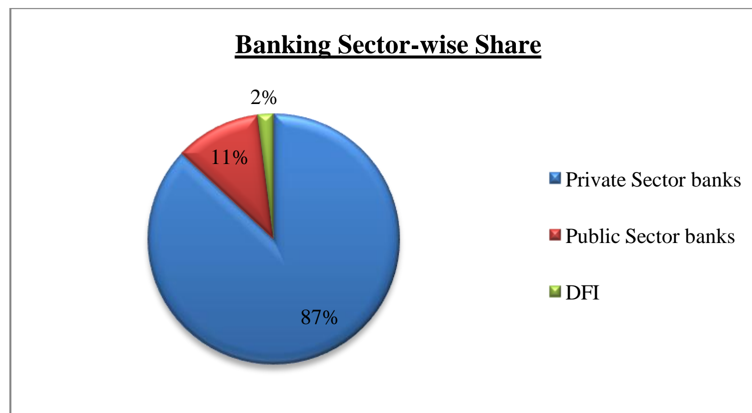


Fig. 5. Banking Sector-wise Share FY06-FY13

Challenges faced by Islamic project financing

This section addresses the research objective of understanding the current challenges of Islamic project financing in Pakistan, based on data extracted and analysed from interviews. There is a small number of challenges mentioned that must be overcome before any of the potential benefits can be realized. Challenges mentioned by the research participants were divided into 12 general categories mentioned in Table 1.

Islamic financial institutions have increased their presence in the global financial system either by opening full-fledged institutions or through Islamic windows in conventional banks. This rapid increase by IFIs requires a well-built regulatory system and this issue was raised by almost all the participants. The second major category that was raised was investment. To enter into infrastructural development, Islamic financial institutions need a large amount of capital. The percentages of other categories mutually agreed upon by all the research participants are shown in Table 1.

Table 1. The percent of research participants, by group and across the sample that brought up each of the categories of challenges

Challenges Category	PSP n=4	IBP n=3	IIP n=2	UIS n=3	IRS n=2	Total% n=14
Regulations	100	100	100	100	100	100
Investment	75	100	100	100	100	95
Standards and practices	75	66	100	66	100	81.4
Risk management	75	66	50	100	100	78.2
Benchmarking	75	33	100	66	100	74.8
Proper Training	50	33	50	100	100	66.6
Shariah Experts	50	66	50	66	50	56.4
Research	25	33	50	66	50	44.8
Rating criteria	25	66	0	66	50	41.4
Trust	50	66	0	66	0	36.4
Information	25	33	0	33	50	28.2
Public Awareness	0	0	0	33	50	16.6

All comments related to challenges were put into general categories; categories are ranked according to frequency, with categories receiving the most comments listed first.
PSP= Public Sector Islamic Institution Professional; IBP= Islamic Banking Professional; IIP= Islamic Insurance Company Professional, UIS= Universities Islamic Scholar, IRS= Islamic Religious Scholar.

Enhancing information transparency and minimizing regulatory arbitrage should be the next step towards acceptable Islamic financial standards and will surely lead towards harmonizing an Islamic regulatory system. There is a difference between the nature of Islamic and conventional financial products, and yet it is hard to make a regulatory structure for them and this proves to be an insuperable challenge to regulators. International regulatory authorities, supervisors and Islamic business leaders are required to maintain strong cooperation in providing roles and guidelines that help them in making regulatory frameworks, which help this sector to enter into the project arena.

Islamic banks and institutions not only operate under diverse regulatory regimes, but they also face differences in the views of scholars on different products. This disagreement among Shariah scholars on Shariah compliant products makes the job of regulatory agencies harder. Islamic finance is not only finance, it is much more than finance. It is a matter of Islamic identity and this identity can find a clear voice when it has a distinct regulatory structure.

