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“Marketing Strategy for Islamic Banking Sector in Pakistan”

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Abstract:

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Title: Marketing Strategy for Islamic Banking Sector in Pakistan.

Problem:

Our main research problem is to investigate that what can be suitable and effective marketing strategy for Islamic Banking in Pakistan?

Purpose:

The main purpose of our research work is that we want to explore and pinpoint some marketing strategies issues which can be helpful for new investors and old stakeholders in the sector of Islamic banking in Pakistan in order to penetrate in the market successfully.

Target Groups:

Our target groups are those Islamic banks and conventional banks (which are providing one window facility for Islamic banking) that are currently working in Pakistan market and those who are interested in exploring the Pakistani market. We hope that our paper will provide useful information for the top management of these banks.

Conclusion:

There has come a swift transition in the financial services in the world including Pakistan. A new mode of banking i.e. Islamic banking has been introduced and accepted widely in many countries of the world including Pakistan. Our thesis has portrayed the current situation for Islamic banking in Pakistan by investigating the current competition of the industry using porter five forces model and at macro level using PEST analysis. We have analyzed that the competition is very high in the industry and Islamic banks could take more market share by introducing the more innovative products with less price as compared to conventional banks and by widen up their branch network to all small and big cities of Pakistan.
Acknowledgement:-

First of all we would like to thank Almighty Allah for showing us the path to gain knowledge. Then we would like to express our thanks to our Advisor, Mr. Ian Roboson, who gave us the courage to complete this task. His friendly behavior, unflagging patience, encouraging remarks and good knowledge made this thesis possible. We would also like to thank Mr. Anders Nilson at BTH who encouraged us with his kind suggestions. We have learnt a lot from this thesis and we hope that the knowledge we have gained by doing this thesis would help us in our practical life. In the end we’ll like to thank all our friends who helped us in collecting the data and completing the thesis by giving their precious comments.

BTH, May 2008

____________________________________  ___________________________
Muhammad Tahir                           Muhammad Umar
Table of Contents

List of Abbreviations---------------------------------------------07

List of Figures-----------------------------------------------------08

1. Introduction----------------------------------------------------09

1.1. Background of banking-------------------------------------------09
1.2. Banking system of Pakistan--------------------------------------09
1.3. Islamic Banking---------------------------------------------------10
1.4. Differences----------------------------------------------------------12
1.5. Problem Identification---------------------------------------------13
1.6. Purpose---------------------------------------------------------------14
1.7. Target Group-------------------------------------------------------15
1.8. Previous Studies----------------------------------------------------15
1.9. Structure-------------------------------------------------------------15

2. Methodology---------------------------------------------------16

2.1. Choosing the topic-----------------------------------------------16
2.2. Formulating the research questions---------------------------16
2.3. Objective of the Research----------------------------------------16
2.4. Research Model----------------------------------------------------17
2.5. Data Collection-----------------------------------------------------18
2.6. Secondary Data-----------------------------------------------------18
2.7. Limitations----------------------------------------------------------19

3. Theoretical Framework-------------------------------------------20

3.1. PEST Analysis---------------------------------------------------------------20

3.1.1. Political and Legal Environment-------------------------------20
3.1.2. Economic Environment------------------------------------------21
3.1.3. Socio-Cultural Environment-----------------------------------22
3.1.4. Technological Environment-----------------------------------24
3.2. Porter Five Forces----------------------------------------------25

3.2.1. Threats of New Entrants---------------------------------------26
3.2.2. Intensity of rivalry among existing competitors---------------27
3.2.3. Bargaining Power of Buyers-----------------------------------29
3.2.4. Bargaining power of Suppliers---------------------------------29
3.2.5. Threat of Substitutes----------------------------------------31

3.3. Ansoff Matrix-----------------------------------------------31
3.4. Summary-------------------------------------------------------32

4. Empirical Findings------------------------------------------33

4.1. Uncontrollable Environmental Factors------------------------32

4.1.1. Political and legal Environment-----------------------------32
4.1.2. Economical Environment-------------------------------------36
4.1.3. Socio-Cultural Environment---------------------------------37
4.1.4. Technology-----------------------------------------------39

4.2. Porter Five Forces------------------------------------------40

4.2.1. Intensity of rivalry among existing competitors-----------40
4.2.2. Threats of new entrants-------------------------------------43
4.2.3. Bargaining power of Buyers-------------------------------44
4.2.4. Bargaining power of suppliers-------------------------------46
4.2.5. Threat of substitute----------------------------------------47

4.3. Summary-------------------------------------------------------47

5. Analysis--------------------------------------------------------48

5.1. Political Environment------------------------------------------48
5.2. Economical-----------------------------------------------------49
5.3. Socio-Cultural-----------------------------------------------49
5.4. Technological-----------------------------------------------50
5.5. Competition in Islamic banking Industry----------------------50

5.5.1. Intensity of Rivalry among existing competitors----------50
5.5.2. Threat of new entrants-------------------------------------51
5.5.3. Bargaining Power of Buyers--------------------------------52
5.5.4. Bargaining Power of Suppliers------------------------------52
5.5.5. Threat of Substitute----------------------------------------53
5.6. Opportunities and Threats------------------------------------------53

5.6.1. Opportunities---------------------------------------------------53
5.6.2. Threats--------------------------------------------------------55

5.7. Summary----------------------------------------------------------56

6. Conclusion and Recommendations-------------------------------57

6.1. Conclusion-------------------------------------------------------57
6.2. Recommendations------------------------------------------------59
6.3. Contribution-----------------------------------------------------60

List of References--------------------------------------------------62
**List of Abbreviations:**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>SBP</td>
<td>State Bank of Pakistan</td>
</tr>
<tr>
<td>Shriah</td>
<td>Islamic Laws</td>
</tr>
<tr>
<td>BLR</td>
<td>Base Lending Rate</td>
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<tr>
<td>P.E.S.T</td>
<td>Political, Economical, Social and Technology</td>
</tr>
<tr>
<td>FSC</td>
<td>Federal Shriah Court</td>
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<tr>
<td>Riba</td>
<td>Interest</td>
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<tr>
<td>IMF</td>
<td>International Monitory Fund</td>
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<td>ICAP</td>
<td>Institute of Chartered and accountancy of Pakistan</td>
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<td>IAS</td>
<td>International Accounting Standards</td>
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<tr>
<td>SME’s</td>
<td>Small &amp; Medium Enterprises</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<tr>
<td>GDP</td>
<td>Growth Domestic Product</td>
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<td>HBFC</td>
<td>House Building finance Corporation</td>
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<td>KSE</td>
<td>Karachi Stock Exchange</td>
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<td>IT</td>
<td>Information Technology</td>
</tr>
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<td>NBFI</td>
<td>Non Banking Financial Institution</td>
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<tr>
<td>USS$</td>
<td>United States Dollar</td>
</tr>
<tr>
<td>Rs.</td>
<td>Pakistani Rupee</td>
</tr>
<tr>
<td>ATM</td>
<td>Automated Taller Machine</td>
</tr>
</tbody>
</table>
List of Figures:

Figure 1: Number of Banks in Pakistan-----------------------------10
Figure 2: Research Model----------------------------------------17
Figure 3: Sources of Data--------------------------------------18
Figure 4: P.E.S.T---------------------------------------------20
Figure 5: Porter Five Forces-----------------------------------26
Figure 6: Exit and Entry barriers-----------------------------28
Figure 7: Buyers and Suppliers power---------------------------30
Figure 8: Ansoff Matrix-----------------------------------------32
Figure 9: Electronic Banking-------------------------------------38
Figure 10: Position of Islamic Banks----------------------------40
Figure 11: Share of Banks in consumer credits-------------------41
Figure 12: Islamic Banking transactions--------------------------42
Figure 13: Islamic Banking Overview-----------------------------44
Figure 14: Performance of Islamic NBFI’s------------------------46
1- Introduction:-

In this chapter we will discuss the background of our thesis, purpose of this thesis and we will also present the problem identification as well. Then research questions and target groups will be described. Finally we will present the outlook of our thesis.

1.1 Background of Banking:

Before the influx of modern banking form, there was a system of direct finance where the owner of capital deals directly with the user of capital. So the savers were dealing with the investors directly. With the passage of time, there was observed a rapid growth in trade and manufacturing industries and that lead to an increased demand in their financial requirements. Direct financing seemed to be unable to fulfill the financial requirements of the investors at this stage and banks came into existence to facilitate financial transactions between savers and investors. Now banks are dealing in various transactions like receiving, collecting, transferring, paying, lending, investing and many more in order to facilitate and achieve excellence in their consumer’s insights. (Woelfel & Charles 1993)

1.2 Banking System of Pakistan:

Before the birth of Pakistan, which is an Islamic country, Muslims of the subcontinent were not fully allowed to participate in the banking sector. There was only a small Australasia bank at that time with only few branches mainly in Lahore. Then in 1941, HABIB bank came into being that was run by the Muslims of the subcontinent. At that time, Quaid-e-Azam (The founder of Pakistan) also gave the idea of Muslim Commercial bank.

Before Independence, all the financial system was mainly of British origin. In the early stages of Pakistan, government really worked hard to strengthen the banking system in Pakistan. And State bank of Pakistan came into being in 1948. Then National bank of Pakistan came into being in 1950 and it was another milestone in the history of banking system in Pakistan.

In 1999, there were 19 domestic and seventeen foreign banks in Pakistan. And from the domestic banks four banks were owned by the government and rest were private banks. By the end of 2007, there are 47 banks working in Pakistan of which 13 are foreign banks and 34 are domestic banks. (Husain 2007)
There are mainly two types of banking systems operating in Pakistan. The first and older one is conventional banking that is based on interest based economy and the second one is Islamic banking that is interest free banking.

### 1.3 Islamic Banking:

The prohibition of interest in Islam caused many writings to come forward with an idea to establish banks that do not work on interest basis. So the basic difference between Islamic banks and conventional banks is that Islamic banks are interest free banks whereas conventional banks are interest based banks. (Kahf 2006) Although interest and profit are very clear concepts but they are misunderstood by many people. Basic difference between interest and profit is that interest is the reward to money and profit is the reward to capital investment. In other words money produces interest and capital investment produces profits. (Toutouchian 2004)

Islamic finance has gripped the world with a strong commitment and passion. It has been depicted that interest in this segment has grown rapidly in almost 60 countries, not only in Islamic countries but in the leading global financial centers. Even United Kingdom has adopted an open door policy and provided a level playing field to Islamic finance and now Singapore is following its lead. (Dr. Shamshad 2007)

Islamic banking has shown tremendous growth in the past 20 years, with estimated deposits surpassing $80 billion in more than 45 countries. Annual turnover is currently estimated at $70 billion and is projected to pass $100 billion by 2000. (O’Sullivan 1994, p. 7) For the last 60 years, the mode of banking in Pakistan was totally of interest based but now there is a shift from western banking to Islamic banking in number of banks in Pakistan and also there are some new banks like Meezan bank which is totally based on Islamic banking. In 2007 Meezan Bank creates a significant milestone in the history of Islamic Banking by opening its 100th branch in the city of Karachi. With 100 branches in 31 cities clearly positions the Bank as the leading Islamic Bank in Pakistan. Two new dedicated Islamic Banks start operations in Pakistan, namely Emirates Islamic Bank and Dawood Islamic Bank. (Meezan Bank 2007)
Islamic banks are trying to fulfill the requirements of their customers by offering innovative products and services so as to compete the market. There are five basic Islamic financing contracts.

**Murabaha: (Cost plus)**

A Murabaha transaction is basically a cost plus profit financing transaction in which a tangible asset is purchased by an Islamic bank at the request of its customer from a supplier. The Islamic bank sells this asset to its customer on a deferred sales basis with a mark up that is bank’s profit. The mark up on the asset cannot be altered during the life of the contract. The Murabaha deals offer enough flexibility to be used in real estate and project financing.

**Ijara and Ijara wa-Iqtina: (leasing and lease purchase)**

Ijara and Ijara wa-iqtina are Islamic leasing concepts similar to western operating and finance leases. Ijara is similar to conventional operating lease, where in an Islamic bank (lesser) leases the asset to the client (lessee) for agreed on lease payments for a specified period of time, but with no option of ownership for the lessee. The maintenance and insurance is the responsibility of the lesser. On the other hand, in ijara wa iqtina, lessee has the option of owing the asset at the termination of the lease. In both types of leasing, the lease payments must be agreed on in advance to avoid any speculation.

**Istinsa: (leasing structured mode)**

Istinsa is a leasing mode which is used to finance long term or large scale facilities involving like construction of a sugar plant. In this mode, bank could either own the plant and charge the lessee a fee based on profits or sell the plant to the company on a deferred basis similarly like the Murabaha transaction.

