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Islamic Finance Modes in Jordanian Economy: A Comparative Study

Abdullah Suliman Atwan Al Zyoud, Mahmoud Khalid Almsafir and Ayman Abdalmajeed al-smadi

Graduate Business school, college of Graduate Studies, University Tenaga Nasional, uniten, Jalan, IKRAM-UNITEN, 43300 Kajang, Selangor, Malaysia

Abstract: The financial industries around the world have increasingly become extremely crucial in our contemporary days, such industries are significant indicators about the economy's performance. If a country enjoys a stable financial regime then its economy would automatically be robust and strong. There are several types of financial models, however, for the sake of this paper it is shedding the light to the Islamic finance which is not newly introduced. Islamic Finance has a long period of incent history where it used to be the commercial, fiscal, and banking linkers between the traders in Africa region and the Arab states. Undoubtedly, there are several Islamic terminologies and concepts that contributed in finding the new techniques which are applied in the banking systems and financial systems nowadays. Such terminologies: bills of exchange, partnership (mufawada, LLC "Limited liability company"), and different forms of capital (Al-Mal), capital accumulation (Al-mal), trusts (Al-Waqf). The information of this paper have been collected from various resources such as Jordanian Islamic Bank (JIB), Central bank of Jordan (CBJ) and Department of statistics (DOS), and several references as is shown in the bibliography and footnotes. This paper examines some secondary data which was distributed through the annual reports produced by Jordan Islamic Bank since 2000 until 2013. Profitability and liquidity have been used as indicators of performance in this study, for instance whenever profits are high then performance is going in the right direction, if loses are higher consequently performance is not good ,therefore, correction must be done. Additionally, SPSS (Statistical Package for the Social Sciences) "18.0" has been used to explore and compare between Islamic finance model and other models. The expected outcome of this paper is to approve that concept of Murabahah model is better than the other models.

Key words: Murabahah, Musharakah, Mudarabah, Salam, Istisna, Ijarah.

INTRODUCTION

Even though Sharia law prohibits banks and financial institutions from receiving interest (Riba), nonetheless, such organizations are not charitable associations, in other words they cannot provide services for free, and that is why the doctrine of Murabaha was introduced. This doctrine will be fully explained through this paper. Such doctrine is being recognized as a distinguished academic system that should be taken into consideration in the decision making process especially when it comes to economic matter, business management, financial matters and many other fields.

Islamic banking system has been in Jordan for roughly two decades, where it played a significant role in funding and contributing to several economic and social activities in the country, where it complies with the principles of Shari'a Law in the area of Islamic banking practices. Islamic finance is increasing in all its aspects and dimensions whether in number of users or size of projects that depend on it universally.

According to a recent statistic, it stated that Islamic banking has grown at an annual rate of 15% over the last five years. Currently, there are more than 250 Foundations, users and assets amounting to US$400 billion (AME Info, 2005).

Almsafir, Al-smadi, & Balfaqih (2013) clearly states that Islamic finance enhances productivity and wealth in the communities. There are two major types of Islamic finance which can be presented as follows:

1) First type is the direct funding and capital funds through partnership (participation and speculative).
2) The second type is the indirect financing through financial lease (leasing) and contracts for the sale (Murabaha, Salam, and istisna).

Both are based on avoiding interest rate as calculated in the commercial banks. They take it into consideration to keep all the Islamic work ethics and morals.

Murabaha can be defined as a "contract that provides the purchase price and the selling price and profit margin, the investor agreed terms, and the provider of funding from the outset." "Musharakah of both partners contribute part of the capital, which is not necessarily on equal terms. Can be contributed to capital are either in the shape of monetary or cash assets worth predicate."

Corresponding Author: Abdullah Suliman Atwan Al Zyoud, Graduate Business school, college of Graduate Studies, University Tenaga Nasional, uniten, Jalan, IKRAM-UNITEN, 43300 Kajang, Selangor, Malaysia.

2.0 Literature Review:

Islamic finance is one of the ways of financing whether projects or buildings etc, therefore it is a part of the Islamic economic system, and deals with ethical value considering the major constraints in this funding. Islamic finance is mainly an organizer corporate financial relationship with the concept comprehensible and companies or individuals.

Many authors and historians claim that Islamic Finance is much better in terms of dealing than other models. One significant instance was written in Derbel *et al*. (2011) where it has been declared that Islamic finance is more stable than conventional finance, which means that even in terms of stability Islamic finance is more stable than traditional finance. some people even went further by saying that one main reason behind the recent financial crises is not applying the Islamic rules properly worldwide, thus, "a way to limit the impact of financial crisis examined the impact on the U.S. market during the crisis period is transmitted adversely all other markets (1997 - 2009)". As a result we can still clearly see the consequences of the crises until nowadays.

