

# The Performance Measures of Islamic Banking Based on the Maqasid Framework<sup>1</sup>

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## Abstract

It has been taken for granted that Islamic banking (IB) is only about avoiding riba. The objectives of Islamic banking have not been formally addressed. As such, the present conventional performance yardsticks being used by IB have focused largely on financial measures. Hence there is a need for developing other performance measures that would complement the financial objectives of IB. This paper therefore proposes the objectives of IB from the theory of Maqasid al-Shari'ah and, derives a model of IB performance measures based on these objectives. A behavioral approach operationalization method (Sekaran, 2000) is used to quantify the Maqasid into measurable IB performance indicators that are later used for testing on a sample of six Islamic banks. The banks are evaluated and ranked at three levels based on their: 1) performance ratios, 2) performance indicators and 3) the overall Maqasid Index.

**Key words:** Maqasid al-Shari'ah, Operationalization,., Simple Additive Weighting (SAW) Maqasid Index.

## 1.0 Introduction

Why has IB come into existence? The obvious answer, apparently, would be that banking as a financial institution has become so vital to almost all modern economies that governments, firms and individuals cannot afford to do without it. Governments use banks - especially the central banks, among others, to regulate and supervise the health of their economies. Firms and individuals rely on banks for savings, investments and the purchase of goods and services. Modern banks through financial intermediaries are central to the activities of the product and factor markets. The rapid changes in government regulations, technologies and financial innovations due to globalization have resulted in more banking facilities. Such facilities include the provision of banking services through electronic channels, namely Automated Teller Machines (ATMs), PC banking, phone banking, banking kiosks, credit cards, debit cards and prepaid cards to mention but a few. These changes have revolutionized the way people raise and use their money.

The first experiment of the modern IB is the Mit Ghamr bank in Egypt, established in 1963. The bank lasted for only 4 years until 1967 (Ready, 1981) as cited by Ariff (1988). Compared to the conventional banking, which has been around for over 900 years,

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<sup>1</sup> This paper was presented at the IIUM International Accounting Conference (INTAC IV) held at Putra Jaya Marroitt, 25 June 2008. The paper won the best paper award for the Conference.

modern IB is only 32 years old since the establishment of the first bank, the Dubai Islamic Bank in 1975. However, the expansion and performance of IB within this period has been remarkable in spite of operating in a competitive environment alongside its conventional counterpart. A few statistics may be necessary here to substantiate the claim.

Up to May 1997, twenty two years after the inception of the first Islamic bank, there were already about 150 Islamic banks and financial institutions managing investments estimated at about USD 75.5 billion in Asia, Africa, Europe and the U.S., covering more than 27 countries (Kamel, 1997). Just less than ten years later, i.e., as of May 2006, there were more than 250 Islamic financial institutions in about 100 countries globally, the majority being in Asia. The IB industry is growing at 15% annually, much higher than the conventional banking growth rate<sup>2</sup>. Total assets now managed by Islamic financial institutions are close to USD300 billion, while Islamic equity funds and off-balance-sheet investment accounts are conservatively estimated between USD15 billion and USD30 billion. Taken together, that's roughly the equivalent of Russia's gross domestic product.<sup>3</sup>

Therefore, apparently IB seems to be expanding rapidly. However, the real question still stands. What are the objectives of IB? Unfortunately, no serious effort has been made to address this question. It has never been discussed formally. What can be seen in many literatures are scanty and disjointed discussions about the objectives of IB. It has been taken for granted that IB is only about avoiding riba (Siddiqi, 2000). Even the concept of riba itself has been confined only to interest.

Since no serious effort has been made by scholars to theoretically study these objectives, most Islamic banks shy away from specifying clearly the objectives of their establishment. The failure to address the objectives of Islamic banks has left some scholars with no choice but to adopt the conventional yardsticks to measure the performance of Islamic banks. Whether these are the right criteria to measure the performance of Islamic banks is subject to empirical test. But apparently, evidences in most studies using conventional yardsticks to measure the results of Islamic banks show Islamic banks trailing behind conventional banks.

### **1.1. Problem of the Research**

Absence of a careful study on the objectives of IB has resulted into misinformation and misgivings about the primary reasons for the existence of Islamic banks. Accordingly, most Islamic banks have mainly relied on financial yardsticks to measure their results. Hence, many IB Stakeholders cannot clearly see the difference between the Islamic and conventional banking. Further more, by using the same conventional yardstick to measure Islamic banking there is a mismatch between these conventional performance indicators and the wider objectives of IB. Whether the present criteria are sufficient to measure the overall performance of IB is subject to empirical test. Given all these

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<sup>2</sup> Beng, P.K. (2004, August 20). The Global March of Islamic Banking. *Asia Times*. Downloaded on 30<sup>th</sup> May 2006 from: [http://www.atimes.com/atimes/Global\\_Economy/FH20Dj02.html](http://www.atimes.com/atimes/Global_Economy/FH20Dj02.html)

<sup>3</sup> Time Europe Magazine 16 Dec 2002).

shortcomings, no careful study – to the best knowledge of the authors – has been conducted to review the objectives of IB.