**Mudaraba: (profit-sharing)**

Mudaraba is a trust based financing agreement in which an investor e.g. Islamic bank give capital to an agent for a project. Profits are based on prearranged and agreed ratio. In case of loss earn no return and the agent receives no compensation for his effort.

**Musharaka: (equity participation)**

Musharaka is similar to a joint venture in which bank and agent jointly invest in some project. They agreed on some prearranged profits and losses.

(Zaher and Hassan 2001)
1.4 Differences:

Some major differences between Islamic and conventional banking can be described as follows:

1- In a conventional bank, a customer is given finances by a contract of loan where the bank is creditor and the customer is debtor. On the other hand in Islamic banking, finances are given to a customer by a contract of sale i.e. a deferred sale contract. In this contract, either bank itself buys goods or appoints the customer to buy on its behalf and later sells them to the clients with a mark up (cost plus an agreed profit margin). Payment is done in installments over a specific period of time.

2- Islamic banks earn their profit by trading and investment activities and this profit can be said legitimate as it involves risk and efforts as compared to conventional banks which earn their profit by financing the customers at a fixed interest rate.

3- Participation in partnership business is the fundamental function of the Islamic banks. So they have to understand their customer's business very well. Whereas lending money and getting it back with compounding interest is the fundamental function of the conventional banks.

4- The Islamic banks have no provision to charge any extra money from the defaulters. Only small amount of compensation and these proceeds are given to charity. On the contrary, conventional banks can charge additional money (penalty and compounded interest) in case of defaulters. (Al-Omer & Abdul-Haq 1996)

5- The nature of Islamic banking is not simply lending the money as experienced by a conventional bank, but it is involved in selling and buying the commodity. Thus the selling price which is a cost price plus the profit margin, which is the contracted amount. In conventional banking practice, interest is regarded as the price of loan. For example, if the worth of asset is $50,000 and interest rate is 15% per year, the price of the loan to be paid by the customer will be $57,500.

6- Profit amount agreed once between the customer and an Islamic bank remains the same, e.g., in murabahah or cost plus profit is fixed at the time of contract and must be agreed upon by the customer. If customer is unable to pay on time, bank cannot ask for a higher price due to delay in settlement of dues. While interest rate is also prefixed at the time of contract would be either unchangeable or would change according to the Base Lending Rate (BLR) which is monitored by the central Bank.
7- Islamic banks face more risk as compared to conventional banks. Although both have to take credit risks, capital adequacy, liabilities and asset-matching risks, currency fluctuation and liquidity risks, the risk for Islamic banks is higher. Because Islamic banks have to face profit and loss in each deal in order to earn profit but in conventional banks, the risk of loss is borne entirely by the client and the lender (bank) safeguards itself against any possibility of loss. However interest rate risk is faced by only conventional banks and not by Islamic banks as interest is not permitted in their operations.

8- Islamic banks cannot remain unconcerned about the nature of the activity for which they are financing. They cannot finance any business which is against the teachings of Islam. While conventional banks don’t have to follow any limitations of religion and they may finance any profitable activity e.g., a gambling casino or an alcoholic manufacturing industry etc.

Many of the services provided by conventional banks that are not related to interest, are also performed by the Islamic banks in the same way e.g., letter of credits, collections, foreign exchange and financial advising etc. (Qasim 1986)

1.5 Problem Identification:

One of our group members has been involved in banking sector as he has been doing his job in Punjab Bank of Pakistan (www.bop.com.pk). He observed during his job that some people are willing to deal in Profit and loss sharing accounts as Islam prohibits the interest based transaction. Most of the clients of the bank belong to business class or rich people and a great fraction of common population is not involved in doing business with the bank.

There has been observed a tendency of opening one window for Islamic banking in already running conventional banks in order to meet the requirements of the consumers and to retain the customers. Meezan Bank is the only bank which started its operations according to Islamic banking rules and is progressing in the region. (Meezan Bank 2007) As it is a newly growing industry, there is much more space available for new investors. It has been observed during our literature review that there has not been done sufficient research work for the marketing issues of the sector. Marketing strategies must be analyzed and tackled carefully for any newly growing industry in order to get sustainable development.

Marketing strategy is one of the most important issues that must be examined carefully in order to improve performance and ensure sustainable growth of Islamic banks as competition in the banking industry intensifies. A suitable marketing strategy becomes essential as Islamic banks operate in an environment where service quality and financial returns are supposed as the essential criteria from customer’s point of view, Along with Islamic banking sector to compete conventional banks which have better experience and expertise in banking business. Once religion was thought the primarily force to drive Muslims to use Islamic banking services, but now has become irrelevant to Muslim
customers. Due to increased competition from both Islamic and Conventional banks and changes in customer’s perception, it is of supreme importance for Islamic banks to assess the effectiveness of their marketing strategy. (Azmi & Haroon 2005)

Although there is seen a lot of public relations and talk in the media, there is no real marketing approach to Islamic finance as in other industries. By implementing real marketing strategies, Islamic financial products could achieve wider attention and awaken sleeping potential. Currently more emphasis is being given on religious prohibitions but it needs to be communicated much more about the specific benefits distinguishing Islamic financial institutions from others. “The absence of prohibited elements will be a condition for business, but no longer enough on its own. Professional asset finance and investments with a social touch will succeed. Islamic finance will become a value-driven business.” (Gassner 2008)

“Every business strategy consists of a marketing strategy plus a compatible technology strategy and sourcing strategy”. (Kotlor 2001) Developing a marketing strategy is essential for any business. The focus of strategy should be that your products and services are more attractive than those of your competitors and develop a long-term and profitable relationship with the customers. A suitable marketing strategy can be developed by understanding internal strengths and weaknesses and the external opportunities and threats. (Business Link, [no date])

There are already running both modes of banking sectors in Pakistan. Our objective of the research is that how Islamic banking can grow in an environment where conventional banking sector has deep roots. What are the opportunities and threats for new entrants and old stakeholders in this sector? For any industry to succeed in the longer run, ethical issues must be tackled carefully, so we’ll examine the ethical perspective along with cultural values as well. As we discussed in the beginning that Islamic banking is a growing sector now a days, so we have choose this sector for our research area. We are not considering “Islamic Banking” in the parameters of religion but we are considering it a newly growing industry.

So our research questions will be:

- What can be suitable and effective marketing strategy for Islamic Banking in Pakistan?

1.6 Purpose:

The main purpose of our research work is that we want to explore and pinpoint some marketing strategies issues which can be helpful for new investors and old stakeholders in the sector of Islamic banking in Pakistan in order to penetrate in the market successfully.
1.7 Target Group:

Our target groups are those Islamic banks and conventional banks (which are providing one window facility for Islamic banking) that are currently working in Pakistan market and those who are interested in exploring the Pakistani market. We hope that our paper will provide useful information for the top management of these banks.

1.8 Previous Studies:

We tried our level best to find any previous studies regarding our choice of topic so that we could take help from that and also find the deficiencies in that which must be overcome. We have found some research work done on the topics like, Difference between Islamic and Conventional banking, Islamic Banking progress, problems and prospects and many more. But we found that there is not much work done, matching our topic and research questions as there has not been done much research work regarding this issue.

1.9 Structure:

Chapter 1: We explain the background and purpose of writing this thesis. We identify the problem, describe its purpose and target group, and present the structure of the thesis.

Chapter 2: We will make clear in this chapter the methodology of our research. We will clarify how the main research topic has been chosen, what research questions, our research objective are and research model. We will describe the limitations which we had to face during this research work.

Chapter 3: We’ll describe the theoretical framework for our thesis.

Chapter 4: This chapter presents the data relative to theories described in chapter 3. We’ll present here our Empirical findings regarding our research questions.

Chapter 5: We will present the analysis based upon the empirical findings in relation to our theoretical framework.

Chapter 6: Here, We’ll present the conclusion of our research work and recommendations based upon this thesis.
2- Methodology:

Here, we’ll present the methodology which we adopted for answering our research question which we have formulated and presented in 1st chapter. Furthermore, we’ll explain that how main topic was selected, how we formulated the research question? We’ll enlighten the way that how we collected the data concerning to our thesis.

2.1 Choosing the Topic:

In the past few decades, there has been observed that a new mode of banking has been introduced in many countries although conventional banks are already there. This mode of banking was introduced by the name of “Islamic Banking”, specially designed to fulfill the requirements of Muslim customers according to the teachings of Islam. One of our group members has been involved in banking job in Pakistan and he observed this transition there as well. It became a hot issue of Islamic finance and Banking system in the financial world including Pakistan. We got inspirations from media talks and discussions about Islamic banking and decided to explore this topic. During our literature review, we came to know that there is much space for research work on this area and sufficient research has not been done on Islamic banking sector. We also have a plan of doing some in depth research and doctorate level research on the issue in future.

2.2 Formulating the Research Question:

After choosing the research topic, there was a concern that what should be our research question? As Islamic banking is a newly growing industry in Pakistan a couple of new Islamic banks and their products are being introduced in the region, so it becomes of vital importance that these banks should develop a suitable marketing strategy for being successful in the market. We depicted from our literature review that there is a lack of research done for suitable marketing strategy for Islamic banking in Pakistan. So, we focused our research on the issue that what can be suitable and effective marketing strategy for Islamic banks in Pakistan? A suitable marketing strategy can be developed by understanding internal strengths and weaknesses and the external opportunities and threats. (Business Link, [no date])

2.3 Objective of the Research:

The objective of our research is to get a complete and overall picture of the whole situation in Pakistan that how Islamic banking sector can grow and sustain by keeping in view the threats and opportunities present in the market. We’ll use Porter five forces model and PEST analysis to examine the opportunities and threats for Islamic banking in Pakistan.
2.4 Research Model:

We developed a research model for our research question which is based upon the theoretical and conceptual frameworks presented by well known Authors in their respective books. We used some concepts as our theoretical reference from “On Competition by Porter”, “Marketing Management”, “and Principles of Marketing” by Philip Kotler and PEST analysis and many other concepts to develop our model.

Figure 2: Research Model

What can be suitable and effective marketing strategy for Islamic banking in Pakistan?

For getting the market picture at macro level:
PESTL (Political, Economic, social and technological)

For getting the market picture at micro level:
Porter’s five forces Model (potential entrants, suppliers, buyers and substitutes)

Analysis
What are the Strengths, weaknesses, Opportunities and threats (i.e. swot analysis) for Islamic banking in Pakistan?

Source: Produced by authors

Conclusion
And Recommendations.
2.5 Data Collection:

For conducting a research, two types of data is used i-e Primary and secondary data. For answering our research question, we used only secondary data for empirical and theoretical findings. We adopted an exploratory approach to our research because the Research question is such that need a qualitative approach and to which there is no specific answer. However, primary data was not used due to time constraints and difficulty in getting significant information from the accurate people because most of the banks do not disclose their information due to privacy policies. We obtained the secondary data mainly from books, article, published journals, internet, official website of State Bank of Pakistan and considered some internal reports and findings of different banks of Pakistan.

2.6 Secondary Data:

Secondary data is not only useful to find information to solve research problem but also helps to better understand the problem. It’s mainly obtained from books, articles, published journals and web sources. There are many advantages of using secondary data like good quality and reliability, saving time and money. “Begin with secondary data, and only when they are exhausted, proceed with primary data.” (Ghauri & Gronhaug 2005) According to Ghauri & Gronhaug, there are two types of secondary data i-e internal and external and we’ll use both sources for our research work.

Figure 3: Sources of Data

Source: Ghauri & Gronhaug 2005
2.7 Limitations:

We are aware that it is not possible to achieve the actual objective of this research in the resources available. The main constraint is of shortage of time and lack of facilities to approach the key persons of this sector. We know that combination of primary and secondary data could be more appropriate for this research work. But we relied upon secondary data only and did not use primary data because of time constraints and difficulty in getting significant information from the accurate people as most of the banks do not disclose their information due to privacy policies.

In this chapter, we’ve explained the methodology which will be adopted in conducting this research work. We also explained that how we chose this topic and how we’ll collect the data. Now in the coming chapter, we’ll describe the theoretical data which we’ll use as our research framework.
3- Theoretical Framework:

In this chapter we’ll elaborate the theoretical frame work regarding our research work. Mainly we will use Porter’s five forces model and PEST analysis as our basis and reference for conducting research along with some other well-known marketing strategies literature. Firstly, we’ll try to elaborate and throw some light on PEST analysis which is widely used in order to scan the external macro-environment in which the organization operates.

