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COMPARATIVE ANALYSIS OF ISLAMIC AND CONVENTIONAL BANKS IN THE UAE DURING THE FINANCIAL CRISIS

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ABSTRACT

The discourses of Islamic and conventional finance differ according to the principles of Islamic finance there is no separation of the spiritual and the secular. Islamic finance is explicitly concerned with spiritual values and social justice, in contrast to conventional finance, which is based on the maximization of individual utility, welfare and choice, as expressed for example in the shareholder value model. Islamic and conventional banks respond differently to financial shocks. This study analyses the performance of Islamic and conventional banking systems in the UAE during the financial crisis. The study was undertaken in two stages, first a comparative analysis one Islamic and one conventional banks from 2007 until 2008. Secondly, a cross sectional analysis, between the Islamic (8 banks) and conventional banking sector (43 banks) that operated in the UAE during the period 2007-2008 was undertaken.

Keywords: Islamic finance, Banks performance, Banking stability and risk management.

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Contribution/ Originality

This study contributes in the existing literature and help to the understanding of Islamic finance principles and its value as a solution to the current and any future financial crises. The findings of this research will be of interest to conventional and Islamic financial practitioners, policy makers and academicians.

1. INTRODUCTION

The discourse of Islamic banking involves: (a) equity rather than debt, (b) financing in strict relation to assets rather than leverage, (c) transparency and information sharing between investor and the manager, (d) diversification of risk by risk sharing. In contrast, the discourse of conventional finance failed as a result of: (a) too much debt, (b) overleveraging of assets and (c) excessive securitization and creation of new assets that were neither transparent nor understood.

The focus of this research paper is to evaluate and compare the performance of Islamic and conventional banks during 2007-2008 in the UAE. The study compares the two banking sectors, in terms of; capital adequacy, profitability, liquidity and leverage. Analyzing different bank's performances during the financial crisis allows for an assessment of the bank's capability to withstand shocks and depressions (stress test).

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The banking industry in the UAE is well developed. The UAE Central Bank was established in 1973, in the early stages it operated under the name UAE currency broad. In December the 10th 1980, as per union law, The Central Bank was formed and was given broader authorities in terms of the monetary system and supervision of banks. The rapid growth in the UAE's economy is reflected also in the growth of The Central bank's activities such as but not limited to: credit, foreign assets, capital and shares. Figure 1: below illustrates the progress in different activates by The Central Bank of the UAE from 1980 to 2007.

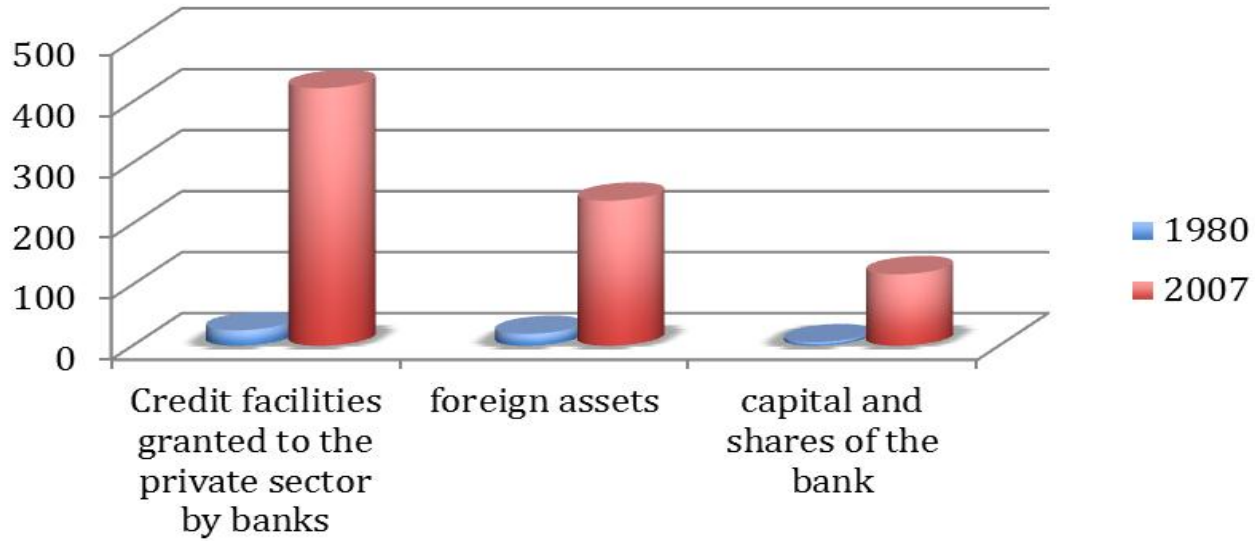

Figure-1. The Central Bank's activities

Source: Central Bank of the UAE Data 2008

UAE government established the first federal law regarding allowance for Islamic banks activities in 1985. Table 1: below demonstrates the coverage of the banking system in the UAE as of October 31st 2012.