## **1.2. Objectives of the Research**

- a. To identify the ideal objectives of IB from the theory of Maqasid al-Shari'ah
- b. To propose an idea of developing a model of IB performance measures based on the objectives identified in (a) above.
- c. To test the IB performance measures developed in (b) above on a sample of six Islamic banks.

The introductory section begins with the background of the study. It then provides a problem statement after a thorough review of the literature, and the research objectives. Section two deals with the literature review, which also includes discussion on the theory of Maqasid al-Shari'ah and, relevant literature on IB performance measures. The third section proposes an idea of developing a model of IB performance measures based on the broad objectives identified in section two. In section three, the research method is discussed, which is followed by the fourth section on testing the performance measures developed in section three. The empirical results and discussion are dealt with in section five. The final section concludes the study and makes suggestions for future research.

## **2. Literature Review**

### **2.0 Introduction**

Objectives are specific commitment consistent with the mission of the organization over a specified time period. They may be quantified, and may be inappropriate in some circumstances (Lynch, 1997, p.425). Objectives are measurable, defined, operational, simple steps, and specific. They contribute to the fulfillment of specified goals, complete with a beginning and an end<sup>4</sup>.

Most of the discussions by modern Muslim scholars on the objectives of Islamic banking, however, have not dwelled in depth into the theoretical framework underlying the objectives of Islamic economics, banking and finance. For example, Kamel (1997) opines that unless the impact of the implementation of IB is reflected in economic development, creation of value added factor, increased exports, less imports, job creation, rehabilitation of the incapacitated and training of capable elements, the gap between the Islamic and conventional banks would be narrower. It is also eluded that IB would strive for a just, fair and balanced society; it is community oriented and entrepreneur friendly emphasizing productivity and expansion in real economy; and it will promote brotherhood and cooperation (Dusuki, 2005) citing (Chapra, 1985, 1992; Ahmad 2000; Chapra 2000a, 2000b; Siddiqui 2001; and Naqvi 2003). Chapra (1985) has outlined the following distinctive features of Islamic banks, among others: abolition of interest, adherence to public interest, catalyst for development, promotion of economic well-being, establishment of social and economic justice, and equitable distribution of income.

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<sup>4</sup> Available at: <http://www.msu.edu/course/aec/806/snapshot.afs/syllabus/notes7.htm>

## **2.1 The Objectives of IB Based on Maqasid al-Shari'ah Framework**

The main aim of this paper is to propose the objectives of Islamic banking based on Maqasid al-Shari'ah framework. Therefore, the authors will not dwell much on this section and elaborately discuss on the theory of Maqasid al-Shari'ah. For a detail discussion on the same, the readers can refer to our previous publication and conference papers (Mustafa, O.M, 2006 and 2007).

As mentioned earlier in the introductory section of this paper, the IB objectives have not been formally reviewed. Hence, the authors have tried to derive the objectives of IB from the theory of the objectives of al-Shari'ah ( Maqasid al-Shari'ah), which Muslim scholars have developed as far as the third century after Hirah, 9<sup>th</sup> Century A.D. (al-Raysuni, 1992).

Almost all the scholars of Maqasid are unanimous about the general objectives of al-Shari'ah, which are to promote welfare (Jalb al-Masalih) and avoid vices (Dar' al-Mafasid) (Ibn 'Ashur, 1998, p.190). However, some of them differ in their classification of the specific objectives inspite of some similarities. For example, Ibn 'Ashur mentions that the specific objectives of the Shari'ah should include the preservation of order, promotion of human welfare, prevention of corruption, establishment of justice and, maintaining stability and harmony (al-Risuni, 1992). Meanwhile 'Ilal al-Fasi includes in his classification objectives such as reforming the human mind, developing the earth, managing benefits for all, preserving order and system of livelihood, establishing justice and, utilizing Allah's natural resources (Ibid). A more refined form of the specific objectives of al-Shari'ah is provided by Abu Zaharah (1997). He classified them into three broad areas, namely:

1. Tahdhib al-Fard (Educating the individual)
2. Iqamah al-'Adl (Establishing justice)
3. Jalb al-Maslahah (Promoting Welfare)

This study shall adopt Ibn 'Ashur's definition of the general objectives of al-Shari'ah and Abu Zaharah's classification of specific objectives (1, 2 and 3 above) as the basis for the objectives of Islamic banking.

## **2.2 Performance of IB**

The word performance may itself be subjective (Politt, 1986). For it is rarely clearly defined. Different authors have given various meanings to the word. Nevertheless, performance measurement is regarded as a feedback, which an organization receives from the activities that it has undertaken (Lynch and Cross, 1991). It is also a process of determining whether an organization has achieved its objectives (Rouse and Puterill, 2003). Thus, performance measurements or indicators have direct relation to the objectives of the firm. In fact, these indicators allow the firm to align its activities to the objectives (Brignall, 1993).