3.1 PEST Analysis:

This analysis is a helpful way to understand the “big picture” of Political, Economic, Socio-cultural and Technological environment. By making good use of PEST analysis, it is ensured that what is going to be done is aligned positively with powerful forces of change. It helps in operating in a new country or region and helps in understanding the realities of that environment. It helps in strategy formation in a sense that these factors (Uncontrollable environmental forces) must be kept in view, which may lead to failure if ignored. The position of PEST analysis in understanding the overall picture of environment can be described by the following diagram: (mindtools 2008)

Figure 4: P.E.S.T

![PEST Analysis Diagram]

Source: quickMba [no date]

3.1.1 Political and Legal Environment:

Political environment, Government agencies and pressure groups have a strong influence upon the activities of any organization in a society. Political environment strongly affects the marketing decisions. The political stability of a country has its impact on the
consistency of policies of local government. Importance of public interest groups and business regulations can be found from the political environment. (Kotler et al 1999, p.167)

Nations vary greatly in their political and legal environment. Sometimes, a government can decide violently to respond a popular feeling even without a change. Any new policy can be introduced regarding tax and trade and tariff control etc. This may give benefits to the organization but the thing matters is how they handle business and financial matters in such unexpected and sudden changes? (Kotler et al 1999, p.196) Political trends may not be of as much importance in stable governments as they are in weak ones, although they can have a significant impact on business. For example, in the United States, the companies in the business of providing social services can have more opportunities when Democrats are in power. (jain 1999, p.137) Political decisions like awarding of subsidies to any sector either directly in the form of grants or through tax incentives can impact the industry circumstances. (Porter 1980, P.248)

Legal factors include the local rules, regulations and legislation prescribed by the government of that country. Legal issues must be understood clearly and have great importance in strategy formation. Legal environment is one of the main forces that give informational inputs which must be factored into the decision-making process. (Jain 1999, p.552) All business activities are directly related to changes in state and federal tax laws and these changes are influenced by the local political and legal factors. Corruption is also a major factor in many countries in which many political persons are involved. Organizations have to face the problem of corruption as well. (Berry and Wilson 2000, p.329)

Some important factors of political and legal environment can be listed as tax policies, political stability, Employment laws, competition regulation and safety regulations etc. (12manage [no date])

3.1.2 Economic Environment:

Economy of a country plays a major role in the profitability and success of any sector and organization in the parameters that how stable, good and growing is the economy of that country. Economic environment consists of factors that affect consumer purchasing power and spending patterns. Nearly all companies examine the economic environment before strategic planning. Economic environment is usually analyzed by keeping in view the following economic indicators: employment, consumer price index, housing starts, personal income, saving rate, industrial production, capacity utilization and productivity etc. (Jain 1999 , p.140) Although the gap between living standards of well-developed Western and developing Asian countries is lessening, yet the uncertain economic climate in the Asian economies has important implications for international marketers. Organizations must determine that how these changing incomes affect purchasing power and how they adopt it for the firm’s profitability. (Kotler 1999, p.180)
In general, following are some of the key factors which help in understanding the economic environment of a country: information about economic growth, interest rates, exchange rate, inflation rates, impact of globalization, unemployment and labor supply and levels of disposable income and income distribution. (Mindtools 2008)

3.1.3 Socio-cultural Environment:

During the formation of marketing strategies, companies have to look after a lot of factors. Deep study of local culture and social setups is also one of the major factors which account much in successful strategy formation. Varying types of consumer behaviors are found in different cultures. The study of culture helps to understand the consumer behavior and in turn assists firms to improve their marketing strategies by understanding issues like:

- The way how consumers think, feel and select between different brands or products.
- The psychology of how consumer is influenced by culture, family and social setups.

Understanding of these issues helps to adopt better strategies by taking the consumer into consideration. By understanding the consumer, firms will be able to make a more informed decision as to which strategy to employ. (Tahir & Umer 2007)

According to Kotler, culture is “the set of basic values, perceptions, wants and behaviors learned by a member of society from family and other important institutions.” (Kotler et al. 2004)

Each country has its own set of values and traditions. The companies must know that how consumers in different countries think and use different products before planning a marketing program. All the positive and negative impacts which a culture may cause must be identified. There might be different dimensions of culture like the social organization of society, religion, literacy levels, political systems and language. (Kotler et al. 1999)

Social factors also influence behavior of consumers. A person's family, friends and social organizations strongly affect product and brand choices. The person's position within each group can be defined in terms of role and status. A buyer chooses products and brands that reflect his or her role and status. (Kotler et al. 1999)

“Cultural environment is made up of institutions and other forces that affect society’s basic values, perceptions, preferences and behaviors.” People have their beliefs by living in a particular society. These beliefs may be either core beliefs or secondary beliefs. Core beliefs are inherited from parents, reinforced by religious groups, business and government. These beliefs have a high degree of persistence. While secondary beliefs can be changed more easily. Marketers have a chance of changing secondary values but it is pretty difficult to change core values. So, Marketers should have a better understanding
of the cultural environment of the country before making any business strategy. (Kotler et al. 2004)

According to Professor Geert Hofstede, “Culture is more often a source of conflict than of synergy. Cultural differences are a nuisance at best and often a disaster.” Management is a process which is interconnected with many other parts of life and cannot be isolated separately from what is happening in the society. It interacts with what happens in politics, family, school, government and also related to the religion and local traditions. “Cultural Dimensions Model” of professor Geert Hofstede presents a framework describing five different dimensions of values between national cultures.

**Power Distance:**

“The degree of inequality among people which the population of a country considers as normal”

It means the difference of power and wealth among population of the country. All societies are different with respect to this. But the level of gap in some countries is greater as compared to other ones where it is smaller but it exists in all cultures and societies. In cultures with large power distance, there is respect for old age and status is important to show power. (Hofstede 2005)

According to Hofstede, Malaysia scores highest on power distance at 104, Pakistan scores 55, whereas Sweden lies at 31 only. (ITIM [no date])

**Individualism verses Collectivism:**

“The extent to which people feel they are supposed to be take care for or to be cared by themselves, their families or organizations they belong to”

There are some societies in which individuals are loosely tied with each other and they are supposed to take care of themselves and look after their immediate family only. On the other hand, the societies which we can call collectivistic societies, the people in these societies are integrated in strong groups and family relations (with uncle aunts and grandparents). They take care of each other without any specific interest. . (Hofstede 2005)

According to Hofstede, Pakistani culture is collectivistic whereas USA has individualistic culture. (ITIM [no date])

**Masculinity verses Femininity:**

“The extent to which a culture conducive to dominance, assertiveness and acquisition of things versus a culture which is more conducive to people, feelings and the quality of life”
The distribution of roles between the genders is another fundamental issue for any society. In masculine societies, roles of genders are clearly distinct i.e. men are supposed to be aggressive, tough and focussed on material success, whereas women are supposed to be modest and concerned with the quality of life. While, femininity are those societies where role of genders overlap. It means both men and women are supposed to be tender, modest and concerned with the quality of life. (Hofstede 2005)

Sweden, Norway and Denmark are feminine cultures whereas Pakistan has masculine culture. (ITIM [no date])

**Uncertainty Avoidance:**

“The degree to which people in a country prefer structured over unstructured situations”

It deals with the society’s tolerance for unstructured and uncertain situations. It shows that a culture programs its members to feel comfortable or uncomfortable in unstructured situations. Unstructured situations are novel, surprising and different from usual. Uncertainty avoiding cultures avoids such situations by strict rules, security measures and religious believes in absolute truth. People belonging to such cultures are more emotional and motivated. On the other hand, uncertainty accepting cultures are more open to different kind of unstructured situations. (Hofstede 2005)

Singapore has a low uncertainty avoidance culture whereas Pakistan has a high uncertainty avoidance culture. (ITIM [no date])

**Long Term verses Short Term Orientation:**

“Long term: values oriented towards the future, like saving and the persistence- short term: values oriented towards the past and present, like respect for tradition and fulfilling social obligations”

Long term oriented societies are characterized by persistence and thrift. Where as in short term oriented cultures people are more concerned with the traditions and they have strong social values. (Hofstede 2005)

**3.1.4 Technological Environment:**

Market place is changing radically as a result of advancements in technology. There are three different aspects of technology: type of technology, its process, and the impetus for its development. Type of technology preferred by a company is dedicated by its interest. (Jain 1999, p.136) Technological environment may be the most dramatic force in changing the working style and destiny of the firms. Technology is changing rapidly and every new technology replaces an older one. New markets and opportunities are created by new technologies; the marketers should watch these trends in technology in order to compete. Companies which fail to anticipate and keep up with technological change find their products outdated soon. Firms must track technological trends and determine that whether their product is fulfilling the customer’s demands still or not. Some major factors
of technological environment may be R&D activity, automation, technology incentives, rate of technological change, impact of emerging technologies, impact of internet and reduction in communication costs. Marketers need to understand the new technologies and the ways that how these technologies can be helpful to serve customers. (Kotler 1999, p.185)

Now, we’ll describe Porter’s five forces model which is mainly used to get a clear picture of the market external forces which have a significant impact on strategy formation at micro level.

3.2 Porter Five Forces:

Competitive strategy means how company is related to its environment. Environment can be very big including social, economical and Political but the main environment of the firm is the industry in which firm is operating. For example, for Islamic bank, banking industry is the main environment. Forces outside the industry are of significant importance in determining the overall efficiency of the industry. These forces effect all the firms in the industry but method of dealing with these forces vary from firm to firm. The state of competition for a company depends on the fives competing forces. The overall strength of these forces determines the success and progress of the company. (Porter 1980)

The strength of these forces varies from company to company, it is very deep in the companies like paper and food where competition is very intense and it is very low in the companies like oil field equipment and car manufacturing. These forces are:

1. Threat of New entrants
2. Rivalry among Existing firms
3. Bargaining power of buyers
4. Bargaining power of suppliers
5. Threat of Substitute products or services
3.2.1 Threats of New entrants:

When a new company wants to enter into the industry, it will often come with the low prices of its products and try to gain the market share, thus it will decrease the overall profitability of already running companies in the industry. So according to porter, the easier it is for new entrants to enter in the industry, the tougher will be the competition. Factors that limit the entry of the new entrants in the industry are called barriers to the entry. If the barriers are high, the threat of new entrants will be low. The following are the some main factors:

a) Economy of Scale:

“Economies of scale refer to declines in unit costs of a product as the absolute volume per period increases”. (Porter 1980) If the economy of scale is higher then the new entrants will face problem of either entering on small scale with high unit cost or by entering at large scale and face the risk of failure of their product. (Grant 2002)
Multi-business companies can increase the scale of economy and thus decrease the threat of new entrants. For example, if a company is producing small electric motors which can be used in their other products like fans, air conditions and hair dryers, then the prices of fans and air-conditions will be low as compared to other firms that are not producing small electronic motors. (Porter 1980)

According to Michael porter, one of winning competitive strategy is the overall cost leadership in which company works hard to achieve the lowest cost of production. So as to keep the price of its product lower than its competitors and enjoy the large market share. (Kotler 1999, pg.517)

b) Product Differentiation:

Product differentiation means that companies have established their brands and customer loyalties by proper advertising and customer services. So the new entrants have to invest heavily for creating their brand and also there would be no guarantee whether their brand will succeed or not. This thing will also decrease the threats of new entrants. (Porter 1980)

According to Michael Porter, differentiation is the winning strategy to compete in the market. Customers will buy the brand if it is different and low price and it will give the company a competitive edge over its competitors. (Kotler 1999)

c) Capital Requirements:

If an industry required investing large financial resources in order to compete, it will create the barrier to new entrants. Like in banking sector, large financial resources are needed to enter in this sector.

d) Legal Barriers:

Legal and Government policies are very crucial and these are the strongest barrier for the new entrants. Government can limit the entry of the companies in particular industry by license requirements and by applying different tax policies. (Jain 1999)

3.2.2 Intensity of Rivalry among existing competitors:

For gaining a good market place, rivalry among the competitors within same industry takes place through lowering the price of the products, by advertising battles and by increasing the customer services. Among these forms of competition, price competition is highly unstable because if a company lowers its prices then all its competitors have to lower the prices and it will decrease the revenues of all the firms. But advertisement battle can expand demand and ultimately greater revenue for all the firms. (Porter 1980)

Intensity of rivalry depends on these industry characteristics:
a) Equally balanced Competitors

When there are large numbers of firms within the industry then there will be greater competition among them. The firms will try to earn greater profits and they will fight with each other through price competition, advertisement and their customer services. But if few firms are enjoying the market share then the intensity of rivalry will be weaker.

b) Lack of differentiation:

This is the situation where services are perceived as a commodity and buyers choose these services or products on the basis of price better service. This type of situation creates intense competition among the firms. On the other hand, product differentiation reduces the competition because now buyers will buy things on the basis of loyalties and preferences to particular sellers. (Porter 1980)

c) Diverse Competitors:

Companies may diverse in visions, goals and strategies. This will give them the opportunity to avoid price competition using their own market strategy which will be different from other companies.

d) Exit barriers:

Barriers to exit work same like barriers to entry. Companies will be unable to exit the particular industry due to different exit barriers and that’s why they have to compete and competition automatically increases. Some exit and entry barriers are shown in the table.

