

RISKS OF INVESTING IN JORDANIAN ISLAMIC BANKS

Mohammad Al-ashaboul, PhD

Salam Al-moumany, PhD

Jadara University, Irbid, Jordan

Abstract

This study aimed to identify the various types of Islamic Finance and how they protect investors and banks from financial risks. To achieve the objectives of this study, the researchers have analyzed the annual reports of the banks work in Jordan, namely, the Jordan Islamic Bank and the Arab Islamic International Bank. The study covers the period between 2007 and 2011.

The study found several results, most important, that Islamic banks can avoid the risk through investment methods used, as the study showed that the working capital for Islamic banks during the period of study continues to grow and showed that the return on investment continues to grow, also found, through analysis, that the return on investment for some financial instruments start to decline. Researchers also noted the lack of interest of Islamic Banks Financing Instruments based on the interest rate could lead to miss some investors who prefer to invest using traditional interest rate basis.

Based on the results reached, the study found some recommendations. Firstly, the banks can guide investors toward the Islamic financial instruments which maximize the bank returns. Secondly, the researchers advise Islamic Banks to establish more healthy investment environment to activate the other financing instruments which may be important in helping the national economy to grow. Finally, the Islamic banks should also find more financial instruments that combine between the favorable features of traditional and Islamic Financial Instruments to attract more customers who prefer such these financial instruments.

Keywords: Islamic Bank, investment, Islamic modes of financing, risk, safety

Introduction

The Islamic banks emerged to satisfy the needs and wants of some investors who prefer Islamic financial instruments. This will help them to escape from the traditional financial tools and to apply Islamic rules. The Islamic Banks try to employ their capital using the

partnership basis. As it is in traditional banks, the Islamic banks do the same financial function as they employ their full capacity and capabilities to serve the community and to achieve sustainable development by satisfying the priorities of the community that are circulated around necessities, needs and luxuries. This also will lead to improve the performance of the economy and its growth.

The functions of the Islamic banks focused on collecting funds from internal and external resources and reinvest them using investment instruments depending on the partnership basis rather than an interest rate basis that does not contradict the Islamic economic rules.

Literature Review

At the beginning we will explain and discuss the main forms of Islamic Financial Instruments which are distinguish the Islamic Banks from Traditional banks.

Firstly, "AL-Mudaraba": Erekat (2010) defined it as an investment contract conducted between two parties, the first party provides capital (called the capital holder) and the second part provides labor and/or management. The contract implies that the profit will be divided between the two parties using specific ratio that is agreed before. On the other hand, the losses will be totally allocated by the capital holder. But if there is any frond or inefficiency in operating and managing the project, the losses will be allocated to the second party.

AL-Ajlouni (2010), demonstrate three forms of "Moadaraba", contract, the first form is the consolidated "Modaraba" which means that the bank employs all of its funds generally without link each investment namely to specific customer personally. The second form is the "Modaraba shares". In this form the entire investment will be divided into number of shares. Each share represents part of the contract that enables its holder to liquidate it in the financial market when they need funds. The last form is the "ownership ended Murabaha". Is this form, the bank provides capital to the customers as a partner with an agreement to amortize the capital using regular installments or by using balloon payment. So the ownership of the investment will go to the costumer.

Secondly: Partnership contract which can be described as a financial instrument that includes more than one party who agreed to participate in financing the investment project and to be responsible for the projects liability that will be not limited. The Islamic bank employs some of their capital in such type of investment instruments.

Thirdly: "AL-Murabaha" contract. AL-wadi (2007) described this contract as an agreement between the bank and its customers by granting them financial facilities to finance

their purchases which are mostly durable goods such as real estates, cars, furniture's, machines and so on.

The mechanism of this instrument contains several steps. At the beginning, the customer selects the product he wants to buy, then he gives an order to the bank asking to buy the asset and the promise to repurchasing it from the bank later. The bank then will sell the product to customers on credit with higher price collected by a number of installments.