Almost all the present Islamic banks have adopted the conventional yardsticks to measure their performance. This is partly due to the absence of formal study on the objectives of Islamic banking. As a result, they seem apparently trailing behind the conventional banks in their performance. This may be attributed partly due to the mismatch between their objectives, which is supposed to be multidimensional in nature, and the conventional yardsticks that are unidimensional, focusing on financial measures. This means that the performance of Islamic banking would require other measures besides the financial measures.

Naqvi (2000) citing (IRTI, 1998) related to a survey of expert opinion on 30 major Islamic banks reveals dismal performance of Islamic banks. Based on the results of the study, it was found that the rate of returns offered by Islamic banks had been generally lower than that of the interest-based banks. The study also concluded that cases of loan default had risen dramatically among Islamic banks, which appeared less able to deal with such cases effectively than the interest-based banks. Mokhtar, et al. (2006) in their comparative study of full-fledged Islamic banks, Islamic windows and conventional banks in Malaysia for the period 1997-2003 conclude that full fledged Islamic banks were less efficient than the conventional banks. Abdus Samad (1999) conducted a study comparing between the efficiency of Islamic Bank (BIMB) and conventional banks in Malaysia. His result using ANOVA test showed that conventional banks had higher managerial efficiency than Islamic Bank of Malaysia. A study by Abd el Rahman, et al. (2003) to investigate the X-efficiency of Islamic banks in Sudan reveals that these banks suffered from technical inefficiency.

A review of literature shows that traditional performance measurement systems (based on financial measures) failed to identify and integrate all those factors that are critical in contributing to business excellence (Valiris et al., 2005)

Hasan (2004) suggests that the performance of Islamic banks be evaluated with reference to their social responsibilities in an Islamic framework. He said, “the mainstream techniques of cost-profit considerations in assessing bank performance: ratio analyses and various sorts of input or output frontier models Islamic economists appear to have used are often marred by gaps, errors, and inconsistencies that render their conclusions vulnerable even in their own framework (Islamic banking).

Recently, there have been some considerable attempts of a shift from the unidimensional measures of IB to the multidimensional measures. Nearly all these attempts, however, have dealt with the subject matter scantily and cursorily with reference to maqasid al-Shari’ah. For example, Martan et. Al. (1984) used a “fuzzy-set” approach to measure the performance of Islamic banks vis-à-vis the traditional banking. The study also touched on some aspects of non-financial measures such as income distribution and social solidarity, economic development, investments and motivation to invest. However, it linked these measures to the objectives of Islamic banks scantily. Similarly, Munawar Iqbal (2001) in his review of thirty years of Islamic banking conducted a survey on the growth, performance and the overall progress of the industry. In the survey, he used a ratio

method to measure the efficiency of Islamic banking vis-à-vis their conventional counterparts. He used the ratio of 100 top conventional banks as the benchmark for comparison.

Hameed et al. (2005) presented in their study some alternative reporting and performance measures, which could be used by Islamic banks. The researchers empirically used what they termed as 'Islamcity Disclosure Index' to measure two Islamic banks and compare their performances. Their index consists of three main indicators, namely Shari'ah compliance, corporate governance and social environment. These indicators were represented by seven criteria, namely profit sharing ratio, zakah performance ratio, equitable distribution ratio, Directors-Employees welfare ratio, Islamic investment vs non-Islamic investment, Islamic income vs non-Islamic income, and AAOIFI Index<sup>5</sup>. Although they have taken multi dimensional approach to measure IB, they were not rigorous in their analysis relative to al-Maqasid.

Dusuki (2005) in his doctoral thesis examined the Islamic perspective of Corporate Social Responsibility (CSR). He investigated whether the stakeholders of Islamic banks in Malaysia subscribe to the idea of CSR. In the third chapter of his thesis, Dusuki also discussed CSR in relation to Maqasid al-Shari'ah. His empirical evidence based on a survey conducted on seven stakeholders group (customers, depositors, local communities, managers, employees, regulators and Shari'ah advisors) reveals that the stakeholders of Islamic banks in Malaysia have generally positive views of CSR.

This is another interesting study that has related to al-Maqasid but its main focus was on corporate social responsibility.

The present study differs fundamentally from the previous studies in that it has developed the IB performance measures from the Maqasid al-Shariah themselves.

### **3. Research Method**

#### **3.0 Introduction**

As mentioned in the introductory section, the first objective of this study is to identify the ideal objectives of Islamic banking from the theory of Maqasid al-Shari'ah. This has been achieved by going through relevant literature and Shari'ah sources. Accordingly, three broad objectives were identified, namely educating individuals, establishing justice and Maslahah.