Figure 6: exit and entry barriers

<table>
<thead>
<tr>
<th>Easy to enter if there is:</th>
<th>Difficult to enter:</th>
</tr>
</thead>
<tbody>
<tr>
<td>➢ Common technology</td>
<td>➢ Difficulty in brand switching</td>
</tr>
<tr>
<td>➢ Little brand franchise</td>
<td>➢ Restricted distribution channels</td>
</tr>
<tr>
<td>➢ Access to distribution channels</td>
<td>➢ High economy of scale</td>
</tr>
<tr>
<td>➢ Low economy of scale</td>
<td>➢ Large capital required to start</td>
</tr>
<tr>
<td>➢ Mild Government policies</td>
<td>➢ Strict Govt. policies</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Easy to exit:</th>
<th>Difficult to exit:</th>
</tr>
</thead>
<tbody>
<tr>
<td>➢ Salable Assets</td>
<td>➢ Specialized assets</td>
</tr>
<tr>
<td>➢ Low exit costs</td>
<td>➢ High exit costs</td>
</tr>
<tr>
<td>➢ Independent business</td>
<td>➢ Interrelated business</td>
</tr>
<tr>
<td></td>
<td>➢ Govt. restrict the exit</td>
</tr>
</tbody>
</table>

Source: (quickMba [no date])
3.2.3 Bargaining power of Buyers:

The impact which customers have on any industry is called the bargaining power of the buyers. If there are number of suppliers and only one buyer then buyer would have greater influence in determining the price of the product. High bargaining power of the customers increases the competition among the firms. (Porter 1980)
If the bargaining power of buyers is weak as compared to producers then it can be balanced by giving good customer services to the customers. (Britton 2003)
The reasons why bargaining power of buyers can increase are as follows:

a) Size of buyers:

If buyers are concentrated in the area and purchasing large volumes of the products as compared to seller sales, then this will increase the importance of the buyers and thus increase the bargaining power of buyers.

b) Differentiation:

If there is less differentiation among different products of the market, then buyers can easily switch to other products on the basis of price and it will also increase the bargaining power of buyers.

c) Switching costs:

The low switching cost provides the buyers an option to switch among different products easily. This thing can be overcome by giving proper services to the customers by improving quality and services. (Drucker 1974)

d) The buyer has full information:

If the buyer has full information about the demand, suppliers and actual price then it will increase its bargaining power. (Porter 1980), (Kotler 1999)

3.2.4 Bargaining power of Suppliers:

An industry that is producing goods or giving services requires different raw material and specialized services from their suppliers. Suppliers can use their bargaining power by increasing the prices of the raw material or by decreasing the services they are providing.

a) Concentration or Size of Suppliers:

If Suppliers are concentrated in the area as compared to their respective industry and supplies are controlled by a few companies, then it will increase the bargaining power of suppliers.
**b) Differentiation:**

If there is less differentiation among the different firms of market, then suppliers can easily switch to other firms on the basis of price and it will also increase the bargaining power of suppliers.

**c) Switching costs:**

The low switching cost provides the suppliers with the option to switch among different companies easily. (Porter 1980)

Figure 7: Buyers and suppliers power

<table>
<thead>
<tr>
<th>Buyers are powerful if:</th>
<th>Suppliers are powerful if:</th>
</tr>
</thead>
<tbody>
<tr>
<td>➢ Buyers are concentrated - there are a few buyers with significant market share.</td>
<td></td>
</tr>
<tr>
<td>➢ Buyers purchase a significant portion of output – distribution of purchases or if the product is standardized.</td>
<td></td>
</tr>
<tr>
<td>➢ Buyers possess a credible backward integration threat – can threaten to buy producing firm or rival.</td>
<td></td>
</tr>
<tr>
<td>➢ Credible forward integration threat by suppliers.</td>
<td></td>
</tr>
<tr>
<td>➢ Suppliers concentrated.</td>
<td></td>
</tr>
<tr>
<td>➢ Significant cost to switch suppliers.</td>
<td></td>
</tr>
<tr>
<td>➢ Customers powerful.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Buyers are weak if:</th>
<th>Suppliers are weak if:</th>
</tr>
</thead>
<tbody>
<tr>
<td>➢ Producers threaten forward integration – producer can take over own distribution/retailing.</td>
<td></td>
</tr>
<tr>
<td>➢ Significant buyer switching costs – product not standardized and buyer cannot easily switch to another product.</td>
<td></td>
</tr>
<tr>
<td>➢ Buyers are fragmented – no buyer has any particular influence on product or price.</td>
<td></td>
</tr>
<tr>
<td>➢ Many competitive suppliers – product is standardized.</td>
<td></td>
</tr>
<tr>
<td>➢ Purchase commodity products.</td>
<td></td>
</tr>
<tr>
<td>➢ Concentrated purchasers.</td>
<td></td>
</tr>
<tr>
<td>➢ Customers weak.</td>
<td></td>
</tr>
</tbody>
</table>

Source: (quickMba [no date])
**3.2.5 Threat of Substitutes:**

According to Porter, all firms in an industry compete with other industries that are producing substitute products. Substitute limits the profit of the firms because customers will have more choices due to difference of prices. For example, in security guard industry, electronic alarm systems became a potential substitute. (Porter 1980)

There will be greater competition if more and more substitute products are available. Identifying the substitute product means to identify those products in the market that are performing the same function as the product of the industry. In early days, buyers were not aware of the substitutes due to lack of advertisements but now buyers are more aware of substitutes products, so threat of substitutes is little higher. (Kotler 1999)

**4-Ansoff Matrix:**

The Ansoff matrix provide the knowledge of products and market choice available to the organization. Market means the customers and products means items needed by these customers. (Lynch 2003) marketing objectives can only be achieved by studying the customers and the products.

Once the marketing objectives are defined then the question comes that what products/services should Islamic bank bring into the market. The Ansoff matrix identifies four possible market/product combinations. (Ansoff 1957, 1989)

Figure 8: Ansoff Matrix

![Ansoff Matrix](image)

Source: (Ansoff 1957)

Four options are available for the companies that want a rapid growth in their existing business. (Kotler 2000, p# 28)
**Market Penetration:**

Market penetration is a technique in which company penetrates the market with its already existing products. The main focus is to retain the already existing customers rather to attract the new customers. (Ansoff 1957)

**Product Development:**

Another approach is to develop new product for the same market segment. The product should be innovative one, not the minor changes in the previous product. This strategy is used for getting the new customers.

**Market Development:**

In this strategy, companies attract new customers for the same existing products by engaging in the new markets.

**Diversification:**

Companies may diverse in visions, goals and strategies. This will give them the opportunity to avoid price competition using their own market strategy which will be different from other companies. (Porter 1980)

Diversification means the new products and new services in the new market place. It is to identify the opportunities to add some more attractive businesses in the already existing business that are totally different from the current business. (Kotler 2000)

**Summary:**

We described in detail the theoretical framework for our research in this section. We explained PEST analysis and Porter’s five forces model as we are going to map our empirical findings according to this theoretical framework and get some analytical data in the coming chapters. We have also explained Ansoff matrix as we’ll use it in analysis and recommendation’s sections etc. The next section will present the empirical findings.
4- Empirical Findings:

In this chapter we’ll present the empirical findings related to the theories described in last segment. These empirical findings are related to micro and macro environment for Islamic banking sector in Pakistan. We’ll try to give a detailed overview about the present situations in Pakistan for banking sector in these findings.

4.1 Uncontrollable Environmental factors for Islamic Banking in Pakistan:

The uncontrollable environmental factors for Islamic banking in Pakistan are presented in the following heads:

4.1.1 Political and Legal Environment:

Pakistan has tried various forms of parliamentary, military and presidential governments in trying to achieve political stability. (Library of congress 2005) Pakistan got its independence in 1947 through a democratic and constitutional struggle. Although history of democratic governments is not so good and consistent but Pakistan after many crises has returned to democratic form of government again. The constitution of the Islamic Republic of Pakistan adopted in 1985 provides for a federal parliamentary system with a president as head of state and a popularly elected prime minister as head of government. The Federal Government assists the prime minister in running the affairs of government. (infopak 2006) Another very important and critical aspect of Pakistan’s legacy is the role of military forces (particularly army) in the governing bodies. Military has overtaken the government many times since independence. Military has always favored its actions by the doctrine of necessity. The military remains one of the country's most cohesive national institutions. (Library of congress 2005)

There is also seen much interference of United States in the policies of Pakistan made by politicians and government. Pakistan's relations with the United States developed against the backdrop of the Cold War. Now Pakistan is playing its role as front state against terrorism as a strategic partner with United States. (Library of congress 2005) Pakistan opened its economy for private investors as it came into existence in 1947 but kept some sectors in its own control like manufacturing and operations of railroads, energy generation, telecommunication and military arm manufacturing industry. Government gave incentives to private investors and the in 1960s economy of the Pakistan became a model of prosperity for developing countries. But the living standard of common man did not improve as the whole economy was under the control of 40 industrial groups. In 1972, the new government nationalized the economy and as result there occurred a fled of private capital from the country. General Zia, a military dictator took the control of government in 1977 and introduced free economy. Government of Nawaz Sharif in 1990s introduced liberalization and deregulation in the economy on large scale. Pervez Musharraf, a military dictator took the control of government in 1999 and his government introduced many new policies for open economy and provided
incentives to private investors. (Library of congress 2005) Now there is again an elected new government which was formed after the elections of 18 February, 2008.

Before the creation of country, the role of Muslims of the areas which were later included in Pakistan was of no significance due to their restricted participation in the banking sector. There was only a small bank namely Australasia Bank having a few branches in Lahore and its suburbs. In 1942, the Australasia bank was housed in a garage of a trader of Lahore who used to trade at a small scale with Australia during that period. However the only Bank was run by the Muslims of the sub-continent was Habib Bank which was established in 1941. When Pakistan came in to being The Habib Bank shifted its Headquarters from India to Karachi. A few of Habib Bank's branches were already in operation in Pakistan. The Muslim Commercial Bank also moved its headquarters from Calcutta to Dhaka and later on to Karachi. At the time of independence, another small bank namely Bank of Bahawalpur also started business from Bahawalpur from December 1947. (Baig 1999)

With the passage of time many new Government and private banks started their operations in Pakistan. In 1980s there was given emphasis for the introduction of Islamic banking (Interest free banking) by the government. The government (Ziaul Haq’s government (a military dictator)) of Pakistan took initiative to institutionalize the interest free banking but never pursued it seriously. On one hand, government wanted to eliminate the interest from the economy but on the other hand, it put a ten year ban on the Federal Shariat Court (FSC) to issue any verdict against the interest based government transactions. The governments that came after the departure of Ziaul Haq did not take any serious interest in implementing interest free banking. In 1990, “the Islami Jamhoori Itihad (IJI)” government put the agenda of transforming the economy on Islamic lines. However, it challenged the 1991 FSC judgement on riba in the SC of Pakistan that had ordered the government to clean interest from the national economy within six months. The government argued that bank interest is not riba and it is completely impossible in the present day circumstances to break up the economy of Pakistan from the international economy by abolishing interest. These contradictions in the sayings and actions of the IJI government revealed that it took these Islamic measures to win the support of people, not for actually implementing it. The military government that came into power in October 1999 showed serious Intentions to transform the economy on interest-free lines under the defined parameters of the 1999 SC judgment on riba. But then it went on supporting the petition of the United Bank Limited in the SC, requesting for the suspension of its judgment on riba. The present government’s claim that it has been promoting the interest-free banking practice under a dual system is not realistic. In fact, the conventional banking system has been a good source of funding for the government, but the interest-free banking was supposed to be not. Therefore, the government did not make any sincere efforts to enforce the interest-free economy in Pakistan. (Khan & Bhatti 2006[nl])

Some main troubles in the society of Pakistan include: bribery, distortion of rules and procedures, favoritism, misuse of funds, abuse of power, illegal appointments and black marketing etc. Regular media reports and enquiring results show that a significant number of politicians, top officials and bank executives have been involved in financial
scams and misuse of power. A large number of business people have been engaged in hoarding, corruption, bribery and tax evasion. (Nadeem, 1993)

Financial system in Pakistan was suffering from political interference even in lending decisions and management appointments. Most of the banks were doing businesses with government or some specific big industrialists and the middle class was being ignored. There were a lot of reasons behind this but to overcome this situation, banking sector reforms were introduced by the SBP (state bank of Pakistan). IMF and the World Bank quoted about these reforms as “far reaching reforms have resulted in a more efficient and competitive financial system. In particular, the pre-dominantly state-owned banking system has been transformed into one that is predominantly under the control of the private sector. The legislative framework and the State Bank of Pakistan’s supervisory capacity have been improved substantially. As a result, the financial sector is sounder and exhibits an increased resilience to shocks”.