Recalling what has been written in Zaki *et al*. (2011) where the authors wrote huge chapters about the Islamic finance as a mean of minimizing the risk where they wrote "that this paper suggesting policies and proceedings to alleviate the risks in Islamic finance by proposing the regulatory model that highlights the various policies needed by the compulsory for effective risk administration. Data collected for the study through primary and secondary sources. Primary data they collected during the interviews of professional Islamic finance including the Islamic banks. Results show that the three major policies which are the variables of the study provide the foundation for efficient mitigating risks and designed a model by after achieve a regulatory framework of suitable mitigate risks, perpetuate long term stability". So as illustrated earlier that Islamic Finance and rules are used a Risk mitigate and minimizer if applied appropriately.

Saleh & Zeitun (2006) in their research tried to study and analyze the Jordan experience with Islamic finance, and in particular the experience of the Islamic Bank first and second in the country, Jordan Islamic Bank for Finance and Investment (JIBFI), and the Islamic International Arab Bank (Arab Bank) in order to evaluate the performance of Islamic banks in the country. This paper uses the assessment methodology performance by making a maximize profit, capital structure, and cash tests.

According to (alfakhre, 2009; Abdoalazeez, 2005; Naser, 2006 and Alajlwne, 2008) Murabaha is sales contract between two or more, and one of them is Islamic banks, in this case the Islamic Bank is selling the goods into second part, which is the profit margin compared to customers add to the price you bought it first introduced the market, known in second part with the goods the original price, and after the second part received goods can be paid what it is owed immediately or within adequate time and in according with the accord.

Based on Saleh & Zeitun (2005) this paper examines and analyzes Jordanian experiment of Islamic banking of services, with focus on the largest Islamic banks in the country: Jordan Islamic Bank for Finance & Investment (JIBFI) and the Islamic Arab International Bank (Arab Bank), and evaluation of this performance of Islamic banks. The report also sheds some light on the local and global challenges facing this sector. The researcher used the performance rating the methodology, and conducted to maximize earnings, capital structure and liquidity tests, and found the efficiency of each of the banks and the ability has increased, both investment and expanded its activities and play an important role in the project finance in Jordan. Results showed that the Jordan Islamic Bank for Finance & Investment has high profitability, which should encourage other banks to hire Islamic financial products. The Bank has changed its logo and the launch of its new corporate identity as part of joining the rest of the banks of the ABG to raise this slogan, in the beginning of the month of July in 2010.

2.1 Murabaha:

Murabaha is literally mean increase in financial or dividends of trading. Murabaha is tool used for financing the purchase of goods and services where buy this fiscal company on behalf of clients (gait, 2008).

Based on (alfakhre, 2009; Abdoalazeez, 2005; Naser, 2006 and Alajlwne, 2008), Murabaha is a contract of sale among two or more parties, and one of them is Islamic banks, in this case the Islamic bank is the sale of goods to second party, which is the profit margins compared customers adding to price that bought it first introduced the market, known in second party with commodities the original price, and after second party received goods can be paid what it is owed immediately or within enough time and in in accordance with the deal.

According to Al-Meaither & Mitchell (2003) Murabaha is the term means that profits which is a type of trade confidence. Financially, it means cost plus profit sale, but, in Islamic Sharia, it refers to particular types of sale of the Islamic fiscal enterprises now used on Murabaha sale as a means of financing. One of clients who want to purchase of goods ask the fiscal company to purchase these items behalf and then sell them to him with a certain amount of profit agreed upon addition to the primary cost. A basic component of the Murabaha is that the seller reveals the actual cost incurred in the getting the goods, then add some profit in this regard. Murabaha with Finance Corporation to purchase goods on behalf of the customer and sell them as a mark-up, but in the period up re-sell the bank has title to the goods and therefore legal liability.

Based on Almsafir, *et al*. (2013) Murabaha used widespread by several banks and financial institutions a means of the Islamic finance in different financing operations such as mortgage finance and auto financing, of personal finance and trade finance. Murabaha in its classic form may not result many issues also been established Sharia legal provisions regarding its application a clear and a comprehensive by the last Jurists

2.2 Musharakah:

According to Archer & Haron (2007) Musharakah can be developed as a microfinance project as Islamic banks would enter into a partnered with owners of small businesses. If there is profit to be shared on the basis of agreed upon in advance rate, and if there is loss, and then be shared according to the ratio of capital contribute.