One of the major challenges faced by IFIs in Pakistan is the lack of investment avenues, especially in the long term, though they also have a few problems in short-term investment as well. Islamic financial institutions are not allowed to invest in conventional interest-based instruments such as treasury bills and investment bonds. This limits the exposure of investment for IFIs and proves to be a key challenge for short- and long-term investment and liquidity management. A stipulation is that certain conditions of Islamic principles need to be adhered to while making decisions for investment. These conditions leave IFIs with the choice to depend on investing in asset-based products to generate return for their depositors.

Though these asset-based products are Shariah compliant, these products face heavy criticism from different critics due to their apparent resemblance to their interest-based conventional counterparts, especially in term of their returns. Instead of trade-based financing, critics demand a more Islamic means of investment in the form of equity-based financing on the basis of profit and loss sharing arrangements. IFIs are restricted by Shariah regulations from taking part in capital and money markets. These IFIs cannot take part in those trading shares or bonds of any company which deals in "Haram" business activities and generate their profit from alcohol, pork, and similar activities which are prohibited by Islam.

Despite the advantages of securitizations in IFIs products, international investors seem to be cautious in trading in the Islamic mode of financing due to its uncommon characteristics. IFIs are not recognized as central banks in non-Muslim countries because they have a marginal role in their economies. In the West, Shariah boards are not understood as being Islamic institutions and decisions are mostly made by Islamic scholars who are not bankers. Islamic banks have a very limited network as far as their outreach is concerned. Most Islamic financial tools are neither available to IFIs nor do they significantly contribute to the economies of these Islamic countries. So governments must back these IFIs so that they can grow inside the Islamic community. Currently, most Islamic banks are functional at a local and regional level. The only Islamic bank with more than 200 branches in 10 countries is Al Baraka Banking Group.

Significant information related to the principles and procedures

related to Islamic contracts is available in Islamic law which must be examined for Shariah compliance. However, the main problem arises when procedures and principles regarding a specific matter are not found apparently and therefore have to be derived from different fatwas. Sometimes the solution for these kinds of problems can be found from interpretations made by different Shariah scholars. Different fatwas on financial transactions are awarded by scholars and various authorities, which creates the problems of pluralism in Shariah interpretation.

In Islamic jurisprudence there are four main schools of thought, these are Hanafi, Maliki, Shafi'e and Hanbali. Each school of thought has its own interpretation of Islamic issues and scholars. These factors sometimes create conflicts and ambiguity on various transactions, and their compliance according to Shariah. In this context the Quran states:

"As for those who divide their religion and break up into sects, thou hast no part in them in the least: their affair is with Allah: He will in the end tell them the truth of all that they did." (Al-Qur'an, 6:159).

Harmonizing and standardizing the Islamic financial transaction across and within borders is no doubt a daunting task. A joint platform will be needed to make sure that all these transactions are accepted by all. At this stage it is extremely difficult to judge which financial product is closest to Shariah. If the Islamic financial industry wants to increase in its size and scope, then it has to rely on standardized policies and procedures. They also make sure that they spend less time in dealing with outliers, because the current trend in conventional financial markets is to move towards more commoditization and standardization.

The need to devise rating criteria for IFIs is of more importance than in conventional finance because within the industry, Islamic banks vary in terms of their procedures and operations. Islamic banks have special characteristics and profiles, which are believed to be recognized in their overall analysis and rating. Some features of Islamic institutions make them less risky while others make their profile riskier, so a rating methodology should be devised accordingly.

Opportunities

This section covers another research objective: to identify opportunities from the perspective of the research participant for an Islamic project financing. Opportunities mentioned by the research participants were divided into five general categories, which are mentioned in Table 2.

Table 2. The percent of research participants by group and across the sample that were brought up in each category of opportunities

Opportunities Category	PSP	IBP	IIP	UIS	IRS	Total%
	n=4	n=3	n=2	n=3	n=2	n=14
Islamic Market Development	50	66	50	66	50	56.4
Islamic funds	25	33	50	66	50	44.8
Social Responsible financing	25	66	0	66	50	41.4
Mergers of IFIs	50	66	0	66	0	36.4
Potential products	25	33	0	33	50	28.2