The Musharraf government took some bold political steps like privatization of banks and reducing the labor force etc. Some of the major reforms can be listed as:

- All the nationalized banks were privatized except one. Pakistan liberalized its foreign exchange regime so that these could meet the demands of Pakistani citizens. A number of incentives were provided to encourage mortgage financing by banks. A new ordinance was introduced to minimize legal difficulties and time delays in recovery of defaulted loans. Licensing and regulatory environment for micro financing institutions was relaxed.
- Government reduced the tax on banks from 58 percent to 41 percent and aimed to lower it to 35 percent in next two years. Islamic banking system was introduced in parallel with conventional banks for consumer’s choice. Many middle and low class individuals and firms were not dealing with conventional banks due to their strong religious belief about prohibition of riba (interest). The State Bank of Pakistan has set up an Islamic banking department and a Shariah Advisory Board to help in the promotion of Islamic banking in the country. The banking supervision and regulatory capacity of the central bank was strengthened. (Husain 2005)

The legal environment in which banks perform their operations is of worth importance that it should be dealt with carefully. (Levine 1998) SBP is the regulatory authority for banking sector in Pakistan and has introduced a legal framework for operations of banks. After being autonomous and empowered effectively, SBP has introduced a flexible legal framework which provides banks an opportunity to perform their operations in a decent manner and earn profits. Some points of this regulatory framework are listed as here:

- SBP has the complete authority to issue and transfer a license to a bank and set criteria for this purpose. Banks have to meet a capital requirement of $ 50 million as of December 2006 and it will be doubled by 31 December 2009. SBP is not issuing new licenses to conventional banks after a period of liberal licensing in order to encourage sector consolidation. Regulatory framework has restricted banks in engaging non-related commercial activities to avoid conflicts between banks and different businesses such as securities, insurance underwriting and real estate investment etc. Islamic banks are being issued new licenses while keeping in view serving the development needs of underserved part of population. Six Islamic banks and 6 micro finance have been allowed so far and it is expected that they will constitute the at least 10% of total banking sector by 2010. A
recent World Bank study on South Asia “Access to Finance” ranked Pakistan corporate governance standards highest among South Asia. SBP in partnership with the ICAP (the premier accounting body of the country) and commercial banks has facilitated adoption of International Accounting Standards (IAS) by the banks. Banks can offer new financing schemes and innovative products to meet the financial requirements of SMEs under SBP regulatory framework. (Governor SBP 2007)

4.1.2 Economical Environment:

Pakistan’s economy has made admirable progress in last couple of years through a comprehensive program. The main aims and goals of this program included, restoring investor’s confidence through stability and consistency in economic policies, issuance of relax work permits, tax reforms, increasing domestic savings, restructuring and privatizing state enterprises, boosting agriculture and reviving industry. Government also introduced a program of financial reforms in order to enhance a competition in banking sector by eliminating directed credit and improving regulation and supervision. (Bureau of Economic and Business Affairs 2002)

GDP growth rate of Pakistan has been showing a consistency of 6 % plus during last four years. There is also seen an increase in per capita incomes that marked almost $ 850. Rate of unemployment has gone down to some extent and the size of economy is double which is now $ 130 billion. Large scale manufacturing has grown in double digits and the cumulative private sector credit by banking system in last three years was more than $15 billion compared to less than $10 billion in the previous ten years. Foreign direct investment (FDI) in Pakistan is increasing every year and is amounting to $ 3 billion and it is the highest FDI amount in South Asia. (Husain 2006) Fast and sustained growth of Pakistan’s economy has enabled Pakistan to position itself as one of the fastest growing economies of the Asian region. This economic growth of Pakistan has got the attention of foreign investors and leading companies and they are investing in different projects in Pakistan. The gradual increase in oil prices and food prices is impacting the economy of whole world including Pakistan. There was a big disaster in Pakistan as a result of a sever Earth quake of October, 2005, but Pakistan’s growth for the year remained impressive instead of these all issues. The service sector showed continuity in its performance and grew by 8 % as against the target of 7 %. Spending power of consumers is also going in upward directions. (Business Recorder 2007)

FDI from United States to Pakistan has increased by a significant amount from $ 635.8 million to $ 1139.9 million during the 1st nine months of the current fiscal year. The US has been the largest investor in Pakistan, accounting for 37.5 % of the total FDI followed by UAE (10.5 %), UK (9.2%), Norway (4.4 %), Switzerland (4.4 %), Oman (4.0 %), Japan (3.0 %), Netherlands (2.9 %) etc. Two sectors remained as major attractive sectors for foreign investors’ i-e communication and financial businesses and 22.5 % was attracted by financial businesses. (Ministry of Finance 2007)

The largest sector in Pakistan in terms of potential clients is the microfinance sector that consists of more than 25to 30 million poor people. This sector is still being considered
underdeveloped having less than 4 % outreach, narrow institutional base and limited capacity due to Pakistan’s late entry in the microfinance sector. (Chaoudry 2007)

Housing is one of the basic necessities of human and the demand of housing in urban areas of Pakistan is increasing at the rate of 8 %. Pakistan is facing real problem in housing units and price of real estate is increasing day by day and as a result it’s becoming very difficult for a common man to build have his own house. Pakistan is facing a shortage of 7.5 million housing units and 3 to 6 persons are living in a house of one room on average. Mainly the mortgage market is being held and dominated by House Building finance Corporation (HBFC) with a market share of 82 %. Government is giving priority to housing sector and allocated significant resources for the development of his sector. The potential effects of the sector will be employment opportunities besides generating industrial, commerce and trade activities. SBP is playing its role as a facilitator, guide and catalyst for the sector. (Javaid 2006)

Consumer financing was noted at 15.4 billion at end of September, 2007 against Rs. 6.4 billion as at end June, 2006. The overall size of financial sector Pakistan has grown by 15 % and it was noted as 6.9 trillion in the 1st half of 2007 as compared to Rs. 5.96 trillion in the full year of 2006. Islamic banking assets are currently holding 3.2 % of total banking assets but its growth has been recorded as 15 % in the 1st quarter of current fiscal year. Assets of Islamic banking have increased from 118 billion in December, 2006 to Rs. 135 billion in March, 2007. FDI in Pakistan’s Islamic banking sector has grown over Rs. 20 billion by the end of September, 2007 and it is expecting an inflow of Rs. 35 billion in next few months. Pakistan is an agricultural country and growth of agricultural sector was recorded at 5% in 2007. Inflation rate rose to 7.8 % due to increase in food prices in 2006-07. During 2007, the KSE-100 index also showed an increase of 40 % and market capitalization became Rs. 4.33 million. Pakistan is also showing its commitment in privatization sector and 166 public sector units have been privatized so far by the government resulting in revenue of $ 7 billion. (Highlights of Economic Events 2007)

In spite of all these positive movements and positively growing statistics, unemployment situation has not yet improved in Pakistan. There is a strong linkage between unemployment and poverty. About one third of the population is living their lives in poverty and most of the rural areas are still very poor. Unemployment rate has declined from 8.3 % to 7.7 % in last two years but the trend is not well spread either geographically or sector-wise. (Governor SBP 2007)

4.1.3 Socio-cultural Environment:

Pakistan is located on a very important geographically location. It is located in the northwestern part of South Asia subcontinent, sharing its border with Iran on the west, Afghanistan on the northwest, China on the northeast, India on the East, and Arabian Sea on the South. The total land area is about 803,940 square kilometers. (U.S. Library of Congress [no date])
There are mainly five ethnic groups in Pakistan and these are Punjabi, Sindhi, Pashto, Muhajirs and Baloch. Languages are the most common identity of ethnicity in Pakistan. There are more than twenty languages that are spoken in Pakistan, but the most common languages are Punjabi, Sindhi, Urdu, Pashto and Balochi. Urdu is the official language and is spoken and read all over the Pakistan. English is the medium of education in most of the schools and universities; therefore it is a de facto national language of Pakistan. (Library of Congress 2005)

The culture of Pakistan has a great influence of the cultures of central Asia, India and the Middle East. Pakistan has a rich cultural and traditional background going back to Indus valley civilization. The region of Pakistan has been invaded in the past, occupied and settled by many different people, including Dravidians, Aryans, Greeks, White Huns, Persians, Arabs, Turks, Mongols and various Eurasian groups. And indeed the region has formed a distinct cultural unit within the main cultural complex of South Asia from prehistoric times. There are differences in culture among the different ethnic groups in matters such as dress, food, and religion, especially where pre-Islamic customs differ from Islamic practices. The cultural origins come from the civilizations of North India and eastern Afghanistan, with significant influences from Persia, Turkistan and Hellenistic Greece. However, it was the first part of the subcontinent to receive the full impact of Islam. Hence it has developed an identity of its own. (Culture of Pakistan [no date])

Pakistan becomes the world’s sixth most populous nation with a population of more than 162 million of which 70 % lives in rural areas and remaining 30 % is in urban areas. Pakistan is an agricultural country and most of the people of rural areas are engaged in agriculture business. The legal work time is 48 hours in a week and the monthly minimum wages is US$ 50 to US$ 75 of an unskilled labor and the highest pay of a managing director is from US$ 4000 to US$ 8000 approximately. (International Labor Organization 2005)

The Pakistan Literacy rate is low as compare to other developing countries. The literacy rate is 48.7% of total population in the year 2007. There are 35.2% female can read and write and 61.7% male can read and write. There is a remarkable difference between both sexes. (CIA world Fact book 2007)

According to Hofstede’s five dimensional cultural model, there is unequal distribution of power and wealth among the people of Pakistan and it causes an increase in power distance. In Pakistan there is a strong joint family system in which people not only take care of their immediate family but also their uncles, aunt and grandparents. So in Pakistan there is a collectivism culture. In Pakistan there is a male dominant society in which opinion of males are preferred over those of females in many parts of life. So there is a masculinity dimension of culture in Pakistan. Pakistan is a Muslim country, where Muslim population is far greater than the Hindu, Christianity and other minorities. People have strong believes in their religion and in absolute truth. This factor marks Pakistani culture as an uncertainty avoidance culture. In Pakistan people have respect for their traditions and emotional behavior is reflected by their attitudes. People are more attached
to their social values. So, Pakistani culture can be regarded as short term oriented culture. (Description of Hofstede [no date])

4.1.4 Technology:

Technology is a common word used now a days referring to methods and techniques for facilitating the work of different people. Technology is important in almost every field of life from e-shopping to e-banking. Information technology is now the backbone of the growth of every country.

Pakistan govt. has launched its technology policy in year 2000 to keep pace with the fast moving world. Many companies in Pakistan are now relying on different technologies, mainly IT for improving their work standards and to satisfy their customers. For example, before the use of IT, Pakistan banking sector was very slow but almost every bank is using different technologies to satisfy their customers now. One important thing in the technology development is the technology acceptance, how employees and customers react emotionally to the acceptance of the new technology. (Wajeeh 2008)

In Pakistan, branchless banking is becoming very common and showing tremendous growth. Banks are introducing new techniques to facilitate their clients. Internet banking, mobile banking, ATM’s are some examples. But still banking in Pakistan is being conducted through branches using papers and forms mainly. (Asad 2007)

Figure 9: Electronic banking

<table>
<thead>
<tr>
<th>Number of retail transactions.</th>
<th>Jul-Sep 2005</th>
<th>Jul-Sep 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electronic based.</td>
<td>15,611</td>
<td>21,723</td>
</tr>
<tr>
<td>Paper based</td>
<td>66,572</td>
<td>79,677</td>
</tr>
<tr>
<td>No. of installed ATM’s</td>
<td>1,142</td>
<td>1,729</td>
</tr>
<tr>
<td>Transaction through ATM’s (99% cash withdrawals)</td>
<td>10.58 million valuing 60.778 billion</td>
<td>11.4 million valuing Rs. 70.3 billion</td>
</tr>
<tr>
<td>Funds transfer through ATM’s</td>
<td>31 thousand transactions valuing Rs. 278.72 million</td>
<td>43 thousand transactions valuing Rs. 1, 717 million</td>
</tr>
<tr>
<td>Online branches</td>
<td>3,030 out of total 7077 (43%)</td>
<td>3, 761 out of total 7, 462 (50%)</td>
</tr>
</tbody>
</table>

Source: (Asad 2007)

Online banking was the first step towards the use of technology in banking. Now people can do transactions through their mobile phones. People can pay their utility bills through the simple method from their mobile phones. The chances of bank robberies would go down automatically and bank customers would be more secure and safe in making banking transactions. It not only saved cost but also provided convenience for the customers as they are now able to carry out transactions from their place without travelling to the nearest bank branch. (Hussain 2005)
Pakistan has also a number of barriers in electronic commerce. There is no proper infrastructure available. There are insufficient telephone lines in the country and frequent power supply failure is another major problem. There is not adequate security for online transactions and also very few people are using internet in Pakistan. But now internet users are increasing in Pakistan. There were almost 10 million internet users in 2005 and it has reached to 12 million by the end of 2007. Internet services are expanded to 2339 cities and towns in Pakistan. (Country commerce 2006)

4.2 Porter five forces:

In this segment, we will present the empirical findings related to the porter five forces.