From the viewpoint of Islamic economy, this method is acceptable as it does not depend on the "time value of money" principle, which means that if the customer fail to settle the installments for a period of time on their maturity dates, there will not be any extra interest imposed on the customer, and the bank also is required to give an extension to the customer until the customer is able to pay. On contract, if the customer settles the installments before their maturity dates, there will not be any deduction from the balance.

Fourthly: Farming contract. In this context, Ajlouni (2010) explained this form as he said that there are two parties in the contract, namely the landowner and the farmer. The farmer does not own the land and capital but he has professional skills in farming. So he gives up his working efforts for gaining profits at the end of each season. So, the resulted profits will be distributed between the two parties according to their agreement before.

Fifthly: Manufacturing contract. Here the role of the bank is an intermediary between the manufacturer and the customer as the bank receive the buying orders from the customer and in turn resend these orders to the manufacturers to produce and sell the product to the bank and then to the customer. The bank will provide a finance to cover these transactions, and then the bank will collect the claims from the customers by a number of installments.

Former Studies

Saadi, (2010) explained that there must be a development of Islamic capital markets so that they conform with the provisions of the Islamic Sharia and solve a lot of problems faced by Islamic banks. He believes that the factors that may lead to investment and liquidity risks must be identified.

- 1- Rashdan (2009) studied factors affecting the performance of the Jordan Islamic Bank for Finance and Investment measured by average profitability during the period (1980 - 2008). Also he studied the nature of the relationship between these factors and the profitability of the bank. The study found a positive correlation, statistically significant, between the size of the bank, measured by total assets, and the profitability. The study concluded several recommendations such as the necessity of focusing on projects that have high profitability when investing their funds.

- 2- Obada (2007) searched for the performance measurement standards of Islamic banks through goals to identify the performance indicators for Islamic banks. The study proposes several criteria that have been drawn from the objectives of Islamic banks that insure the fulfillment of profitability goals and capital retention.
- 3- Altaleb (2005), in his study, which aimed to assess the financial performance of Jordan "Islamic Bank for Finance and Investment", has been analyzing the financial position of the banks access to its financial investment, and the fields of capital investment during the period 1998-2000. The study recommends that the banks should review all investment bank lines and associated budgets, and then search for instruments for expansion in Islamic banking in the Arab region as a whole.
- 4- Sawalha (2010) demonstrates the role of Islamic Financial Organizations of accumulating and reinvesting funds in Jordan. Through collecting and analyzing data, he provided evidence about the important role of Islamic banks in accumulating and reinvesting funds. The study recommends that it is very important to encourage these types of banks in Jordan and spend more efforts on promoting financial methods used by them.
- 5- Bashir (2003), has dealt with the performance of Islamic banks in the Middle East from 1993-1998, the study examined the outputs and profits reached with the banks, the study selected the parameters which describe the features of performance. The researcher has found that foreign Islamic banks achieved larger Profits than the local Islamic banks who are working in the same environment.
- 6- Salman (2004) analyzed the sources of liquidity risk in Islamic banks as he defined the different sources of liquidity risk in Islamic banks. The study examined the experiences of Islamic banks in dealing with these risks. The study found that there is a need for a future studies to find a measure of liquidity risk in Islamic banks.

In this study we asked the following questions:

- 1- Do you use a variety of instruments of finance to protect Islamic banks from facing risk and protecting depositors' money?
- 2- Do you use a variety of financial instruments in Islamic banks that lead to enhance profitability thus the growth of depositors' money?
- 3- Do you use diversified funding instruments that participate in economic development?