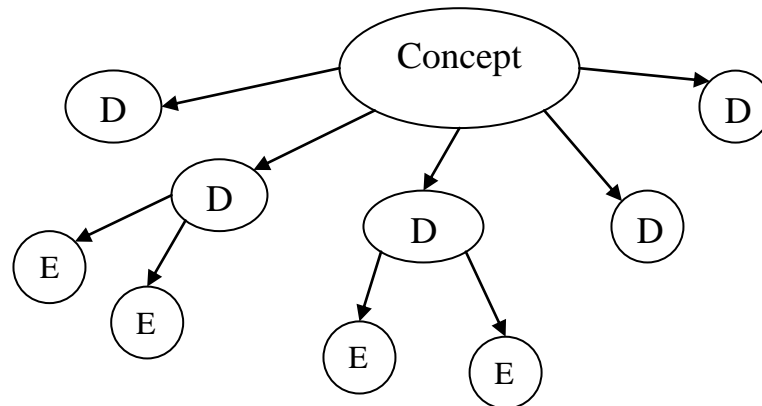
Secondly, this study proposes, besides the financial measures, IB performance measures from the three objectives identified above. The authors have made use of Sekaran's method (2000, pp.176-195) to operationally define these objectives of Islamic banking into measurable items. This is done by looking at the behavioral dimensions denoted by the concept. These are then translated into observable and measurable elements so as to form an index of measurement of the concept.

#### **3.1 Overview of Sekaran's concepts of Operationalization Method**

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<sup>5</sup> AAOIFI Stands for Accounting and Auditing organization for Islamic Financial Institutions.

Sekaran's method breaks down abstract notions or concepts (C) into observable characteristic behaviors, which she termed as dimensions (D). The dimensions are then further broken down into measurable behaviors that she referred to as elements (E). She cited the example of thirst as a concept. The behavior of thirsty people is to drink a lot of fluid (Dimension). The degree of thirst can be measured by the number of glasses drunk by each thirsty individual (Element). Sekaran's model can be illustrated as follows where D denotes Dimensions and E, Elements.



*Operational Definition of the Objectives of Islamic Banking (IB)*

Using Sekaran's method, the three (3) broad objectives of IB, namely educating individuals, establishing justice and Maslahah are operationally defined. Each of these objectives or concepts (c) are then translated into broad characteristics or dimensions (D) and finally into measurable behaviors or elements (E) as follows:

**Table 1**

**Operationalizing the Objectives of Islamic Banking**

Concepts (Objectives)	Dimensions	Elements	Performance Ratios	Sources of Data
1. Educating Individual	D1. Advancement Of Knowledge	E1. Education grant	R1. Education grant/total income	Annual Report
		E2. Research	R 2. Research expense/total expense	Annual Report
	D2. Instilling new skills and improvements	E3. training	R 3. Training Expense/total expense	Annual Report
		D3. Creating Awareness of Islamic banking	E4. Publicity	R 4. Publicity expense/total expense
2. Establishing Justice	D4. Fair dealings	E5. Fair Returns	R 5. profit/ total income	Annual Report
	D5. Affordable products and services	E6. Affordable price	R 6. Bad debt/ total investment	Annual Report
	D6. Elimination of injustices	E7. Interest free product	R 7. Interest free income/ total income	Annual Report
3. Public Interest	D7. Profitability	E8. Profit ratios	R 8. Net profit/ total asset	Annual Report
	D8. Redistribution of income & wealth	E9. personal income	R 9. Zakah/ Net Income	Annual Report
	D9. Investment in vital real sector	E10. Investment ratios in real sector	R 10. Investment deposit/total deposit	Annual Report

*The performance Ratios (PR)*

The 10 performance ratios (see Table 1 above) were chosen based on the following criteria:

- Discussion on the objectives of Islamic banking and on the dimensions and elements identified from these objectives.
- Past similar research using the same ratios for measuring performance of Islamic and conventional banks (Mahmood al-Osaymy et al., 2004, Shahul Hameed et al., 2006, Ali Khass, 1996).
- Statistical conveniences in relation to the source of data (Annual reports) and the research method (Multi Attribute Decision Making) – (Hwang and Yoon, 1981)
- Accurate possible representation of the conceptual level of Maqasid al-Shari'ah, though not necessarily exhaustible.

From the Table 1 above, four ratios, namely 1) educational grant/total income ratio, 2) research expense/total expense ratio, 3) training expense/total expense ratio and 4) publicity expense/total expense ratio are assigned as measures to the first objective of Educating Individual. Hence, the higher the budget that the bank allocates for these four indicators, the more the bank is concerned about achieving educating individuals in its program. This is also good for the bank to enhance the quality of its human resource and at the same time work towards creating informed customers about its objectives and product.

Three ratios: 1) Profit/total income ratio or interest/ total income ratio, 2) bad debt/total investment ratio and 3) interest free income/ total income ratio are identified for measuring the second objective of Establishing Justice.

High rate of the ratio of bad debt to total investment indicates widening gap in income distribution due to indebtedness. Usually the banks will end up imposing penalties or repossessing the assets or projects. Likewise, high ratio of Interest free investment to total investment contributes positively towards minimizing the income and wealth disparity, since interest basically transfers wealth from the poor to the rich<sup>6</sup>. Hence the bank must ensure the kind of product they offer do not create high probabilities of default.