Musharakah can also be exposed to the risk of financial for impairment capitalism as the project may not retrieve project capital, as it ranked lower upon liquidation debt instruments (Aaron and Achilles 2007). Musharakah is "a deal among two or more persons to carry project a private work with the point project consideration project sharing of profits during common the investment"(Arshad 2010).

Based on AL-Harran (2003) originally Musharakah or shirkah (Partnership) there two types. Namely, (a) Shirkah al-milk (non-contractual partnership) (b) Shirkah al-uqood (contractual partnership), Shirkah al-milk (non-contractual) means a joint property, come into being when two or more persons happen to get common property of some assets without being entered into an official partnership deal; Shirkah al-uqood (contractual partnership) Can be regarded as a proper partnered because the parties relevant have voluntary entered into a contractual agreement for joint investment and sharing of profits and risk.

Based on Baele, Farooq & Ongena (2012) Musharaka of the decade is more comparable to equity financing from traditional bank credit, and make up only a small ratio of the market of Islamic loans. Musharaka afford very closely resemble with interest rate decades in conventional banks, which would make it problematic to compare the default rates for each of them. The ideal modes of Islamic finance are the participation (partnership, where all partners investing both money and some or contribute to their experiences)

2.3 Istisna':

Most Fuqaha consideration Istisna as one of a division of the peace, and therefore fall under the definition of public security. However Hanafi school of doctrine makes Istisna held separate and distinct. Gave jurists of Hanafi School at different tariffs to Istisna, and some are: "This is a contract manufacturer with to make something" and "is on a good held regarding liability with the requirement of the work" Al-Amine (2001).

According to Zarqa (1997) Istisna is a special type of sales contract. Sales contracts of the three basic traditional Islamic jurisprudence, from the perspective funding are: A) contract of sale a joint, as well their price is exchange of simultaneous. Any funding an engaged, both for the vendor or buyer. B) Deferred Sell for a price. The seller financed a buyer, because it delivers goods now, for a price is paid at later time. C) Under which Sell the buyer peace seller funded through pay him the full price now, for good fungible to be presented at a later time.

Usmani (2005) describes Istisna held create a moral commitment a manufacturer for the manufacture the goods, but before the work starts, no right to any of parties to cancel the contract after the giving notice to the other. But then the manufacturer began work, cannot cancel a contract unilateral. 'Istisna is a second kind of sale as the items are deal before it comes into existence. It means that order the manufacturer for the manufacture specific items to the buyer. If manufacturer undertake to for manufacturing the goods with his materials from the manufacturer, this deal of Istisna come into existence.

Based on Zarqa (1997) the suitability of Istisna'for financial intermediation is based on the Fiqh Permissibility for the contractor in Istisna'to subcontract. Thus a financial institution may set about the construction of a facility for a deferred price, and subcontract the actual construction to a specialized firm.

Wilson (2004) Istisna involves the financing of manufacturing capacities of payments through pre-production, but these related to construction or equipment purchases where they can identify the actual ability. Originally, was seen Istisna and suitable way to finance manufacturing and goods have to be produced and the costs incurred before being sold.

2.4 Mudarabah:

Based on (Bacha, 1997) Another Islamic finance mode, Mudarabah is defined as profit sharing principle and losses normally applied for work or a commercial contract between party that offers the fund or capital, which manages the business side. This means profit sharing held between the participants. In Mudarabah finance, and one party, and RAB-UL or taxpayer money, provide capital, while the other party, and requests, and offers entrepreneurial the spirit and effort to run the business.

Faridi (2008) noted that the pointed directory on the legality of year Mudarabah is what the Prophet (peace be upon him) himself, who was working Mudarabah to Khadija. Almsafir *et al* (2013) Advertise that the best and the most profitable way is a state of sharing with the worker in the forecast profit (Mudarabah) because it is not always possible for the owner to hire someone with the skills to make regular wage trade efficiently on his behalf.

Mudarabah is collaboration between the investor who gives the money or fund to the party, which will oversee the store or the capital to trade. The gain will be divvied up between the two parties, the investor and the one who takes care of the business. Bank Negara Malaysia (BNM), the Central Bank of Malaysia, has already deployed a draft of the new Shariah parameter on Mudarabah the contract. The rationale for this parameter with the provisions of the Islamic Sharia is providing a reference on the nature and features of contract Mudarabah to the Islamic financial services industry, which is to strengthen the harmonization of Islamic financial market practice (Atmeh & Ramadan 2012).

2.5 Salam:

According to Obaid, (2006) Salam contract is amongst kinds of sale that be exempted from the ban on the sale of what is not exist or that the vendor does not confine the use of his attitude from the word Salam (or advances) seals the contract as deferred selling something specific and described as outstanding (debt) in exchange for getting thing else (the price).