Table-1. Banks in the UAE

Type of financial institutions in the UAE	Headquarters in the UAE	Number of branches in the UAE
UAE national banks	23	922
Gulf countries banks	6	1
Foreign banks	22	136
Business banks	4	-
Offices of international banks and financial companies	113	-
Financing companies	25	23
Investment finance companies	23	25
Exchange companies	120	677
ATM machines	4346	-

Source: Central Bank of the UAE Data 2012

1.1. Islamic Financial System

One of the key differences between conventional and Islamic banking is the ban on Riba (usury); riba is any return/addition/increase for the use/rent of money. Islamic financial institutions must "trade" in real assets or services. There are several reasons for the prohibition of riba such as Unjust; a contract based on interest involves injustice to one of the parties, the lender or the borrower. Penalizing someone for default is unjust; a judge should decide the amount of any compensation for a default, not the party to whom the debt is owed. Qur'an (2:279) *"clearly states that taking an amount in excess of the principal would be unjust"*. And Implies Unlawful Appropriation of Other People's

Property; Interest on money is regarded as representing an unjustified creation of instantaneous property rights. It is unjustified, because interest is a property right claimed outside the legitimate framework of recognized property rights.

1.1.1. Non Riba (Usury) Finance

Islam has always emphasized the importance of risk sharing system which has a number of (competitive) advantages over the system of based upon pre-determined interest rates. We can innumerate some standard properties of riba finance according to Islamic finance scholars as follows:

Inefficiency

- Interest results in an inefficient allocation of resources since the investible funds go to the more creditworthy borrowers rather than to more productive projects.
- Debt finance based on predetermined and guaranteed rates of return on money has unlinked capital movement from the production processes it is supposed to finance.

Money verses real market

- Money creation in a system of debt finance is based on lending, which makes it prone to oversupply, as there is no direct linkage between additional production and additional money supply.

Public sector

- Public sector borrowing, when it is not backed by tangible assets, raises a debt burden for future generations. Islamic asset-backed financing does not constitute a debt burden as assets are available which can be liquidated to repay the debts.

Price level

- Inflation will be minimal (under an Islamic finance system) as the money supply will be correlated to economic activities.

Islamic finance encourages individuals to share business risks in return for reward with the understanding that the level of the expected reward is related to the level of risk. What is condemned in Islamic banking is the notion of a risk free reward or return which is in contrast to conventional banking principles. Islamic banking principles do recognize the time value of money but provided that profits are earned through trade and not on lending money. The distinguishing factors between Islamic from conventional banking are:

- Gharar (uncertainty): Any contract based on a future of uncertain event within Islamic banking is not generally allowable this includes dealing in conventional derivatives and options.
- Maysir (gambling): Speculative mentality transactions creating towers of debt based on speculation.
- Halal business: Islamic (Sharia) law prohibits dealing in some products or activities e.g. pork, interest based finance, debt, gambling, alcoholic liquor...etc.

2. LITERATURE REVIEW

Parashar (2010) compared selected conventional and Islamic banks on five performance parameters; capital adequacy, efficiency, profitability, liquidity and leverage. Their analysis suggests that during the crisis Islamic banking, were impacted more in terms of capital adequacy and leverage while conventional banking more in terms of return on average assets and liquidity. For full year analysis the study found that Islamic banks performed better than conventional banks for the period 2006-2009. The study suggests that Islamic banks did suffer during crisis in terms of lowering of *CAR*, *E/TA* and *ROAE*.

Loghod (2008) compared the financial performance (profitability, liquidity and structure) of Islamic and conventional banking from 2000 - 2005. The study found no significant differences in terms of profitability. However, the key differences found were; Islamic banks are less exposed to liquidity risk, and conventional banks depended more on external liabilities than Islamic banks.