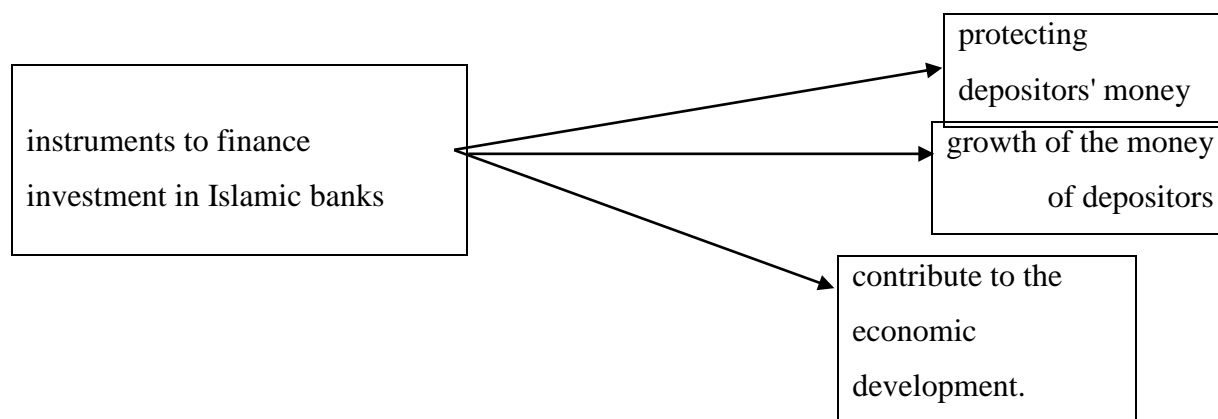
Research Model and Hypothesis

This study seeks to test the following hypotheses:

H01: - The Banks does not use a variety of instruments of finance to protect themselves from facing risk thereby protecting depositors' money.

H02: - The Banks does not use a variety of financial instruments in Islamic banks that lead to enhance profitability thus the growth of depositors' money.

H03: - The Banks do not use diversified funding instruments that participate in economic development.



Research Methodology

This study is an applied analytical that focuses on the Islamic Banks sector in Jordan, namely, the Islamic Jordanian Bank and International Arab Islamic Bank. The study covered the period between 2007 and 2011.

Study Population and Sample

The population of the study consists from the Islamic Banks sector working in Jordan.

The sample of the study consists from two banks, namely, the Islamic Jordanian Bank and International Arab Islamic Bank. We excluded Dubai Islamic bank from our sample because of the short period time for the emergence of Dubai Islamic Bank.

Research Procedures and Statistical Treatment

This study will use descriptive and empirical methods. Also the study will be applied to the financial statements of the Islamic Banks for the period between 2007 and 2011. The researchers will address the subject of research by identifying the Islamic financing techniques in terms of concept and application; researchers will also use the method of financial analysis of investment instruments in the Jordanian Islamic banks.

To stand on the participation rates in investment funding instruments, the Islamic banks represented by the Jordan Islamic Bank and Islamic International Arab Bank in Jordan. To illustrate these percentages, the study analyzed the related financial data taken from the annual reports of the two banks as follows:

First: analysis of financial data relating to the Islamic International Arab Bank: given the Table (1) and the finance portfolio of Islamic International Arab Bank, as shown below:

Table (1) Financing portfolio of Islamic International Arab Bank

YEAR	2007	2008	2009	2010	2011
ITEM					
Murabaha	230,282,173	215,760,540	209,069,266	235,090,632	260,665,931
Mudaraba	11,509,376	4,494,906	3,511,178	7,416,717	3,853,146
Istisn	4,999,636	7,041,469	5,561,435	6,726,972	7,184,531
Participation	357,240	308,080	42,239	31,999	22,292
Ijara	58,334,434	63,769,812	78,942,297	120,106,427	190,611,473

The table above shows the Islamic instruments of financing such as Murabaha, Ijara, Istisnae and participation. The amount of money invested in each of these methods represented by the time series from 2007-2011. Where it is noted that the volume of funds invested through methods of financing investment style was Murabaha. It acquired the largest share of these funds invested during the time period 2007 - 2011, followed by Ijara, Mudaraba, Istisna and participation. This combination protects the risk exposure as the banks minimize the risk to the lowest level.