4.2.1 Intensity of Rivalry among existing competitors:

In Pakistan, conventional banks are running in parallel with Islamic banks providing the choice to the customers. Before Islamic banks, Most of the Pakistani people were not doing business with the banks because of their strong believes against interest based banking. These people were mostly from the middle class and low class, now have the opportunity to invest in different businesses by taking loans from Islamic banks without any interest. (Husain 2004)

Meezan bank was the First full fledged Islamic bank in Pakistan that started its operations in January 2002. (meezanbank 2007)

For the promotion of Islamic banking, SBP allowed financial institutions to establish full fledge Islamic banks or subsidiaries of Islamic banking or different stand alone branches by already running commercial banks. There are six full time Islamic banks with more than 150 branches as on 31st December 2007 and many commercial banks are opening stand alone branches of Islamic banking as the demand is increasing.

Islamic banking is showing a decent growth in Pakistan constituting an asset base of Rs. 178 billion and deposits of Rs. 124 billion at end of September 2007 as compared to Rs. 159 billion and Rs. 108 billion respectively in September 2007. However, the share of Islamic banking to the conventional banking is 3.8% of the asset and 3.6% of the total deposits. (SBP 2007)
Table: Position of Islamic banks

<table>
<thead>
<tr>
<th>Descriptions</th>
<th>Sep-07</th>
<th>Jun-07</th>
<th>Dec-07</th>
<th>Dec-05</th>
<th>Dec-04</th>
<th>Dec-03</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total assets</td>
<td>178</td>
<td>159</td>
<td>118</td>
<td>72</td>
<td>44</td>
<td>13</td>
</tr>
<tr>
<td>% of banking industry</td>
<td>3.8%</td>
<td>3.4%</td>
<td>2.9%</td>
<td>2.1%</td>
<td>1.4%</td>
<td>0.5%</td>
</tr>
<tr>
<td>Deposits</td>
<td>124</td>
<td>108</td>
<td>83</td>
<td>50</td>
<td>30</td>
<td>8</td>
</tr>
<tr>
<td>% of banking industry</td>
<td>3.6%</td>
<td>3.1%</td>
<td>2.8%</td>
<td>1.9%</td>
<td>1.2%</td>
<td>0.4%</td>
</tr>
<tr>
<td>Financing &amp; Invest</td>
<td>114</td>
<td>90</td>
<td>72</td>
<td>48</td>
<td>30</td>
<td>10</td>
</tr>
<tr>
<td>% of banking industry</td>
<td>3.2%</td>
<td>2.6%</td>
<td>2.4%</td>
<td>1.8%</td>
<td>1.3%</td>
<td>0.5%</td>
</tr>
<tr>
<td>Full-fledged Islamic banks</td>
<td>6</td>
<td>6</td>
<td>4</td>
<td>2</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Conventional banks with Islamic banking branches</td>
<td>12*</td>
<td>13</td>
<td>12</td>
<td>9</td>
<td>7</td>
<td>3</td>
</tr>
<tr>
<td>No. of branches</td>
<td>207</td>
<td>167</td>
<td>150</td>
<td>70</td>
<td>48</td>
<td>17</td>
</tr>
</tbody>
</table>

Source: (SBP 2007)

Islamic banking is now available in more than 16 big cities of Pakistan however conventional banks are covering almost the whole Pakistan including small and big cities. There are large numbers of foreign banks present in Pakistan which are also opening Islamic banking branches. (Qureshi 2007)

In money market, the objective is to meet the liquidity requirements whenever they arise. The market facilitates those banks which need money to borrow the surplus amount of the other banks. Islamic money market performs the same function of meeting the short term liquidity needs but instead of taking interest, it facilitates Islamic banks to share surplus amount on profit and loss bases. The conventional banks are taking advantage of Islamic money market through their Islamic branches. But full-fledged Islamic banks will only have to deal with in Islamic money market and can’t take advantage from conventional money market. (Kaleem 2007)

There is not much differentiation among the products within Islamic banking; however the products are slightly different from the conventional banks. But as now conventional banks are also opening Islamic branches, that’s why product differentiation is very less. (Ladyjay 2007)

A total of 44 banks are operating in Pakistan, 25 are domestic and 19 are foreign banks. The 25 domestic banks have more than 8,000 branches all over the Pakistan. Commercial banks are more interested in doing business in corporate sector, that’s why consumer banking is mostly undeveloped. Mostly banks are not interested in lending to poor individuals and these people purchase all the things on cash basis. (nationsencyclopedia 2007)
Most of the Islamic banks in Pakistan are doing business mainly with Ijarah (leasing) and Murahaba (cost plus). These two transactions are more or less similar like the conventional banks transactions with slight modification.

**Murabaha or Cost plus**

A Murabaha transaction is basically a cost plus profit financing transaction in which a tangible asset is purchased by an Islamic bank at the request of its customer from a supplier. The Islamic bank sells this asset to its customer on a deferred sales basis with a mark up, that is bank’s profit. The mark up on the asset cannot be altered during the life of the contract. The “Murabaha deals” offers enough flexibility to be used in real estate and project financing. In conventional banks, bank does not buy the asset rather gives money to the customer to buy it and charge interest on that money.

**Ijara or leasing**

Ijara is Islamic leasing concepts similar to western operating and finance leases. Ijara is similar to conventional operating lease, where in an Islamic bank (lesser) leases the asset to the client (lessee) for agreed on lease payments for a specified period of time, but with no option of ownership for the lessee. The maintenance and insurance is the responsibility of the lesser. (Zaher and Hassan 2001)
4.2.2 Threats of new Entrants:

State bank of Pakistan has the sole authority in issuing of license to the banks. Currently, banks are required to meet the capital requirements of $50 million that will be reached to $100 million by 31st December 2009.

SBP has given the suspension order of issuance of new bank license. SBP has stopped giving licenses to commercial banks but they are giving license to Islamic banks. Foreign interest in Pakistan banking sector and even in Islamic banking sector is very high and this banking sector has attracted almost $2 billion foreign capital inflow. Standard chartered bank has acquired union bank and is progressing very fast. All other major foreign banks like ABN AMRO, Citibank, and Saudi bank have interest in expanding their businesses. Foreign interest in Islamic banking is very strong and four out of six banks are foreign in this sector. Islamic banks are expected to have 10% market share of total banking sector of Pakistan by the end of 2010. (Governor SBP 2007)

The numbers of branches of Islamic banking are increasing with every year passing. There were 34 Islamic banking branches of conventional banks that are raised to 68 by
the end of 2007 and 37 branches of two Islamic banks in 2005 which are raised to 129 by the end of August 2007. Meezan bank is the strongest among the Islamic banking sector with more than 100 branches all over the Pakistan. (Financial stability review 2006)

Distribution costs of Islamic banking products as well as documentary and legal expenses are very high as compared to conventional banks. This is because Islamic banks focus on single transaction. They don’t have some universal frame to do all the transactions. There is also not standardization of Islamic banking instruments. Approval of each transaction by ‘shriah’ board is also a big hurdle in proper development of Islamic banking. Shriah board is the new board that is unique to Islamic banking. There is shortage of good Shriah scholars and there exits wide different point of view about the same product by different scholars, that’s why time required for proper structuring the new product and transactions becomes elongated. (Ishrat 2006)

Maybank (Malaysia largest bank) is also interested in buying the 20% shares of the leading bank in Pakistan i.e. MCB. MCB is one of the biggest banks in Pakistan and is renowned for its innovative products. (Sindhu 2008)

4.2.3 Bargaining Power of Buyers:

Pakistan is the 6th biggest country in the world with respect to population. Total population of Pakistan is more than 167 million by the year 2008 of which 52% are male and 48% are females. Literacy rate in Pakistan is 49.9%, male 63% and female 36%. Most of the population is living in rural areas and almost 35% are living in urban areas. Islam is the major religion and 97% of population is Muslim in Pakistan with 3% Christian and Hindus. (The world fact book 2008)

The buyers of Islamic banking can be divided into two broad categories.

1. General Public.
2. Institutions.

The general public can be divided into two main categories, those who are living in rural areas and those who are living in the urban areas. The concentration of Islamic banks is mainly in the big cities. (Wouters 2008) In big cities people who are dealing with banks are those, whose monthly income is more than 20,000 and they are very few. As the minimum amount of opening an account in the banks is mostly 10,000 RS. (MCB 2008)

10-15% of customers that are dealing with Islamic banking are new to banking who stayed away from conventional banking just because of the religion as conventional banking is interest based banking. (Anwar 2007)

Researches also divide Islamic banking customers into three categories.

1. Total religiously motivated.
2. Customers who demand high profit
3. Customers who are religious but also demand profit at least like conventional banks.

Customers related to 2\textsuperscript{nd} and 3\textsuperscript{rd} category are greater in number as compared to religiously motivated customers. Customers belonging to 2\textsuperscript{nd} category are mostly institutions; they demand high profit from banks irrespective whether it is Islamic banking or conventional banking. (Kaleem 2007)

Figure 13: Islamic banking Overview

<table>
<thead>
<tr>
<th>PAKISTAN Islamic banks - Subsidiaries - Standalone branches</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
</tr>
<tr>
<td>Deposits</td>
</tr>
<tr>
<td>Loans</td>
</tr>
<tr>
<td>Islamic banks</td>
</tr>
<tr>
<td>First licensed Islamic bank</td>
</tr>
<tr>
<td>Branches</td>
</tr>
<tr>
<td>Potential market*</td>
</tr>
<tr>
<td>Cities more than 100,000**</td>
</tr>
<tr>
<td>Cities more than 250,000**</td>
</tr>
<tr>
<td>Surface</td>
</tr>
<tr>
<td>Market share assets (%)</td>
</tr>
<tr>
<td>GDP overall*</td>
</tr>
<tr>
<td>GDP per capita*</td>
</tr>
<tr>
<td>Economic sectors (%)***</td>
</tr>
<tr>
<td>Labor force - sectors (%)***</td>
</tr>
<tr>
<td>Literacy (%)***</td>
</tr>
</tbody>
</table>

Source: (Wouters 2008)

In Pakistan, female population is 48\% of the total population of the country but still mostly they don’t deal with the banks. Literacy rate is one of the problems but the other problem is that women don’t know about the banking transactions. First women bank was founded in 1989 in Pakistan and it struggled a lot for the betterment of women. (Springwise 2006)
Islamic banks are mostly doing business in leasing and cost plus which is similar to the conventional banks transactions. These are not doing the microfinance and SME’s, that’s why people are in the state of confusion that whether this is Islamic banking or it is just the conventional banks using name of Islam. (Aziz 2007)

Penetration ratio of financial services is very low in Pakistan. Only 15 % of population is availing financial services and number of borrowers is only 3 % of the total population. There are only 171 deposit accounts per 1000 people and only 30 loan accounts per 1000 people in Pakistan.

There are also very high administrative costs in banks due to rising salaries of banking professionals and high operating costs. (Shamshad 2007)

Pakistan has more than a dozen major and multinational advertising agencies. Internet, television, radio and newspaper are largely used for the advertisements. There are more than 270 newspapers in Pakistan. Numbers of TV channels are increased from the past few years. Pakistan media regulatory authority has given 36 TV channel licenses to private companies.

In general, price is the most important factor in the promotion of the product. But Islamic banks are using the name “Islam” for their promotional activities. (UK trade & investment 2008)

4.2.4 Bargaining power of Suppliers:

The suppliers of the Islamic banking in Pakistan are as follows:

1. Shriah Scholars.
2. Professionals who are working in Islamic bank.
3. IT companies, those who are providing Islamic banks, with software and hardware.
4. Investors of Islamic banking like shareholders and government.