Zaki (2012) looked at the following two interrelated research issues: Identifying and explaining the determinants the financial turmoil in the UAE's financial markets and evaluating the impact of the UAE's government bailouts on the UAE's economy in the short and long run. The findings were that the government saved the troubled banks through bailouts and drawing down FXRES (Government economic activity). The timing of the increase in the ratio of leverage risk measures of the banking system and reserve adequacy (liquidity risk) of the UAE's economy is consistent with the model's prediction that the government's bailouts and foreign reserve policy played a crucial role in reducing the adverse reaction to the financial crisis in 2007 - 2008. These developments significantly contributed to the positive expectations in the market. The result was survival of the banking sector with the confidence of market participants intact.

Beck *et al.* (2010) observe that Islamic banking have lower overhead costs and cost-income ratio and higher returns over asset but capital asset ratios is smaller. Islamic banks have higher fixed asset ratio and lower non-interest earning asset ratio. Maintaining a high fixed asset ratio implies that the Islamic banks are managing their assets more efficiently and profitably than conventional banks.

Viverita (2010) analyzed the performance of Islamic compared to conventional banks in Indonesia. Different ratios were used and they found that the cost efficiency ratios were lower in Islamic than the conventional banks in addition the revenue and profit efficiency ratios were higher in Islamic banking. Also the Islamic banks net interest margin (NIM) have maximum of 0.182, while conventional banks have 0.097. Furthermore, the operating income to average asset in conventional bank was 0.006 while in the Islamic bank the mean was 0.013. Islamic banking is generating higher income from its asset, which is a positive indicator of revenue efficiency performance in Islamic banks.

Mobeen *et al.* (2011) studied the top 10 Islamic and conventional banks performance during the financial crisis, they found that the aggregate net profit for the conventional banks observed a drop while Islamic banks experienced an increase in their net profit in the same period. Moreover, the leverage ratio (asset/equity) for conventional banks increased from 16.6% in 2006 up to 18.2 in 2008, however, Islamic banks leverage ratio was 5.8 in 2006 boosted to 6.6 in 2008. The leverage ratio measures the firm's long term solvency, the ability to meets its obligation, as the leverage ratio is smaller it means that the firm is using less debt.

Rashwan (2010) assessed the performance of Islamic and conventional banks from 2007 to 2009 in terms of return on asset and on equity, net loan to total asset and loan loss reserve to gross loan. They used data from 46 Islamic banks and found that Islamic outperformed conventional bank in 2007, but in 2008 there was no significant difference between the two banking systems. However, conventional outperformed Islamic banks in 2009. they summarized that although there was no significant difference in terms of performance in 2008, the financial crisis impacted both banking systems, yet the impact on Islamic banks was limited to a decline in returns.

Toumi *et al.* (2008) studied the performance of Islamic and conventional banks in the period 2004 - 2009 in terms of profitability, leverage ratios, return on asset/equity, net margin, dividend payout, total debt to common equity, long term debt to common equity, total debt to total asset and the size of the bank asset they used a sample of 50 Islamic and 59 conventional banks from 18 countries. Their findings is that Islamic have lower debt to equity ratio than conventional banks, 7.8 times and 11.48 times for Islamic and conventional banks respectively. Islamic banks rely more on shareholder capital, unlike conventional banks which relies more on debt to structure the bank. Moreover, in terms of profitability, they found that Islamic have higher ROA than conventional banks and lower debt

to asset ratio than conventional banks, in terms of long-term debt to common equity. The study found significant difference between Islamic and conventional banks; Islamic banks have lower debt to asset ratio than conventional banks. The findings can be interpreted that Islamic banks have lower leverage than conventional banks.

3. RESEARCH METHODOLOGY

This research implemented a case study and cross sectional analysis on Islamic and conventional banks during the years 2007 and 2008 in the UAE. The purpose of this analysis is to determine which banking system has adequate performance and was more stable during the financial crisis in terms of capital adequacy, profit, liquidity, and leverage. The case study analysis was executed on two chosen banks, Abu Dhabi Islamic Bank (ADIB) and Abu Dhabi Commercial Bank (ADCB) for the period 2007 and 2008. There are several reasons for the choice of these two banks, the study focus on local banks to measure accurately which of the two banks sectors, Islamic or conventional, performed adequately. Secondly, the two banks are suitable for analysis in terms of asset size. Thirdly they both have a large market share, and both banks have a wide coverage in the UAE, ADIB have 69 branches and ADCB has 48 branches in the UAE. Moreover, both banks were established in 1997, putting these two banks at relatively the same phase in their business cycle.