It is noted that there is variation in the amounts invested through methods of financing up and down, and attributed based on the financial data in the annual reports of the bank to the diversity of financial instruments, the Islamic investment in the acquisition of these amounts of investment, with the survival of the steady increase in the volume of money invested in line with the view investible funds.

Table (2) shows the financial position of the Islamic International Arab Bank, as follows:

Table (2) The difference between assets and liabilities Islamic International Arab Bank

ITEM / YEAR	2007	2008	2009	2010	2011
Assets	593,987,017	906,311,975	1,040,778,297	1,133,111,480	1,127,482,501
Liabilities	223,975,837	456,556,818	412,762,035	429,608,953	398,400,177
Net after deducting liabilities	370,011,180	449,755,157	628,016,262	703,502,527	729,082,324

Notes from Table (2) that there is a steady increase in the assets of the Islamic International Arab Bank during all the years covered in the study period. This will motivate the bank to increase its investments.

The statement attributed Islamic instruments of financing investment in study worked on the statement of these ratios through Table (3).

Table (3) Financing portfolio of Islamic International Arab Bank

ITEM / YEAR	2007	RELATIVE WEIGHT	2008	RELATIVE WEIGHT	2009	RELATIVE WEIGHT
Murabaha	230,282,173	75%	215,760,540	74%	209,069,266	70%
Mudaraba	11,509,376	4%	4,494,906	2%	3,511,178	1%
Istisna	4,999,636	2%	7,041,469	2%	5,561,435	2%
Participation	357,240	0%	308,080	0%	42,239	0%
Ijara	58,334,434	19%	63,769,812	22%	78,942,297	27%
Total investments through Islamic formulas	305,482,859	100%	291,374,807	100%	297,126,415	100%

Continue:

ITEM / YEAR	2010	RELATIVE WEIGHT	2011	RELATIVE WEIGHT
Murabaha	235,090,632	64%	260,665,931	56%
Mudaraba	7,416,717	2%	3,853,146	1%
Istisna	6,726,972	2%	7,184,531	2%
Participation	31,999	0%	22,292	0%
Ijara	120,106,427	33%	190,611,473	41%
Total funding through various formulas	369,372,747	100%	462,337,373	100%

Notes from Table (3) above, that the Murabaha method is a method acquired the largest turnout of the amount of money, although with the participation rate has started to decline since 2007, but this method remained method on the largest percentage of the amount of money invested until 2001, followed by Ijara, Mudaraba, Istisnae and participate. Where there was a decrease in the proportion of funds invested in the financing instruments investment outlined in the table with the exception of finance lease through a series of time 2007 -2011, with a steady increase in the volume of money invested, where the increase was fluctuate rise and fall in the components of the portfolio: Investment Self, investment commodity LCA, pledges customers for documentary credits, customer commitments for guarantees, acceptances, as shown in the table above. Perhaps the advantaged due to careful management of the bank to hedge the risk in order to save depositors' money and work on the growth and continuity.

With regard to the rates of growth or decline in the volume of money invested in venture funding instruments and the rest of the components of the portfolio assets, it is also shown in Table No. (4), where the statements have been prepared based on the year 2007 as the base year for each year the time period 2007 - 2011.

Table (4) Growth in the ratios for each version of Islamic instrument of financing Islamic International Arab Bank

ITEM / YEAR	2007	2008	2009	2010	2011
Murabaha	75%	-1%	-7%	-15%	-25%
Mudaraba	4%	-50%	-75%	-50%	-75%
Istisna	2%	0%	0%	0%	0%
Participation	0%	0%	0%	0%	0%
Ijara	19%	16%	42%	74%	116%

The table above shows the growth rates in Murabaha are decreasing by the year 2011, as well as for the speculation, but participation remained throughout the period of time fixed, while the growth rate was increasing steadily over the period with the exception of 2008, and notes regarding the components of the asset portfolio that they're decreasing in: custom commodity investment, customer commitments for letters of credit, customer commitments for guarantees, acceptances. The growth rate was increased to about wobbling over the time period. The interpretation of this is to the Islamic Bank Department is keen to achieve an increase in depositors' money, which is the item of investments for clients.