Salam is also a kind of exchange or replacement, which leading to the debt owed by seller, the it is gaining meaning of the treatment that involves both selling and buying, borrowings and loans. Umar (1991) reported that Salam is the sale obviously benefiting the seller. This way, the predetermined price is usually less than the prevailing spot price (El-Gamal, 2006).

The legitimacy Salam of the decade can be deduced from the Quran and the Sunnah of the Prophet (peace be upon him) and the legal the compatibility of Islamic scientists. The majority of scholars see that there are three requirements of Salam contract, which is client's parties, subject, and some form of Salam contract. Price should be obviously defined and fully paid by the buyer at the time of the sale to avoid the conflict later. Seller on the other hand, you should grab the price in full before leaving each other, and should be selected the exact date and place of delivery in the contract. (Almsafir *et al*., 2013)

2.6 Ijarah:

It means that employ the services of Parson on wages. Other type of Ijarah related to paying of the rent for the use of an asset or property lease is a contract the right to use known and suggested against specified and lawful return or consideration for the service or return for the benefit proposed to be taken, or the effort or work proposed to be spent. (Khanfar, 2009).

According to Almsafir, *et al* (2013), the common mechanism of Ijarah as applicable in Islamic banking contracts happen when the client identifies and approaches the vendor or supplier of the asset that he or she needs and collects all the relevant information. Then the client approaches a bank for Ijarah of the assets and promise to take the asset on lease form the bank upon purchase and the bank makes payment of price to the vendor. After the vendor transfers ownership of the asset to the bank, the bank leases the asset, transfers possession and specific right of use to the client.

3.0 Methodology:

This paper aims to investigate the best Islamic modes that using in Jordanian Islamic bank, secondary data have been used depend on annual reports for the period (2000 – 2013). The main question raise in this research: What is/are the best Islamic Finance mode/s?

According to the literature review, research objective and research question, the following hypotheses have been developed:

H1: Mudarabah is the best Islamic Finance mode.
H2: Musharakah is the best Islamic Finance mode.
H3: Murabaha is the best Islamic Finance mode.
H4: Ijarah is the best Islamic Finance mode.
H5: Salam is the best Islamic Finance mode.
H6: Istisna' is the best Islamic Finance mode.

SPSS 18.0 (The Statistical Package for the Social Sciences) has been used in order to analysis the data for this study. Multiple Regressions has been run to determine the factors that may effect on the performance of each Islamic finance. This research has been used three modes out of six which are Musharakah, Mudarabah and Murabaha. Because it was impossible to get data for the six modes.

4.0 Empirical Results:

4.1 Descriptive Analysis:

Descriptive statistics which include the means and standard deviation are illustrated below:

Table 1:

	N	Minimum	Maximum	Mean	Std Deviation
Musharakah	13	100	230688	70354.21	89070.51
Mudarabah	13	312	40306	15445.95	12282.103
Murabaha	13	106533	1927568	874656.30	641568.9

According to table (1), Murabaha has got (874656.30) which is the highest value among others modes, which mean that Murabaha mode is the must usable mode among others.

4.2 Pearson Correlation Coefficient:

On order to determine the existence of any relationships between the Islamic finance modes. A Pearson correlation test was conducted to determine the relationship between profit and liquidity as dependent variables and the three Islamic finance modes of Musharakh, Mudarabah and Murabaha and as independent variables.

Table 2:

Variables		Profitability	Liquidity
Musharakah	Pearson Correlation	.012	.003
	Sig. (2-tailed)	.481	.495
	N	13	13
Mudarabah	Pearson Correlation	.175	.-140
	Sig. (2-tailed)	.230	.278
	N	13	13
Murabaha	Pearson Correlation	.473	.278
	Sig. (2-tailed)	.017	.118
	N	13	13

4.3 Linear Regression:

Regression analysis was conducted to identify which of the three Islamic finance modes has the most important dimension in explaining organizational performance. The results are illustrated as following:

4.3.1 Profitability:

One of the most important performance measures is profitability because it will show and measure which one of the four Islamic finance mode performs better. The linear regression analysis for profit as dependent variable is shown below

Model summary

Model	R	R square	Adjusted R square	Std. Error of the estimate
1	557	.310	.311	289128.141

a. Predictors: (constant), Musharakh, Mudarabah and Murabaha.
b. Dependent variable : profit

Coefficient

Model	Unstandardized coefficient		Unstandardized coefficient	T	Sig
	B	Std. error	Beta		
Constant	5755.901	226446.955		.025	.980
Musharakh	-.670	1.242	-.172	-.540	.598
Musharakh	-9.193	12.160	-.375	-.756	.462
Murabaha	.423	.209	.849	2.028	.598