Islamic finance scholars are very few in the country and hence demand very high price of their services. The basis of Islamic banking is that its product should be inline with the Islamic shariah. There are not structured products and Islamic banking is dependent on the shriah scholars. (Samdani 2006)

Shriah Advisory Board is a basic part of the Islamic banking. The board consists of the Islamic scholars who give consultancy to the Islamic banks. Every bank in Pakistan has its own shriah board. These scholars are provided with the same information as in conventional banks editors are. In annual report of Islamic banking, this board certifies that all these transactions are according to Islam. (Burghardt 2004)

There is also shortage of trained and experienced Islamic banking human resource. There is a need of those professionals who have the knowledge of both banking and Shariah.
There are only a few Islamic banking professionals and banks are giving them huge compensation as compared to the market. (Ishrat 2006)

Banking software is always very complex and difficult to deploy within banks. Most of the banks have their own IT departments but these are just maintaining the system. (PSEB 2008)

Modarba (profit sharing) is the transaction of Islamic banking in which depositors become the suppliers of the capital and bank will invest it in some project and both will share the profit. The bank acts as the money manger and invests the money in some project. So, in this transaction bank’s customers become the bank’s supplier. (Zaman 2001)

4.2.5 Threat of substitutes:

Different Mudarba Companies and Mutual funds companies are doing their business in Pakistan and providing services to customers under the umbrella of Islamic non banking financial institutions (NBFI’s). Islamic NBFI’s growth rate in 2006 was 19.6 percent which is better than the year 2005 when it was only 13 percent. Mutual funds showed a great growth rate of 28 percent in an environment where conventional NBFI’s are ruling. (Financial stability review 2006)

Figure 14: Performance of Islamic NBFI’s

<table>
<thead>
<tr>
<th>Growth rates</th>
<th>Year 2005</th>
<th>Year 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Modarba Companies</td>
<td>19.7%</td>
<td>10.9%</td>
</tr>
<tr>
<td>Mutual Funds</td>
<td>6.5%</td>
<td>27.8%</td>
</tr>
<tr>
<td>Average growth</td>
<td>13.1%</td>
<td>19.3%</td>
</tr>
</tbody>
</table>

Source: (Financial stability review 2006)

State bank of Pakistan is also encouraging the establishment of microfinance banks to poor and low income people of Pakistan. State bank is expecting that it will help under privileged society of Pakistan to come out of the poverty. These banks will also follow the “Shriah” rules according to SBP. (Said 2007)

4.3 Summary:

We’ve presented empirical findings related to our research and theoretical framework in this section in detail. We tried to focus on all those empirical findings which are of considerable value in making analysis of the Islamic banking sector in Pakistan (in terms of opportunities, threats, strengths and weaknesses). Analysis of our research work based upon these findings will be presented in the next chapter.
5- Analysis:

In this chapter we’ll present our analysis about the current market scenario for Islamic banking in Pakistan. Our analysis will be based upon the theoretical framework and the Empirical findings which we have elaborated in previous sections.

5.1 Political Environment:

Analysis of Political environment is very critical and this environment has a strong influence upon the activities of any organization in a society. Political environment strongly affects the marketing decisions. The political stability of a country has its impact on the consistency of policies of local government. (Kotler et al 1999, p.167)

As we have discussed in the previous section (section # 4.1.1 ) that Pakistan has always been struggling for political stability since its creation. Government has been changing in Pakistan many times due to multiple reasons and most of the times Military has taken the charge of the government. So, there are significant political risks in Pakistan. Successive military and civilian regimes have failed to implement and formulate sound policies for long terms. Standard & Poor’s has rated Pakistan as high instable political environment. Pakistan has also suffered from a long periods of poor governance. (Liew 2003)

Each Government started his ruling with a different slogan. Zia-Ul-Haq gave a slogan of Islamization and in his times it was proposed that whole financial system of the country must be under Islamic laws. Without going into details of this (as discussed earlier), there has been a lot of ups and downs in policies. State bank of Pakistan has also been influenced by the ruling party as it was under the control of Ministry of finance. Religious groups have also great pressure on the government in policy making as people of the area are very sensitive in the matters of religion. Each ruling party is found involved in corruption. So, these political instabilities and problems like corruption is a very big hurdle for any sector to grow properly including Islamic banking.

But the positive aspect is that State bank of Pakistan has been given sovereignty and it is now an autonomous body in making its decisions. This factor has brought some stability in the policies of the State Bank of Pakistan for banking sector as the change of government has no concerns with them. So, banking sector is enjoying some long-term policies now. SBP has played a vital role in reforming banking sector and has provided guidelines for implementing Islamic banking as well. From this perspective environment becomes suitable and favorable for Islamic banking in the region as banking policies are being formed for long times and religious pressure groups are also in favor of this sector. Islamic banks can make their strategies accordingly as there is no chance for any major change of policies in near future. Legislation is not fully implemented but it is progressing slowly and going in right direction. Regulatory framework given by SBP for banking sector has defined the parameters for their operations. These parameters are flexible and are providing banking sector a fair market without conflicts. SBP has promoted Islamic banking as it has banned issuance of new licenses for conventional
banks but Islamic banks are still being granted. So, such legislation is going in favor for Islamic banking sector in Pakistan.

5.2 Economical:

Economy of a country plays a major role in the profitability and success of any sector and organization. Economic environment consists of factors that affect consumer purchasing power and spending patterns. Nearly all companies examine the economic environment before strategic planning. (Jain 1999, p.140)

As we have discussed Pakistani economy in last section (section # 4.1.2) and presented many facts and figures as well. It can be analyzed from those statistics that Pakistani economy is good for foreign investments and it is also good for Islamic banking sector of Pakistan.

Pakistan’s economy was a model economy for developing countries in 1960. But inconsistency in policies, wars with India and may other factors accounted bad for it. But the wide-range structural reforms which were implemented over the past few years have helped the economy in stabilizing itself. These reforms include trade liberalization, energy-sector deregulation, restructuring of banking sector and tax reforms etc. So, the economy is now less vulnerable to shocks. (Liew 2003)

GDP rate of Pakistan is showing a consistency in upward direction and per capita income has increased as compared to past. FDI is increasing every year. Home economy is in recovery phase but it is showing good indicators for banking sector. Some transactions of Islamic banking like modaraba have been promoted by giving incentives. As Pakistani economy is showing some level of stability and consistency from last couple of years, so it’s good sign Islamic banking as well.

5.3 Socio-Culture:

Deep study of local culture and social setups is also one of the major factors which account much in successful strategy formation. Varying types of consumer behaviors are found in different cultures. According to Kotler, culture is “the set of basic values, perceptions, wants and behaviors learned by a member of society from family and other important institutions.” (Kotler et al. 2004)

Pakistan is situated at very important geographically location and it has a diverse culture. Islam is the religion of majority of the population and Islam has deep and ever lasting influences upon the culture of the people of the area. So, the life style of people and attitudes of consumers is favorable for Islamic banking as people are religious and they want to deal in Islamic finances. Pakistani people have a respect for their religious and cultural celebrations. Islamic banking is taking an advantage of this socio-cultural environment of Pakistan. Pakistan is the 6th populous nation in the world. So it is a big market for any sector.
5.4 Technological:

Technological environment can act as the most dramatic force in changing the working style and destiny of the firms. Technology is changing rapidly and every new technology replaces an older one. Marketers need to understand the new technologies and the ways that how these technologies can be helpful to serve customers. (Kotler 1999, p.185)

Technology has reshaped the businesses and services as well. Technology has also brought a great change in banking sector. A lot of facilities are being provided to the customers by the banks which were not possible without it. In the world of technology, IT sector is the leading one which has revolutionized the world. There is lack of proper infrastructure in Pakistan, for that reason different sectors are not becoming able to cope with the technology. Banking sector has introduced a lot of innovative services with the help of technology. Islamic banking is also on its way but it is expanding slowly as compared with potential demand of Islamic banking.

5.5 Competition in Islamic banking industry:

This analysis is made on the basis of Porter five forces model.

5.5.1 Intensity of Rivalry among existing competitors:

The current competition in Islamic banking industry is very high and it is increasing with the passage of time. Competition is intense in the urban areas where most of the Islamic banks and conventional banks are located. However in the rural areas, the demand is increasing but banks are not paying attention towards the rural areas, that’s why there is still so much potential for Islamic banking in the rural areas of Pakistan.

Further in Pakistan, both Islamic and conventional banks are doing their businesses. Lot of conventional banks, both local and foreign, are opening new Islamic banking branches that’s why competition is very intense. And one important thing is that although Islamic banking share to the total banking industry is increasing but it’s just 3.8% of total industry and conventional banks are enjoying the remaining industry share.

According to Michael Porter, differentiation is the winning strategy to compete in the market. Customers will buy the brand if it is different and low price and it will give the company a competitive edge over its competitors. (Kotler 1999) (Ansoff 1957) Products are not differentiated among the Islamic banks, that’s why people can easily switch to other brands on the basis of low prices and this increases the competition. But most of the products of Islamic banks are different from the conventional banks, but the problem is that Islamic banks are mostly doing business of products that are similar to the conventional banks.
Competition can also be judged by finding the nature of visions, goals and strategies by different companies within the same industry. (Porter 1980) Islamic banking vision and goals are quite different from the conventional banks but overall strategy is almost same.

One other important factor which is increasing the competition is that the foreign banks are concentrating only on the corporate sectors leaving local banks for the other normal banking which result in the low profitability of the local banks.

In conclusion, competition is very high within the Islamic banking industry and it is increasing day by day.

5.5.2 Threat of new entrants:

Deregulation of banking sector in Pakistan and soft policies of state bank of Pakistan for the Islamic banking are making it easy for new entrants to enter into the Islamic banking sector.

There are currently six Islamic banks in Pakistan and Govt. is still willing to give more licenses to new Islamic banks. Conventional banks are also opening new Islamic branches in their banks as it is easy for them to enter in this industry because they have already big setups to sell their products.

Banks need large distributions areas for selling their products. The existing banks have covered major cities of Pakistan thus this will be threat for the new entrants because they have to spend a large amount of money to compete with these banks. Economy of scale is maintained by the giant banks in the industry and new entrants face very difficulty in operating in intense competition.

Government policies are very crucial and these are the strongest barrier for the new entrants. (Jain 1999) State bank of Pakistan has stopped giving licenses to the conventional banks just to facilitate the Islamic banking in Pakistan, so this has become the safe side of Islamic banking that no more conventional banks can enter in the market.

With the advancement in the IT sector, banks have new modes of distribution channels like mobile banking and internet. This thing lowers the entry barriers and it would be easy for the banks to come in this industry with few resources.

The minimum capital requirements to enter in this industry has been raised by the state bank from 50 million to 100 million and due to this, entrance into the industry would be little difficult.

The shortage of “Shariah” scholars and trained staff about Islamic banking is also entry barrier in this industry. Although Pakistan is the Islamic industry, but people with good Islamic knowledge are very few. SBP has made it compulsory for Islamic banks to have “Shariah” board by which every transaction of Islamic banking will be approved. New
entrants will have to keep this in their minds that without good Islamic scholars and quality staff they can’t make progress in this field.

In conclusion, threat to new entry in Islamic banking sector is moderate. Barriers are not too high to enter the market.

**5.5.3 Bargaining Power of Buyers:**

Buyers are more concentrated in the urban areas, so in the urban areas buyers have more options and choice to choose among different banks.

Only 15% of the total population is using different financial services and out of this 15%, very few are using Islamic banking products. People are more attracted to higher returns on deposits and institutions are always more concerned with the more profit.

People are mostly poor and the initial amount for opening an account is quite high in approximately all the banks, so people go for those banks which require fewer amounts to open an account.

One important reason of higher bargaining power is that the products of Islamic banking are not much differentiated. These banks are also doing major business in leasing and cost plus which is also quite similar to conventional bank’s transactions.

Now a day, people have almost every type of information because of the media and cut throat competition by the companies. Banks are spending lot of money on their advertisements and due to this advertising, customer have more options and information to switch between different products.

In conclusion, bargaining power of customers is high in urban areas and institutions have more power than the individuals.

**5.5.4 Bargaining Power of Suppliers:**

Suppliers have the highest power in this Islamic banking industry. The “Shriah” scholars hold the main power as supplier of Islamic banking. They are concentrated and few in numbers. For the reason, they demand higher prices of their services because they are the one who design the products and with out their permission Islamic banking transaction is not possible.

The IT industry is not that much strong in Pakistan. Banking software is very complex and difficult to implement. Only few companies are in this business, so they hold the power as the suppliers.

Similarly there is a shortage of Islamic banking professionals. The ones who are experienced in this field demand high prices. So, these Islamic bank’s professionals have more opportunities for their career because competition is increasing day by day.
The switching costs are not very high for suppliers because there is a no. of banks, both Islamic and conventional who want suppliers. There are also not so many substitutes for the suppliers’ products/services. So, they hold the power.

In conclusion, supplier power is very high in Islamic banking industry and “Shriah” scholars hold the most of the power because every product has to be approved from the “Shriah” scholars.

5.5.5 Threat of Substitute:

Different microfinance banks are getting licenses in Pakistan and SBP is also encouraging them to come in. But the growth of other Islamic financial institutes is very low as compared to Islamic banks.

In conclusion, threats of substitutes are low in the industry.

5.6 Opportunities and Threats:

In this section we will present the opportunities and threats for Islamic banking in the market as these are very important for making a successful marketing strategy.

5.6.1 Opportunities:

1. Govt. has provided a framework regarding legislative which helped in reducing the difficulties and time delays in recovery of defaulted loans. (Khan 1999) Although the risk involved in doing Islamic banking transactions is very high but this framework will considerably reduce the risks.

2. Now Islamic banks have more opportunity to do business in Pakistan because Govt. has reduced the tax on banks from 58% to 41%. Govt. has also stopped giving licenses to conventional banks and promoting Islamic banking in Pakistan which will help Islamic banks gaining more market share in coming years.