Lastly, three PR are selected for the third objective – Maslahah. They are 1) Net profit/total asset, 2) Zakah paid/net asset and 3) investment deposit/total deposit. High profitability shows that the bank is enjoying high financial maslahah and, high Zakah net asset Ratio shows transfer of income and wealth to the poor and the needy, thereby helping to bridge the inequality gap. Similarly, investment deposit to total deposit ratio indicates that the bank is directly investing considerably in the real sector of the economy. Such sectors include agriculture, mining, fisheries, construction, manufacturing and small and medium scale businesses, etc. The importance of these real economic

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<sup>6</sup> Al-Rum, 30:39



sectors has direct implications to the wider population, especially those in the rural areas and the long term capital formation of a country.

### 3.2 Verification of the performance Measures

The IB performance measures developed from Maqasid al-Shari’ah framework (see Table 1) were sent to Shari’ah experts from the Middle East and Malaysia who are well versed in both the Islamic and conventional banks for verification, which was done at two levels. The first level was in the form of interview. Twelve experts in the areas of Islamic banking, Fiqh and Islamic economics were interviewed in order to triangulate the performance measures developed. Nearly all the experts, through the interview, have verified the appropriateness of the IB performance measures developed. The second level of verification was in the form of questionnaire. Sixteen experts were requested to assign weights to the components and to determine whether the performance measures are acceptable. The averages weights given by the experts are presented in table 2 below:

**Table 2**  
**Average weights for the three objectives and ten Elements given by Shari’ah experts**

<b>Objectives</b>	<b>Average Weight (Out of 100%)</b>	<b>Elements</b>	<b>Average Weight (Out of 100%)</b>
O1. Education (Tahdhib al-Fard)	30	E1. Education Grants/Donations	24
		E2. Research	27
		E3. Training	26
		E4. Publicity	23
		<b>Total</b>	<b>100</b>
O2. Justice (Al-‘Adl)	41	E5. Fair Returns	30
		E6. Fair Price	32
		E7. Interest free product	38
		<b>Total</b>	<b>100</b>
O3. Welfare (Al-Maslahah)*	29	E8. Bank’s Profit Ratios	33
		E9. Personal Income Transfers	30
		E10. Investment Ratios in real sector	37
<b>Total</b>	<b>100</b>	<b>Total</b>	<b>100</b>

\* Maslahah includes the bank’s interest plus the public interest

### 3.3 Data

In this study, a sample of the following 6 Islamic banks is considered:

1. Bank Muamalat Malaysia
2. Islami Bank Bangladesh
3. Bank Syariah Mandiri, Indonesia
4. Bahrain Islamic Bank
5. Islamic International Arab Bank, Jordan
6. Sudanese Islamic Bank, Sudan

The aggregate data of the 6 Islamic banks for 6 years period (2000 – 2005) were obtained from Bank Scope Database.

#### 4.0 Testing the Performance Measures

The third objective of the study is to test the performance measures developed and verified by the experts. This has been done by evaluating the performances of the 6 sample banks at three levels:

- Performance Ratios for the 6 banks
- Ranking the 6 banks based on their Performance Indicators (PI) for the 1<sup>st</sup> and 3<sup>rd</sup> Shari'ah Objectives
- Ranking the 6 banks based on the overall Maqasid Index

#### 4.1 Performance Ratios

Out of the ten performance ratios identified, the study will only use the following seven ratios to evaluate the individual performance of the sample banks. The first four ratios are related to the first Shariah objective, namely Education while the last three ratios relate to the third objective, Maslahah (see Table 3 below). The three performance ratios related to the second Shari'ah objectives (Justice) have been omitted from this analysis due to the unavailability of sufficient data for all the 6 sample banks.

- i. Education grant/total income ( $R_1^1$ )
- ii. Research expense/total expense ( $R_1^2$ )
- iii. Training Expense/total expense ( $R_1^3$ )
- iv. Publicity expense/total expense ( $R_1^4$ )
- v. Net profit/ total asset ( $R_3^1$ )
- vi. Zakah/ Net Income ( $R_3^2$ )
- vii. Investment deposit/total deposit ( $R_3^3$ )

#### 4.2 Ranking the 6 banks based on their Performance Indicators (PI)

The Simple Additive Weighting Method (SAW) – (Hwang and Yoon, 1981) has been utilized for the weighting, aggregating and ranking processes<sup>7</sup>.

SAW is a Multiple Attribute Decision Making (MADM) method that works as follows:

The Decision Maker (DM) identifies the attributes and intra-attribute values. In our case the attributes are the three objectives and, the intra-attributes are the 10 element and the 10 performance indicators (see table 1 above)

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<sup>7</sup> The author would like to acknowledge the help of Assoc. Prof. Dr. Moussa Larbani of the Department of Business Administration, Kulliyah of Economics and Management Sciences, International Islamic University Malaysia in introducing to him the SAW mathematical model in giving valuable inputs for improving the paper.

The DM assigns weights to each attribute and intra-attribute identified in (a) above. Accordingly, the weights for the 3 objectives and the 10 elements have been assigned by the Shari'ah experts (see Table 2 above). Whereas the evaluations for the 10 performance ratios were derived from the annual reports (2000 – 2005) of the sample banks in the study.