The Multiple *R* shows a substantial correlation between the four independent or predictor variables and the dependent variable (*R* = .557). The R-square value identifies the accounted portion of the variance by the independent variable. Approximately 31% of the variance is accounted by Musharakh, Mudarabah and Murabaha. This also means that there are also some other factors that can help to explain the profitability but were not being considered in the study. The Adjusted *R* Square is considered a better population estimate and is useful when comparing the *R* Square values between models with different number of independent variables. The value of Adjusted *R* Square obtained is 0.113 which reveals that 11.3% of changes in dependent variable which can be explained by the four independent variables of Musharakh, Mudarabah and Murabaha.

The beta value for Ijarah (β = -.045), Mudarabah (β = -.375), Murabaha (β = .849), and Musharakah (β = -.172) explain the significance of the four independent variable. Among all three Islamic financial modes, Murabaha (β = .849) is the strongest variable, followed by Musharakh, Mudarabah and Murabaha.

4.3.2 Liquidity:

Liquidity which is described by cash flow and outflow is used as a tool of measuring the performance of each Islamic finance mode. Thus, to determine which one among them has the best performance. The tables below describe the analysis of liquidity as a dependent variable

Model summary

Model	R	R square	Adjusted R square	Std. Error of the estimate
1	.351	.123	-.127	25650880383

a. Predictors: (constant), Musharakh, Mudarabah and Murabaha .
b. Dependent variable : profit

Coefficient

Model	Unstandardized coefficient		Unstandardized coefficient	T	Sig.
	B	Std. error	Beta		
Constant	138607.566	2008993.150		.689	.502
Musharakh	4.646	11.017	.152	.422	.680
Mudarabah	-142.343	1.88207	-.738	-1.319	.208
Murabaha	2.419	1.852	.616	1.306	.213

The Multiple *R* shows a substantial correlation between the Islamic finance modes and the liquidity *(R* = .351). Approximately 12.3% of the variance is accounted by Musharakh, Mudarabah and Murabaha. which means that there are also some other factors that can help to explain the liquidity but were not mentioned in the study. The beta value for Musharakah (β = .152), Mudarabah (β = -.738) and Murabaha (β = .616), and explain the significance of the three independent variable. Among all three Islamic financial modes, Murabaha (β = .616) is the strongest variable, followed by Musharakah and Mudarabah. Therefore, Murabaha has the most significantly influence on the liquidity for the bank.

4.4 Results of Hypothesis Testing:

The empirical results of the current study provide evidence that Islamic Banking practice has been improved for the last two decades. The finding has suggested that Murabaha mode is the most efficient practiced Islamic finance mode which is in line with the findings of Al-Meaither (2004). There are six hypotheses for this research in which only one of them is accepted while others are rejected. According to the results above, the accepted hypothesis is:
H3: Murabaha is the best Islamic Finance mode.

Murabaha contracts have been widely used by many Islamic banks and financial institutions as a mode of financing in various financing operations such as home financing, motor vehicle financing, personal financing and trade financing. It involves the sale of commodity through Murabaha contract to the purchase order (MPO) for a pre-agreed selling price, which includes a pre-agreed profit mark-up over its cost price. The payment is payable within a fixed future date by lump sum or fixed installment.

An example of applying Murabaha contract can be seen from buying motor vehicle. It starts when the customer identifies the motor vehicle to be acquired. The bank purchases the identified motor vehicle from the owner on cash basis then it sells the motor vehicle to the customer at a cost plus profit on credit basis. Finally, the customer pays the bank within the agreed terms of financing.

5.0 Conclusion, Limitation and Further Studies:

5.1 Conclusion:

This study has provided evidence and achieved its objective of investigating the best performance of Islamic finance modes. Profitability and Liquidity have been used as measuring dependent variables which explain the performance of each mode. It has been observed that Musharakah, Mudarabah and Murabahah are the most applied Islamic finance modes. From the findings of this study, Murabaha has the best performance among other modes involved in this study which are, Mudarabah, and Musharakah. Apart from that this study might help scholars to pursue a diligent approach to comprehend the relationship between the Islamic finance modes.

5.2 Limitation:

This study had limited its scope with only three Islamic finance modes which are Mudarabah, Murabaha, and Musharakah which applied in Jordanian Islamic Bank and this may have impact the outcomes of the research.

5.3 Further studies:

For future studies, the researchers could modify the prominence to a single Islamic finance mode practices to narrow the scope to derive more precise evidence regarding the performance of each Islamic finance mode.

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