A cross sectional analysis was conducted for the period 2007 - 2008. The purpose of this analysis is to observe the performance of the whole population of the two systems, Islamic and conventional. Executing a cross sectional analysis between Islamic and conventional banks provides a macro representation of the performance of the two banking sectors in the UAE. Additionally, this is a pioneering research topic since all previous research papers focused on the aggregate performance of Islamic banks in the GCC countries.

Financial ratio analysis has been executed to assess the performance of Abu Dhabi Islamic Bank (ADIB) and Abu Dhabi Commercial Bank (ADCB). Balance sheet and income statement for both banks in year 2007 and 2008 have been obtained as a resource for the financial ratios analysis. The following ratios were observed return on asset and on equity, asset utilization, profit margin, liquidity, debt to equity ratio and equity to net loan ratio. For the cross sectional analysis, similar ratios where observed to determine which financial system performed better during 2007-2008 in terms of capital adequacy, profitability and liquidity. Several ratios were added in the cross sectional analysis including; tier one, nonperforming loan ratio, liquid asset to total asset, loan to total asset and loan to total deposit ratio.

To measure Islamic and conventional banks' performance during the financial crisis several financial ratios have been used. These financial ratios are: capital adequacy ratio, profitability ratios, return on asset ratio (ROA), return on equity ratio (ROE) & nonperforming loan ratio (NPL), liquidity ratio, the current ratio, liquid asset to total asset ratio, loan to total asset ratio, loan to total deposit ratio (LTD), profit margin ratio (profitability), asset utilization ratio (efficiency), leverage and insolvency ratios & debt to equity ratio.

There are various ways in which the liquidity, leverage and profitability of the banks can be studied. Using ratios as financial performance indicators for banks is a commonly used tool in the financial studies. The common way of measuring the financial performance of a bank is to calculate its ratios and compare it with the past to make interpretations (Cornett *et al.*, 2011) and Oberholzer and Westhuizen (2004). The following ratios will be used as a framework for analyzing;

- *Liquidity:* Liquidity ratios measure the ability of the bank to meet the short term financial obligations. Most commonly three ratios are used to measure the liquidity of the bank; loan to deposit ratio, cash & portfolio investment to deposits and loan to total assets.

- *Profitability*: The earnings ratios or the overall profitability ratios indicate how efficient the concern is in utilizing the assets. For the purpose of measuring; profitability return of assets, return on equity and earning per share have been taken.

4. FINDINGS

First in in terms of generating profit from asset, in 2007 Abu Dhabi commercial bank (ADCB) has a higher percentage compared to Abu Dhabi Islamic bank, (ADIB) 1.96% and 1.7% respectively. There is a decrease in ROA in 2008 for ADCB almost 0.919% and for ADIB 1.6%. This fact could be a result of the reliance of Islamic banks on real assets as Sharia encourages owning real assets rather than derivatives. This can be interpreted as the financial crisis impacting conventional banks more in terms of generating revenue from assets because there is a sharp decline in ROA for ADCB in 2008. The findings for the analysis is different to Rashwan (2010) where the researcher concluded that there is no difference in the return over asset between Islamic and conventional banks in 2008, the financial crisis impacted on both Islamic and conventional banks. The observation in the UAE is different since Islamic banks have higher ROA than conventional banks in 2008. In our case we notice a higher impact of the financial crisis on Abu Dhabi commercial bank than Abu Dhabi Islamic bank in terms of profitability and ROA. The findings are in line with Toumi *et al.* (2008) which they suggested the ROA for Islamic banks, is slightly higher than

conventional banks. The results also support (Sehrish *et al.*, 2012) whose finding were identical regarding the profitability of Islamic banks being higher compared to conventional banks between 2007 to 2008. From the ROA of both banks it can be interpreted that Islamic banks reliance is on real assets, tangible rather than financial instruments, which is why Islamic banks maintain a higher ROA than conventional banks. The conventional bank purchased different types of assets such as financial derivatives, that is why they were adversely affected by the crisis.