All comments related to opportunities were put into general categories; categories are ranked according to frequency, with categories receiving the most comments listed first.
PSP= Public Sector Islamic Institution Professional; IBP= Islamic Banking Professional; IIP= Islamic Insurance Company Professional, UIS= Universities Islamic Scholar, IRS= Islamic Religious Scholar

In the last decade as a result of the global financial crisis the Islamic capital market has been accelerated by Muslim and non-Muslim investors. International Islamic organizations were established in order to further develop the emerging Islamic capital market. Due to the global financial crisis in markets, Western investors are in need of an alternative system. The Islamic market provides the opportunity of having a stronger market with special characteristics, different from the traditional one. These conventional market investors also need to be linked together with other financial systems and this can be applied to Islamic capital markets.

As Islamic finance could perform an extremely efficient part in mobilizing deposits and offering funding in the West, the growth of an Islamic investment market will allow the business industry to source some of its funding needs. The growth of the Islamic investment market could be a part of the international investment market because it will contribute to the performance of mobilization and allowance of sources worldwide. It is critically important at this stage to promote the benefits of IFI's instruments in the Western world and portray this

sector as the best alternative for their financial transactions. This may draw the interest of Western businessmen and investors in Islamic financing.

The primary Islamic market is performing better and is predicted to grow but the secondary Islamic market needs attention. A sustainable and energetic secondary market encourages and promotes the functions of the primary Islamic capital market. Only 5% of low-income people globally have access to banking services. Islamic financial institutions, through microfinance, will help accomplish a higher economical addition, which is one of the essential pre-requisites for developing a healthy and maintainable financial growth.

Furthermore, public sector participants groups mentioned that the Islamic market has potential in the Halal food industry. Currently, the global Halal meal market has a worth of more than US$650 million and is expected to grow by 20% in the long run. The Halal food market should integrate the Islamic financial market in its processes.

Sukuk are certificates of equal value in which the bond holders have ownership in tangible assets or in the assets of projects or in some special investment activity. The basic difference between the conventional and Sukuk certificate is that the Sukuk holder has the ownership of a real asset while the conventional bond holder owns a debt. The Sukuk bond has proved itself useful for financial market developers, governments and infrastructural projects. Due to the potential in the Sukuk market and its attractive features, the State Bank of Pakistan issued Rs.50 billion Sukuk in 2011.

Shariah compliant products can bridge the needs of Western investors, with an emphasis on social justice, wealth preservation, sustainable development, human values and benefits to mankind. Islamic finance is a system of moral investing that is becoming popular in investing groups all over the world. Using the concepts of Islamic law, of which the prohibition of interest is just one, Shariah advisors supervise the whole procedure.

Mergers and acquisitions (M&As) in different conventional institutions are very common in practice. With this in mind, our respondents highlighted an opportunity for IFIs to work on a large scale as mergers of IFIs or to make a consortium for project financing. These mergers can be done domestically as well as internationally.

IFIs can achieve the benefits of economies of scale through M&As. Mergers in IFIs will initiate fast growth and institutions become more powerful and new technologies will be made available to them. These mergers also increase the range of products provided by IFIs in the global market. This will definitely help them to build a market space for themselves.

Conclusion

The focus of this study was to investigate the role of Islamic finance in financing infrastructural development projects. This investigation was done through using existing literature, in depth interviews and project financing reviews in Pakistan.

IFIs exist both in Muslim and non-Muslim countries. The potential growth of IFIs is quite possible as an alternative financial system; however, there are some challenges that must be addressed to expedite the growth. These challenges include but are not limited to Islamic finance regulations, investment margins, standards involved in financing practices, risk management practices, research and development, and expertise. Parties new to Islamic project financing face risks compared to conventional project financing, but they need to know what the risks involved are.

Furthermore, Islamic project financing has opportunities in terms of its market and fund development, and expansion in Islamic products. The Islamic financial system has so far been able to gain a very small share of the global financial market and, even if it operates perfectly as desired by the Shariah, it may not be able to create a significant impact on the international financial system in the near future. This will be more effective if it implements the system seriously and sincerely in its own countries to practically establish its effectiveness in promoting financial health and stability.

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