With regard to the financial analysis of growth rates in earnings the Bank's financing instruments for the time period 2007 - 2011, as shown in Table (5).

Table (5) Growth rates in earnings for each variation of funding for Islamic International Arab Bank

ITEM / YEAR	2007	2008	2009	2010	2011
Murabaha	446,113	-18%	-62%	-56%	-52%
Mudaraba	23,793	-59%	-90%	-74%	-84%
Istisna	11,896	-17%	-59%	-49%	-36%
Participation	0	0%	0%	0%	0%
Ijara	113,015	-4%	-42%	-11%	38%
Total revenue for the funding formulas	594,817	493,039	241,043	305,219	381,127

Note through the previous table that growth rates in earnings per variation of investment funding decreased in 2011 compared with 2007 and this meant less profit by the ratio for the base year, the formula financing leasing has increased in 2007 compared to 2011 by 38%, and this means that there is an increase profits by percentage for the base year, moreover, denotes feature multiple instruments of financing Islamic investment and through which the degree of safety is enhanced and diversity in investment funding.

Second: analysis of financial data relating to the Jordan Islamic Bank: Given the net financing and deferred sales receivables of Jordan Islamic Bank as shown in the table (1) below:

Table (1) Net financing and deferred sales receivables of Jordan Islamic Bank

ITEM / YEAR	2007	2008	2009	2010	2011
Individuals (retail):	338,162,694	386,329,526	384,049,280	395,211,572	430,539,240
Murabaha	159,006,812	200,332,652	249,893,425	260,272,536	287,503,285
Real estate funds	13,569,917	14,490,021	15,156,632	15,927,784	18,219,217
Declining participation	51,544,600	76,983,910	127,111,463	136,448,577	146,065,221
Small and medium enterprises:	380,659	0	0	0	0
Murabaha	44,939,757	13,001,012	47,140,097	49,347,166	55,502,745
Declining participation	153,239,605	240,344,762	243,099,152	282,752,606	315,038,378
Major companies:	49,306,258	110,308,179	134,951,442	168,539,668	222,921,648
International Murabaha	55,502,745	49,347,166	47,140,097	13,001,012	44,939,757
Murabaha	315,038,378	282,752,606	243,099,152	240,344,762	153,239,605
Capital Leases	222,921,648	168,539,668	134,951,442	110,308,179	49,306,258

Notes through Table (1) above, that the investments and funds investment is divided into three parts: a personnel, institutions medium, large companies, and even though the distribution but their way of Murabaha to buy something, compared with financing instruments in other investment, was distinguished in both three sectors, where he had the largest share in those sectors then followed by real estate financing, hire-purchase, post declining, according to the chronology of the year 2007-2011, as shown in the table above.

As can be seen that there is a steady increase for the base year 2007 in all formats of financing and deferred sales receivables for all years, except Murabaha fell only in 2008 and then rolled upward through a series of time, and this is due to the financial strength of the bank, which is to increase depositors' money has achieved growth in depositors' money as shown in Table (2) below:

Table (2) The difference between assets and liabilities of the Jordan Islamic Bank
(2007-2011)

ITEM / YEAR	2007	2008	2009	2010	2011
Assets	1,596,832,574	1,848,373,078	2,183,062,940	2,603,683,927	2,898,300,754
Liabilities	498,382,380	598,116,506	664,423,122	780,842,619	866,376,486
Net after deducting liabilities	1,098,450,194	1,250,256,572	1,518,639,818	1,822,841,308	2,031,924,268

Table (3) Net funding ratios and deferred sales receivables of the total investment prepared for each item of the Jordan Islamic Bank for the period (2007 - 2011)