Table-2. ROA for ADIB and ADCB

Banks	**ADIB**		**ADCB**	
Years	2007	2008	2007	2008
ROA (%)	1.7	1.6	1.96	0.92

Source: ADIB & ADCB Balance Sheet 2007 - 2008

In terms of return on equity there is a remarkable increase in return on equity holdings of Islamic banks compared to conventional banks. Significant increases in ROE during the financial crisis evidences the sustainability of the Islamic banking system. From an investor perspective, investing in Islamic banks is safer and more certain in terms of return. ADIB had ROE ratio 14.2% and 15.1% in 2007 and 2008 respectively. However, ADCB's return over equity was decreased compared to ADIB 18.2% and 8.53% in 2007 and 2008 receptivity. The increase in ROE for Abu Dhabi Islamic Bank is a very significant indicator that can be interpreted that the Islamic banking

System provides adequate return for shareholders even in financial crisis compared to the conventional banking system. The finding is in line with a (Toumi *et al.*, 2008) which concluded that Islamic banks maintain a slightly higher ROE relative to conventional banks during the financial crisis.

Table-2.1. ROE for ADIB and ADCB

Banks	**ADIB**		**ADCB**	
Years	2007	2008	2007	2008
ROE (%)	14.2	15.1	18.2	8.53

Source: ADIB & ADCB Balance Sheet 2007 - 2008

In terms of efficient asset utilization, the financial crisis has impacted both financial institutions. The asset utilization of both banks decreased, for ADIB the asset utilization decreased from 6.5% to 5.9% in 2007 and 2008

respectively. On the other hand ADCB's decreased from 3.5% to 2.9% in 2007 and 2008 respectively. Although the financial crisis impacted both banks, Islamic banks have higher asset utilization percentage than conventional banks. The findings of the analysis is different than the results produced by Sehrish *et al.* (2012) which determined that asset utilization for Islamic banks was lower than conventional banks during the financial crisis in Pakistan. In the UAE asset utilization in Islamic banks during the financial crisis decreased but it was higher than conventional banks.

Table-2.2. Asset Utilization ratio for ADIB and ADCB

Banks	**ADIB**		**ADCB**	
Years	2007	2008	2007	2008
AU (%)	6.53	5.94	3.5	2.99

Source: ADIB & ADCB Balance Sheet 2007 - 2008

ADCB in year 2007 had a higher liquidity ratio than Abu Dhabi Islamic Bank 34.5% and 9.27% respectively. Yet, in 2008 Abu Dhabi Islamic Bank exceeded Abu Dhabi Commercial Bank with a high percentage of liquidity 10.14% and 6.20% respectively. There is a decrease in the liquidity ratio for Abu Dhabi Commercial Bank, yet Abu Dhabi Islamic Bank's liquidity ratio increased between 2007 and 2008. This finding demonstrates that Islamic banks maintain an adequate level of liquidity compared to conventional banks during the financial crisis. This finding is in line with Ika and Abdullah (2011) who conclude that there is a significant difference, Islamic have better liquidity ratios than conventional banks. When the bank maintains high liquid asset, as a result it will have a high liquidity ratio, so the bank can mitigate liquidity risks.

Table-2.3. Liquidity for ADIB and ADCB

Banks	**ADIB**		**ADCB**	
Years	2007	2008	2007	2008
Liquidity (%)	9.27	10.14	34.5	6.2

Source: ADIB & ADCB Balance Sheet 2007 - 2008

In terms of leverage, the result of the analysis illustrates that Abu Dhabi Islamic Bank has a lower percentage of total debt to equity compared to Abu Dhabi Commercial Bank which was 7.1% and 8.3% in 2007 respectively. Moreover in 2008, although Abu Dhabi Islamic Bank increased its ratio to 8.0% Abu Dhabi Commercial Bank decreased to 8.28%, Abu Dhabi Islamic Bank maintained a lower ratio during the financial crisis. The result of the analysis is in accordance with previous research papers conducted by Toumi *et al.* (2008) that accomplish the same result; Islamic banks have lower debt to equity ratio compared to conventional banks. This demonstrates that the Islamic banking system is less risky compared to the conventional bank system. The low leverage ratio for Islamic banking indicates that, an Islamic bank is better at absorbing shocks in financial crisis, implying that Islamic banks are safer in the financial crisis.