The DM then obtains a total score for each bank by multiplying the scale rating for each attribute by the evaluations obtained for each corresponding intra-attribute and, adding the total score for the products.

Hence mathematically, the evaluation of the individual IB Objectives can be computed as below, where the Performance Indicator for Objective 1 is denoted by PI (O1).

$$PI(O1) = W_1^1 \times E_1^1 \times R_1^1 + W_1^1 \times E_1^2 \times R_1^2 + W_1^1 \times E_1^3 \times R_1^3 + W_1^1 \times E_1^4 \times R_1^4$$

$$\text{OR } W_1^1 (E_1^1 \times R_1^1 + E_1^2 \times R_1^2 + E_1^3 \times R_1^3 + E_1^4 \times R_1^4) \quad (1)$$

Where,

(O1) denotes the 1<sup>st</sup> Shari'ah Objective, i.e., Tahdhib al-Fard (Education)

$W_1^1$  is the weight assigned to the 1<sup>st</sup> Shari'ah Objectives (derived from Table 2 above)

$E_1^1$  denotes the weight assigned to the first element of the 1<sup>st</sup> Objective (see Table 2)

$E_1^2$  denotes the weight assigned to the second element of the 1<sup>st</sup> Objective (see Table 2)

$E_1^3$  denotes the weight assigned to the third element of the 1<sup>st</sup> Objective (see Table 2)

$E_1^4$  denotes the weight assigned to the fourth element of the 1<sup>st</sup> Objective (see Table 2)

$R_1^1$  denotes the evaluations for the performance ratio corresponding to the first element of the 1<sup>st</sup> Objective (see Table 3)

$R_1^2$  denotes the evaluations for the performance ratio corresponding to the second element of the 1<sup>st</sup> Objective (see Table 3)

$R_1^3$  denotes the evaluations for the performance ratio corresponding to the third element of the 1<sup>st</sup> Objective (see Table 3)

$R_1^4$  denotes the evaluations for the performance ratio corresponding to the fourth element of the 1<sup>st</sup> Objective (see Appendix 2)

$$\text{Furthermore, } PI(O1) = PI11 + PI21 + PI31 + PI41 \quad (2)$$

Where,

$$PI11 = W_1^1 \times E_1^1 \times R_1^1 \quad (3)$$

$$PI21 = W_1^1 \times E_1^2 \times R_1^2 \quad (4)$$

$$PI31 = W_1^1 \times E_1^3 \times R_1^3 \quad (5)$$

$$PI41 = W_1^1 \times E_1^4 \times R_1^4 \quad (6)$$

The Performance Indicator for Objective 3 is denoted by PI (O3).

$$PI(O3) = W_3^3 \times E_3^1 \times R_3^1 + W_3^3 \times E_3^2 \times R_3^2 + W_3^3 \times E_3^3 \times R_3^3$$

$$\text{OR } W_3^3 (E_3^1 \times R_3^1 + E_3^2 \times R_3^2 + E_3^3 \times R_3^3) \quad (7)$$

Where,

(O3) denotes the 3<sup>rd</sup> Shari'ah Objective, i.e., al-Maslahah (Promoting welfare)

$W_3^3$  is the weight assigned to the 3<sup>rd</sup> Shari'ah Objectives (derived from Table 2 above)  
 $E_3^1$  denotes the weight assigned to the first element of the 3<sup>rd</sup> Objective (see Table 2)  
 $E_3^2$  denotes the weight assigned to the second element of the 3<sup>rd</sup> Objective (see Table 2)  
 $E_3^3$  denotes the weight assigned to the third element of the 3<sup>rd</sup> Objective (see Table 2)  
 $R_3^1$  denotes the evaluations for the performance ratio corresponding to the first element of the 3<sup>rd</sup> Objective (see Table 3)  
 $R_3^2$  denotes the evaluations for the performance ratio corresponding to the second element of the 3<sup>rd</sup> Objective (see Table 3)  
 $R_3^3$  denotes the evaluations for the performance ratio corresponding to the third element of the 3<sup>rd</sup> Objective (see Table 3)

$$\text{Furthermore, PI (O3)} = \text{PI13} + \text{PI23} + \text{PI33} \quad (8)$$

Where,

$$\text{PI13} = W_3^3 \times E_3^1 \times R_3^1 \quad (9)$$

$$\text{PI23} = W_3^3 \times E_3^2 \times R_3^2 \quad (10)$$

$$\text{PI33} = W_3^3 \times E_3^3 \times R_3^3 \quad (11)$$

### 4.3 The Maqasid Indexes

The total overall performance Indicators for the three Shari'ah objectives for each bank constitute its individual Maqasid Index (MI). Since we are using only two Shari'ah objectives for the analysis in this paper due to the reasons given in section 4.1, thus

$$\text{MI} = \text{PI (O1)} + \text{PI (O3)} \quad (12)$$

In other words, the Maqasid Index (MI) for the individual bank is the sum of its performance indicators in respect to Objective 1 and Objective 3.