3. Growing GDP rate and increase in per capita income reflects that economy of Pakistan is improving. FDI is also increasing in Pakistan and one of the major attractive sectors for foreign investors is financial business. Living standard of common population is increasing and as a result consumer power has increased. An expanding economy and increase of consuming power can act as a fueling demand for Islamic loans and investments from consumers and companies. (Nambiar 2005)

4. Although the literacy rate of Pakistan is low but it is increasing. There are more educated persons in the market who have brilliant ideas but don’t have the
sufficient investment to start new business or study abroad for higher education. Islamic banking can give more loans and by introducing new transactions for these young people can really enjoy more market share and also it will help in the reducing unemployment in Pakistan. (Saleem 2007)

5. Micro financing is one of the major businesses of Islamic banks and it is also the largest sector in Pakistan in terms of potential clients. So Islamic banks have great opportunity to invest heavily in this sector and earn profit.

6. There is much space and potential available in housing and real estate sector for investors in Pakistan. So, Islamic banks can invest in this sector as a demand of housing in urban areas of Pakistan is increasing at the rate of 8%.

7. One third population of Pakistan lives in rural areas and most of them are engaged with agricultural activities in anyway. There are not available any considerable financial institutes to provide services in this sector. So, Islamic banking has an opportunity to take advantage of low competition within this sector. (madden 2007)

8. According to Hofstede, there is a collectivism culture in Pakistan, in which people are more associated with their families and try to support them financially as well. Hofstede also rated Pakistani culture as uncertainty avoidance culture because people have strong religious believes. So Islamic banks can take advantage of these factors by introducing different financial schemes which could support local culture.

9. Islamic banking is now operating in Muslim as well as many non-Muslim countries. JAK bank in Sweden and Denmark (Douthwaite 2002) and number of banks in other European countries are good example of this. It means Islamic banking has more opportunities as it is being accepted by non Muslims as well. It was also accepted by World Bank and other banking associations. Money market is the problem in Islamic banking in Pakistan. But with the popularity of Islamic market there would be larger pool of money market available and it will help in the progress of Islamic banking.

10. By the growth of Islamic banking in Pakistan, conventional banks have now started Islamic banking branches. It means they have accepted that there is growth in Islamic banking sector. They are now opening new branches thus utilizing more capital and also spending lot of money on advertising and marketing. This situation has lowered their profit margins.

11. Islamic banking has started their business in the 21st century which is the era of IT. They have more opportunities in electronic banking and online banking. IT and communication sector is increasing in Pakistan, Islamic banks can take advantage from this by facilitating their customers through different forms of IT and telecom.
12. Pakistan is a Muslim country and 97% of its population is Muslim. Most of the people were not doing business with the banks because of their strong believes against interest based banking. Only six full fledge Islamic banks are working in Pakistan and they have big pool of clients interested in dealing with Islamic banking.

5.6.2 Threats:

1. There is a relationship between political insatiability and per capita GDP growth, political instability has adverse effects on economic growth as the long term policies are not implemented affectively. (Swagel et al. 1996) There has been political instability in Pakistan as Governments have been changing frequently. Every new Govt. starts with a new set of policies and old policies are terminated often. This is a major threat for new growing Islamic banking sector as they have to face problems in implementing long term policies.

2. Corruption and bribery has its deep roots in Pakistani business culture. The motivational factor behind this can be a combination of economic, social and cultural factors. (Daniele 2006) Our empirical findings show that even top officials and bank executives have been found involved in corruption cases. It has been common practice in Pakistan that some people of influential groups and bureaucracy take loans from the banks and don’t pay back their loans. They make their loans adjusted by using their different political links or using bribery.

3. Our empirical findings show that increase in oil and food prices in the world has caused rise in inflation rate in Pakistan. Inflation rate rose to 7.8% in 2006-07. Although SBP is trying to control it by tightening its monitoring policy but it is a major threat for businesses and investors as the price of products increases and value of money decreases.

4. Our empirical findings show that there is a poor physical infrastructure in Pakistan. So Islamic banks have to face problems in managing their business activities on remote locations which on the other end can be a good market place for Islamic banks.

5. People of Pakistan come in the category of uncertainty avoidance group according to Hofstede. People believe on rumors with out any confirmation and justification. A large number of people in Pakistani are doubted about the Islamic banks whether these banks are Islamic or they are just using name of Islam and doing the same thing as conventional banks. This is a big threat to Islamic banks.
5.7 Summary:

We presented the analysis of our research work in this chapter that how the environmental uncontrollable factors can influence the Islamic banking industry and how the competitive forces can control this sector? Based upon the empirical findings, theoretical framework and analysis, some opportunities and threats were also explained in this chapter. Now, we’ll give the conclusion of our thesis in the next section and also we’ll give some recommendations based upon our analysis and conclusion.
6- Conclusion and Recommendations:

In this chapter we will present conclusion and recommendations based on our analytical and empirical findings.

6.1 Conclusion:

There has come a swift transition in the financial services in the world including Pakistan. A new mode of banking i.e. Islamic banking has been introduced and accepted widely in many countries of the world including Pakistan. Our thesis has portrayed the current situation for Islamic banking in Pakistan by investigating the current competition of the industry using porter five forces model and at macro level using PEST analysis.

Our empirical findings clearly show that there are many prospects for the growth of Islamic banking in Pakistan and environment is favorable for the sector. There is much more potential for already running Islamic banks and newly investors in this segment as well. Although there is a political instability in Pakistan, but the autonomous position of SBP is providing a shelter to this sector against political instability. SBP has provided the Islamic banking sector with sufficient legislations and policies, so as to assist this sector and increase its efficiency. Although economic of Pakistan has shown a consistent growth in the last couple of years but the rise in inflation rate (due to multiple factors) can cause problems for investors. The socio-cultural factors of Pakistan are in favor of Islamic banking but it needs to be addressed properly and carefully. Pakistan is an Islamic democratic country, so there is much space and opportunity available for Islamic financial service providers including Islamic banks. There is also one problem that people are not very educated and literacy rate of Pakistan is very low that’s why many people think that Islamic banks are just using the name of the Islam otherwise they are same like conventional banks.

Technology wise Islamic banks have many opportunities because in Pakistan there is a boom of telecom sector and IT industry. Most of the banks are using these services like e-banking, online banking and ATM machines for facilitating their customers.

Competition in the industry is very high. Islamic banking is new in the industry. There are so many conventional banks in the industry already. But the growth rate of Islamic banks is very good but they are still far behind from the conventional banks in terms of market share. There are a lot of obstacles in the progress of the Islamic banking in Pakistan like separate ‘Shariah’ boards of each bank and shortage of educated human resource. Conventional banks are also coming in this field by opening stand alone branches of Islamic banking which has increased the competition.
What can be suitable and effective marketing strategy for Islamic Banking in Pakistan?

On the basis of all our previous discussion, the marketing strategy for Islamic banking will be explained in this section.

The marketing strategy makers of Islamic banking should take care of the 4Ps of the marketing i.e. Product, price, place and promotion. Best market strategy for Islamic banking will be the one in which these four things are dealt carefully. (Kotler 2000)

Product:

So far Islamic banks are using two products i.e. leasing and cost plus for doing their businesses. They should bring more innovative products in the market. As explained in the first chapter, they have many products but are reluctant to use those products. Innovation is the main thing which will distinguish them from the conventional banking.

Price:

As we have explained in the previous chapters that majority of people in Pakistan belong to middle class and are very price sensitive. And as the competition is getting intense day by day with more banks coming into the Islamic banking industry and bargaining power of people is also very high, so people have now more choices and they choose the particular service on the basis of price. Price of Islamic banking products/services should be lower than the conventional banks or at least inline with the conventional banks.

Place:

Mostly banks are situated in the urban areas. We described earlier that there is a great potential available for Islamic banks in the rural areas and small towns. Islamic banks have far less branches as compared to conventional banks. Only Meezan bank has 100 branches, all other Islamic banks have branches less than 50. Islamic banks should increase their branches and they should pay special attention to small towns and urban areas, as there lies much more potential in those areas.

Promotion:

Promotion is very important aspect as far as Islamic banks are concerned. So far, main promotion of Islamic banking is based on the religion because 97% population of Pakistan is Muslim. But, during our research we have found that only 10-15 percent people are customers of Islamic banks due to the name of Islam. Their promotional strategies should be very aggressive and inline with those of conventional banks as well as Shriah. They should create awareness about the Islamic banking products, how these are different from conventional banks and how it is inline with the Shriah.
“Winning companies are those that meet customer needs economically and conveniently and with effective communication”. (Kotler 2000)

**6.2 Recommendations:**

1. We came to know during our analysis that Islamic banking sector is offering somewhat same services and products with a little change (according to Islamic Shari'ah laws) as compared to conventional bank’s products. Although they have developed many different transactions but mainly they are focusing on Ijara (Leasing) and Musharaka (Cost plus) which are very close to leasing and cost plus transactions of conventional banks. We recommend them that they should bring innovation in their products and services which could be achieved through more research on Islamic banking and consumer behavior. Innovation can be of different types like product innovation, service innovation and process innovation. (Davenport 2006). Islamic banks must have separate research departments and Shari'ah board should assist this department. Islamic banks should have more innovative products which should be inline with Shari'ah. They should go beyond the traditional type of banking in which only upper class of the population can take part. They should bring more innovation using technology like IT and telecom and introduce a varied range of services and products, so as to capture maximum pool of clients. This recommendation is also based on the product development option from the four available options of Ansoff Matrix.

2. We have observed during our empirical findings and analyses that all Islamic banks in Pakistan have their own Shari'ah boards which assist them in finalizing the products and services that either these are valid according to Islamic laws. Although these Shari'ah boards give their recommendations according to Islamic laws but conflicts have been observed among the opinions of different Shari'ah boards for the same product. As a result of these conflicts, consumers get confused that which Islamic bank is right and what product is according to Shari'ah. Islamic banks must introduce a standard Shari'ah board which could bring standardization in the sector.

3. Mostly Islamic banks are trying to promote the sector just in the name of religion. We have analyzed that although many people are interested in dealing with Islamic banks just because of prohibition of interest in Islam. Yet, there are a great number of customers who choose the banking services on the basis of services, quality and profitability. We recommend to those who planning to start new Islamic banks or those who are already running Islamic banks that they should run a proper media campaign so as to bring awareness to the consumers about their services and products on the basis of competitiveness. They should arrange some seminars, events and media talks for the managers of small and large organizations and laymen as well, to make them realize the actual essence of Islamic banking. As the spirit of Islamic banking is not only profitability but also the betterment of the society. So they should start investing in projects through
which people get more benefits and employments. This can be their positive contribution for the society from where they are getting their business. As only those businesses retain in the long run and get loyal customers who take care of ethical perspectives in the marketing strategies and unethical businesses are less likely to succeed. (Robson 2007)

4. Our analysis reveals that one third population is living in rural areas and there is also a lack of financial services for them. People of rural areas are comparatively more religious than those of urban areas. Female population has also been ignored to target by other financial institutions. We recommend that Islamic banks should widen their activities to these areas and try to capture and involve the female segment of the population as it constitutes a big set of consumers. This strategy is “Diversification” according to Ansoff Matrix. Diversification means the new products and new services in the new market place.

5. Mainly the staff of Islamic banks does not have adequate knowledge about Islamic banking as most of them have their educational and training background in conventional banking sector. Scholars of Shriah boards have good knowledge of Islamic teaching and laws but some are lacking behind in the field of banking knowledge. We recommend that there must be conducted training sessions and workshop to overcome this problem.

6.3 Contribution:

Islamic banking is a growing sector in Pakistan and many other countries as well. Authors have analyzed the present situation of Pakistan by using the theoretical framework of mainly Porter’s five competitive forces and PEST analysis, for Islamic banking sector in Pakistan.

In order to improve performance and ensure sustainable growth of Islamic banks, marketing strategy is one of the most important issues. A suitable marketing strategy can be developed by understanding internal strengths and weaknesses and the external opportunities and threats. (Business Link, [no date]) Authors have given their analysis based upon the empirical findings and pinpointed some important opportunities and threats for this sector. Authors have also given some recommendations which can be useful for those who want to build a competitive marketing strategy for Islamic bank in Pakistan. These recommendations and discussions can be very useful in making a suitable and effective marketing strategy which in turn can lead to sustainable growth. We have tried to cover Pakistan’s political, economical, socio-cultural, technological and legal environment and framework in general. So, this information may not be only useful for Islamic banking sector but also for other sectors who want to get knowledge about these uncontrollable environmental forces as sufficient knowledge and analysis of these forces is necessary in order to make a good marketing strategy. This framework can be
applied to any organization and sector in general but to Islamic banking sector in Pakistan in specific.
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