Table-2.4. Debt to equity ratio for ADIB and ADCB

Banks	**ADIB**		**ADCB**	
Years	2007	2008	2007	2008
Debt to equity ratio (%)	7.12	8.08	8.3	8.28

Source: ADIB & ADCB Financial Statement Sheet 2007 - 2008

4.1. Cross Sectional Analysis

Figure 2 below describes the total assets of Islamic and conventional bank percentage to the UAE's GDP in 2007-2008. The graph shows the conventional banks total assets decreased from 109.7% to 106.3% in 2007-2008 respectively. On the other hand Islamic banks experienced an increase in its total asset from 18% to 19.7%. The

increase in Islamic banks total asset to the UAE GDP is slight but it is significant in the specified years since most conventional banks experienced a decrease in their total asset to the UAE GPD.

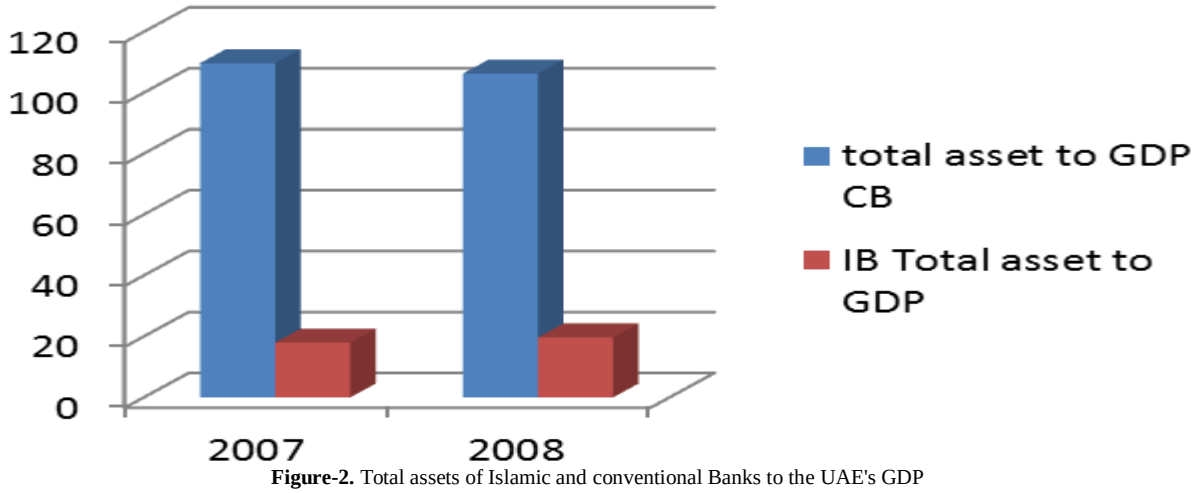

Figure-2. Total assets of Islamic and conventional Banks to the UAE's GDP
Source: Central Bank of the UAE Data 2007 - 2008

Figure 3 illustrates the market share for Islamic and conventional banks in the UAE during 2007-2008. As the graphs shows, conventional banks have more market share in the UAE than Islamic banks but during the period under study Islamic banks experienced an increase in their market share from 14.2 to 15.7 billion, conventional banks market share decreased from 85.8 to 84.3 billion. There was a very small in increase the market share of Islamic banks in the UAE, but compared to conventional banks it is a positive indication of Islamic banks resilience in shocks.