## 5.0 Empirical Results

### 5.1 Performance Ratios (PR)

Table 3

Performance Ratios (PR) for 1<sup>st</sup> and 3<sup>rd</sup> Shari'ah Objectives

Banks	PRs of the 1 <sup>st</sup> Objective Average Ratios (2000 – 2005)				PRs of the 3 <sup>rd</sup> Objective Average Ratios (2000 – 2005)		
	$R_1^1$	$R_1^2$	$R_1^3$	$R_1^4$	$R_3^1$	$R_3^2$	$R_3^3$
SIB	<b>0.1021</b>	0.0033	0.0053	0.0053	0.0139	<b>0.0631</b>	0.1447
IIAB	0.0148	<b>0.0197</b>	0.0029	0.0207	0.0084	n.a	0.8225
BIB	0.0112	n.a	0.0013	0.0293	<b>0.0158</b>	0.0419	0.8603
BSM	n.a	0.0005	0.0234	<b>0.0916</b>	0.0136	0.0039	<b>0.9137</b>
IBB	0.0053	0.0090	0.0053	0.0075	0.0078	0.0069	0.8768
BMMB	n.a	n.a	<b>0.0707</b>	0.0227	0.0023	0.0400	0.6928

Where,

SIB = Sudanese Islamic Bank, Sudan, IIAB = Islamic Int'l Arab Bank, Jordan, BIB = Bahrain Islamic Bank, BSM = Bank Syariah Mandiri, Indonesia, IBB = Islami Bank Bangladesh, BMM B = Bank Muamalat Malaysia

## **Performance Ratios for the 1<sup>st</sup> Objective**

### a) Education grant/total income (R1)

From table 3 above, the Sudanese Islamic Bank (SIB) has performed relatively better in terms of providing education grants or scholarships to the public. Ten percent of its net income on average is allocated for the purpose. On the other hand, IIAB and BIB have allocated slightly above 1% of their net income for educational purpose. There is no separate data available for BSM and BMMB specifically on education grant. Recently however, some Islamic banks like BMMB have used products such as personal financing or Commodity Murabahah in the form of student loan for the same purpose. This is however not covered in the scope of the period under investigation. Therefore, the SIB has surpassed the other 5 Islamic banks in achieving this component of the first Shari'ah objective.

### b) Research expense/total expense (R2)

In terms of research the Islamic International Arab Bank of Jordan (IIAB) has shown relatively good performance compared to the other 5 banks in the sample. IIAB has earmarked almost 2% its total expense for research activities. This is followed by IBB, which has allocated almost 1% of its total expense for research. BSM has only started its contribution to research activities in the year 2005 with a very small amount. There is no separate data for research allocation available in the BIB and BMMB annual reports in the sample. It will be appropriate that the two banks have separate accounting entry for research in their annual reports to reflect the importance of this activity towards their future product development.

### c) Training Expense/total expense (R3)

In staff training programs, Bank Muamalat Malaysia Bhd (BMMB) is leading the other 5 banks in the sample. BMMB has allocated on average, over 7% of its total expense for the training expense. Probably the high figure for BMMB is because of using 'Other Expenses' as a proxy for the training expense. Nevertheless, BMMB has indicated in its annual report the bank's emphasis on improving its staffs' core competencies, risk management and upgrading their skills and knowledge particularly in financial analysis. Second to BMMB is BSM allocating over 2% of its total expense on training. The other four banks contribute far less than 1% of their total expense to training.

### d) Publicity expense/total expense (R4)

As Table 3 shows, Bank Syariah Mandiri, Indonesia (BSM) out performs the other five banks regarding publicity. Over nine percent of its total expense goes for publicity. Three banks, namely BMMB, BIB and IIAB spend between 2-3% of their total expense on publicity. Whereas the other two banks, SIB and IBB spend less than 1% of the total expense for the same purpose.

### **Performance Ratios of the 3<sup>rd</sup> Objective**

#### i) Net Profit/total Asset (R8)

This ratio measures the profitability of the bank. Accordingly, Bahrain Islamic Bank (BIB) has proven relatively profitable than the other banks in the sample. Its net profit represents almost 1.6 % of its total asset. BIB is followed by other two banks, SIB and BSM, whose profit-asset ratios are slightly below 1.5%. Two banks, namely IIAB and IBB have profit-asset ratios near to 1 %. Whereas BMMB profit asset ratio is far less than 1%.

#### ii) Zakah/Net Income (R9)

Once again, SIB leads the other 5 banks in terms of its zakah contribution, which is slightly above 6% of its net income. Other two banks, BIB and BMMB, pay 4% of their net income for zakah. IIAB does not pay zakah. It leaves the responsibility to depositors and shareholders. IBB and BSM pay less than 1% of their net income towards zakah. BSM on the other hand started its payment of zakah only in 2004. So the average data for BSM is for only 2 years (2004-2005).

#### iii) Investment deposits/total deposit (R10)

This ratio measures the extent to which the Islamic bank contributes its investment to the real sector. Hence, over 90% of BSM total deposit is for investment purposes. Three banks: IIAB, BIB and IBB have over 80% of their deposits for investments. On the other hand, BMMB investment deposit represents almost 70% of its total deposit. The least ratio is from SIB where only 14% of its total deposit is investment deposit. Whereas the liability side of these banks is represented by a large proportion of investment deposit one expects their contribution to the real sector on the asset side to be enormous too. But unfortunately this is not the case. Most of these investment deposits are used to finance debt related activities such as the purchase of assets and investment in securities. Accordingly debt financing using al-Bay' Bithamanin Ajil, al-Murabahah, al-Salam and al-Istisna modes represent on average over 80% of their investment activities. While equity based modes represent only 4 % on average. Similarly, investment in sectors like agriculture, mining, fishing represent an average of 10 % of the total asset. Therefore, as far as this Shariah objective is concerned, more needs to be done.

## **5.2 Ranking the 6 IB Based on their Performance Indicators (PI)**

**Table 4**

### **Performance Indicators (PI) for the 1<sup>st</sup> and 3<sup>rd</sup> Shari'ah Objectives**

Banks	PI for 1 <sup>st</sup> Objective					PI for 3 <sup>rd</sup> Objective			
	PI11	PI21	PI31	PI41	Total1	PI13	PI23	PI33	Total3
SIB	<b>0.0074</b>	0.0003	0.0004	0.0004	<b>0.0085</b>	0.0013	<b>0.0055</b>	0.0155	0.0223

IIAB	0.0011	<b>0.0016</b>	0.0002	0.0014	0.0043	0.0008	0	<b>0.8826</b>	<b>0.8834</b>
BIB	0.0008	0	0.0001	0.0020	0.0029	<b>0.0015</b>	0.0036	0.0923	0.0974
BSM	0	0.0004	0.0018	<b>0.0063</b>	<b>0.0085</b>	0.0013	0.0003	0.0980	0.0996
IBB	0.0004	0.0007	0.0004	0.0005	0.002	0.0007	0.0006	0.0941	0.0954
BMMB	0	0	<b>0.0055</b>	0.0016	0.0071	0.0002	0.0035	0.0743	0.078

(The figures are rounded up to the nearest 4 digits)

### 1<sup>st</sup> Shari'ah Objective

As mentioned above, the Performance Indicators (PIs) are the products of the weighted objective times the weighted elements times the ratios. The total of the four PIs for the 1<sup>st</sup> objective constitute the total performance indicator for that objective.

Accordingly, SIB is in the forefront in terms of providing education grant to the public (PI1). Whereas IIAB, BMMB and BSM are leaders regarding research (PI2), training (PI3) and publicity (PI4) respectively.

### 3<sup>rd</sup> Shari'ah Objective

Based on the figures for the third objective, Maslahah, BIB has performed better in relation to profitability (PI1). SIB has outperformed other banks in zakah while IIAB has achieved the highest in investment deposit.

With regard to the total performance indicators (Total1) for the first objective – education, SIB and BSM have equally shown a leading role in achieving that objective. This is partly due to the high weighted performance of SIB in providing education grants or scholarships and BSM's weighted achievement in publicity. For the total performance indicator (Total3) of the third objective – Maslahah, IIAB has shown a lead. This is attributed partly to the high weighted score it has attained in its contribution in attracting investment deposits.

## **5.3 Ranking the IB Based on the Maqasid Indexes (MI)**

**Table 5**

### **Maqasid Indexes (MI)**

No.	Names of Banks	PI (O1)	PI (O3)	MI [PI (O1) + PI (O3)]	Ranking
1	Sudanese Islamic Bank, Sudan	0.0085	0.0223	0.0308	<b>6</b>
2	Islamic Int'l Arab Bank, Jordan	0.0043	0.8834	0.8877	<b>1</b>
3	Bahrain Islamic Bank	0.0029	0.0974	0.1003	<b>3</b>
4	Bank Syariah Mandiri, Indonesia	0.0085	0.0996	0.1081	<b>2</b>
5	Islami Bank Bangladesh	0.002	0.0954	0.0974	<b>4</b>
6	Bank Muamalat Malaysia	0.0071	0.078	0.0851	<b>5</b>

The Maqasid Index measures the overall performance for the two Shariah objectives, namely the 1<sup>st</sup> and 3<sup>rd</sup>. Accordingly, overall, IIAB has out performed all the other banks

in the 1<sup>st</sup> rank, followed in the sequence in a descending order by BSM, BIB, IBB, BMMB and SIB respectively.

## 6. Conclusion

The greatest significance of this study is that it proposes the objectives of IB from the Maqasid al-Shari'ah perspective. It has also suggested a methodology that could be used to develop IB performance measures based on the Shari'ah framework. The result of the study has shown variations in the performances of the selected Islamic banks. No single bank is able to realize high performance in all the seven performance ratios, alternatives and performance indicators. Such variations show inconsistency on the part of the individual Islamic banks to focus on the overall Shari'ah objectives. This study has come at an opportune time for Islamic banks to revisit their objectives after three decades in operation. Since this is an exploratory study, hopefully future research will take it as a point of departure for developing further the objectives and performance measures of IB based on Shari'ah framework

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