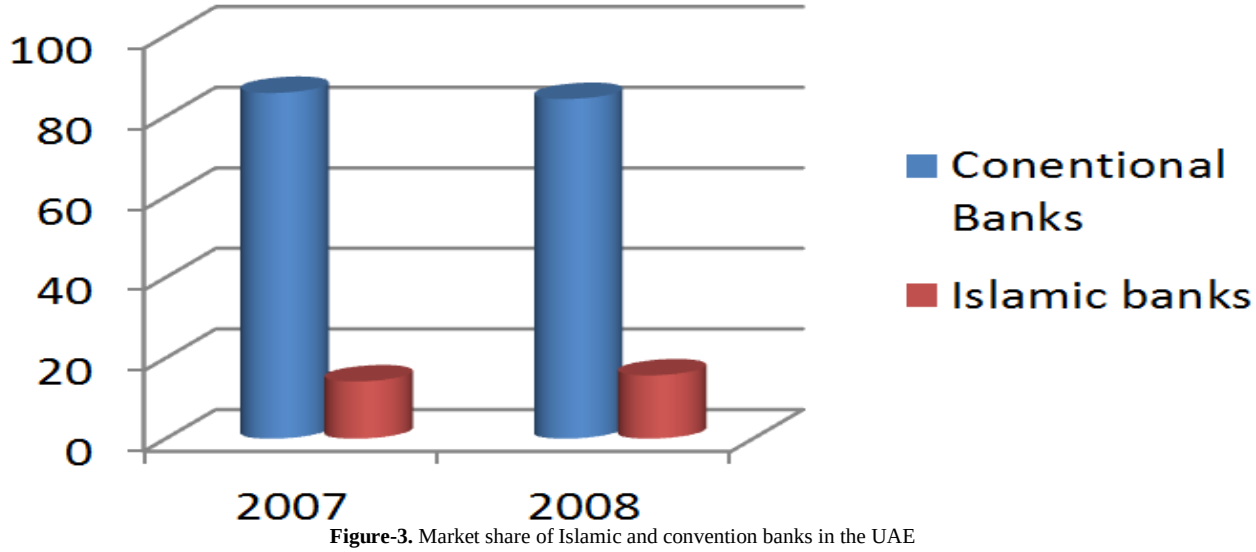

Figure-3. Market share of Islamic and convention banks in the UAE
Source: Central Bank of the UAE Data 2007 - 2008

4.2. Profitability

In the cross sectional analysis, the return on assets for Islamic and conventional banks were both impacted by the financial crisis. ROA for Islamic and conventional bank was 2.2% and 2.0% in year 2007 respectively. The following year both banks ROAs have decreased to 1.4% and 1.9%, Islamic and conventional bank respectively. Moreover in terms of return on equity, both banking systems in the UAE experienced a decrease, for Islamic it decreased from 18% to 12.5%. Conventional bank also had a decrease in return on equity from 21.7% to 18.2%. This finding is not in

line with the previous research project done by Viverita (2010) which finds that Islamic banks have higher ROA and ROE than conventional banks in the year 2007 and 2008.

In terms of nonperforming loans, both banks had an increase in their ratios but conventional bank have a higher number of nonperforming loans than Islamic banks. It increased from 18.8 to 20.8 billion UAE dirhams for conventional banks, while for Islamic banks it increased from 2.1 to 4.6 billion UAE dirhams. This is a significant finding, as according to Hanif *et al.* (2012) findings a high nonperforming loan ratio is a major contributor to liquidity risk.

The result shows that Islamic banks execute good credit analysis, low nonperforming loans ratio explains that Islamic banks were more conservative in expanding their capacity in lending. The low NPLs ratio indicates that Islamic banks restrict their lending activities, which as a result mitigating the liquidity risk.

4.3. Liquidity

In terms of liquid asset/total asset ratio, Islamic banks maintained higher ratios than conventional bank during the two years. In 2007 Islamic banks liquid asset to total deposit were 22.7% and for conventional banks it was 11.3%. The following year there was a decrease in both banks liquid asset/total asset ratio, which suggest that the financial crisis impacted on both sectors, yet Islamic banks maintained a higher ratio than conventional banks, 17.3% and 4.1% respectively. The analysis demonstrates the solid structure of assets in Islamic banks, since it maintains a higher liquid asset to total asset ratio. Maintaining a high liquid asset to total asset ratio implies that Islamic banks are safer in terms of liquidity, which leads the Islamic bank to avoid the main problems that spread in financial crisis, which is illiquidity.

In terms of loan to total asset, Islamic banks have a higher ratio in 2007, 62.2 and conventional banks had 56.8. In 2008 Islamic and convectional banks increased their ratio 66.7 and 68.4 respectively. The result indicates that Islamic banks in 2007 were relying more on loans to generate profit income (Murabaha and Musharaka) than conventional banks. However, in 2008, the conventional banks experienced a steeper increase in the ratio of loan to total asset, which indicates that conventional banks were relying more on loans to generate income. As the bank maintains lower loan to total assets, it means the bank is diversifying its asset portfolio. The finding is not in line with results accomplish by Fayed (2013) who concluded that conventional banks outperformed Islamic banks between the year 2008 to 2010 in terms of loan to total asset in Egypt.

Loan to deposit ratio shows an increase for both banks between 2007 and 2008, from 87.0 to 90.5 for Islamic banks. Conventional banks achieved a higher loan to deposit ratio it was 98.6 and 110.7 respectively in the two years. This finding suggests that both banks increased their lending activities, however, conventional banks maintain a higher loan to deposit ratio (LTD). As the bank recorded a high LTD ratio it indicates that the bank is using more of its deposits to lend which can expose it to liquidity risk. The fact that Islamic banks maintain lower LTD ratio, could be interpreted as Islamic banks are less risky in terms of liquidity than conventional banks in the UAE during the financial crisis.

5. CONCLUSION

The financial crisis has impacted the global banking system around the world, yet Islamic banking has been displaying better performance. Particularly in the UAE, the performance of Islamic banks has shown competitive enhancement compared to conventional banks in the period 2007-2008. The study finding reveals the following: Firstly; on macro level analysis both banking sectors were impacted negatively by the crisis as evidenced by the decrease in terms of ROA and ROE. This finding is supported by previous research by Rashwan (2010) that there is no significant difference between Islamic and conventional banking in terms of ROA.

In terms of the cross sectional analysis, the market share and total asset of the Islamic banking industry maintains a higher percentage compared to conventional banks. Secondly; the analysis reveals that Islamic banks preserve a higher percentage of liquidity than conventional banks in the UAE during the financial crisis. Thirdly; in terms of non-performing loans, Islamic banks maintain a lower percentage than conventional banks, which can be translated as a good quality, credit screening conducted by Islamic banks.

Overall, the effect of the financial crisis was limited on Islamic banks; Islamic banks were affected in terms of ROA and ROE mostly. In terms of mitigating liquidity risk and insolvency, Islamic banks were outperforming conventional banks as Islamic banks managed to have a high percentage of liquid asset. As a result the Islamic banks were less likely to have liquidity problems and bankruptcy declarations, because they are not allowed practicing banking activity that was directly linked with debt instruments.

The Islamic approach emanates from a foundation set of ethical principles. therefore discussion of Islamic finance in connection with global financial practices introduces an ethical dimension that is welcome. Khan (1986) believes that Islamic finance potentially has appeal for the mainstream as well as Muslim consumers because of its ethical basis: "*Islam teaches us that money should be channeled toward the 'real' economy, the production of real goods and services and not the 'financial' economy such as hedge funds and derivatives*," he argues, "*It keeps us in touch with the real economy and away from speculation and Islamic system of finance might create a more stable world financial market* "[i].

The real roots of the financial crisis are in the attempt to construct a financial system, a materialist heaven, in denial of limitation and mortality that are the realities of living in time and space. The promise was unbounded exponential growth, extending infinitely to a paradise of consumption.

Would Islamic finance based on profit and loss sharing, if adopted universally, avoid such sequences of events? The answer is probably: yes[1]. The financial authorities in the USA and the UK are not forthcoming about how they have computed stress tests, using the ratio TCE/TA (tangible common equity /tangible assets). A 4% ratio is equivalent to 25 times leverage of assets (holding of business and other debt as a proportion of bank equity). Immediate pre crisis levels of leverage were very often more than twice this level. Equity based system and profit/loss sharing based on tangible assets would clearly more than meet this criterion, on reasonable assumptions about the contribution of enterprise. Equity would provide the buffer against failure. Overoptimistic estimates of the value of enterprise would be problematic though, and Islam has not developed bankruptcy laws, so failure could be diffused and not confined to the original investment partners.

We could cite a number of Quranic messages: that *God does not change the condition of a people until they change their own inner selves" (*Quran 13:11*)*; *Mankind was created as one nation, but they became divided because of differences among them"* (Quran 10:19*)*. We are reminded of *Al Fatiha* and *al-rrahmani al- rraheemi*, most Gracious, most Merciful. *Illa an yashaa*, if God so wills (Quran 18:24-25). Let's see.

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Contributors/Acknowledgement: All authors contributed equally to the conception and design of the study.

[1]Chapra (2008). emphasizes that since the current architecture of the conventional financial system has existed for a long time, radical structural reform of the kind that the Islamic financial system is unlikely. He suggests some movement in that direction may be possible but does not discuss inertial factors which we think are likely to be overwhelming in the near future. Current discourse is dominated by what we have called Chicago thinking: the lure of bonuses and the political power of the financial sector is immense and destructive.

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Appendix

Conventional Banks				
Year	**Profit (million)**	**Profit Growth (%)**	**Market Share**	**Asset (%) to GDP**
2007	20751	28.1	85.8	109.7
2008	23423	12.9	84.3	106.3

Islamic Banks				
Year	**Profit (million)**	**Profit Growth (%)**	**Market Share**	**Asset (%) to GDP**
2007	3695	49.5	14.2	18
2008	3102	-16	15.7	19.7

[i] Mark Tran Monday May 27, 2002; Guardian. UK.