ITEM / YEAR	2007	RELATIVE WEIGHT	2008	RELATIVE WEIGHT	2009	RELATIVE WEIGHT
Individuals (retail):	338,162,694	64%	386,329,526	66%	384,049,280	59%
Murabaha	159,006,812	33%	200,332,652	31%	249,893,425	38%
Real-estate funds	13,569,917	2%	14,490,021	3%	15,156,632	2%
Declining participation	510,739,423	58%	601,152,199	63%	649,099,337	54%
Total	51,544,600	100%	76,983,910	99%	127,111,463	100%
Small and medium enterprises:	380,659	0%	0	1%	0	0%
Murabaha	51,925,259	7%	76,983,910	6%	127,111,463	11%
Declining participation						
Total	44,939,757	4%	13,001,012	18%	47,140,097	11%
Major companies:	153,239,605	66%	240,344,762	62%	243,099,152	57%
International Murabaha	49,306,258	30%	110,308,179	20%	134,951,442	32%
Murabaha	247,485,620	35%	363,653,953	31%	425,190,691	35%
Capital Leases	1,201,401,491		1,041,790,062			
Total	35%	425,190,691	35%	363,653,953	31%	247,485,620

ITEM / YEAR	2010	RELATIVE WEIGHT	2011	RELATIVE WEIGHT
Individuals (retail):				
Murabaha	395,211,572	59%	430,539,240	58%
Real estate funds	260,272,536	39%	287,503,285	39%
Declining participation	15,927,784	2%	18,219,217	2%
Total	736,261,742	51%	671,411,892	
Small and medium enterprises:				
Murabaha	136,448,577	100%	146,065,221	100%
Declining participation	0	0%	0	0%
Total	136,448,577	10%	146,065,221	10%
Major companies:				
International Murabaha	49,347,166	10%	55,502,745	9%
Murabaha	282,752,606	56%	315,038,378	53%
Capital Leases	168,539,668	34%	222,921,648	38%
Total	500,639,440	38%	593,462,771	40%
Total Overall	1,308,499,909		1,475,789,734	

Notes from Table (3) above that the participation rate method Murabaha to buy something in most sectors of the three, by acquiring the largest share in the volume of financing and deferred sales receivables, as also noted that this ratio in 2007, was high in the individual sector by 66 percent. This means the ability of Islamic investment methods of financing for individuals and small businesses, and thus demonstrates that the Murabaha to buy something reached 100% in financing for individuals and small enterprise sector, and 62% in the financing of the corporate sector.

Were we note from Table (3) that the Islamic finance investment rates were steadily increasing the size of the total funds invested each year with the exception of international Murabaha. However, the method Murabaha to buy something remained captures on the largest percentage of the total volume of financing and deferred sales receivables each year, and then come MMP and hire-purchase. This is due to the flexibility of financing instruments of Islamic investment towards responding to the demand for money for investment, in addition to achieving the objectives of the Islamic Bank to maintain depositors' money and growth and to achieve liquidity and risk aversion and thus continuity and competitiveness in

the performance of its role in supporting the development through financed various investments and comparative in possession of multiple investment funding formulas meet its requirements.

With regard to the rates of growth or decline in the volume of money invested in venture funding instruments. It is also shown in Table No. (4), where the statements have been prepared based on the year 2007 as the base year for each year the time period 2007 - 2011.

Table (4) Growth in the ratios for each version of the funding of the Jordan Islamic Bank (2007 – 2011)

ITEM / YEAR	2007	2008	2009	2010	2011
Individuals (retail):	66%	-3%	-11%	-11%	-12%
Murabaha	31%	6%	23%	26%	26%
Real estate funds	3%	-33%	-33%	-33%	-33%
Declining participation	63%	-8%	-14%	-19%	-21%
Total	99%	-90%	-90%	-90%	-90%
Small and medium enterprises:	1%	-100%	-100%	-100%	-100%
Murabaha	6%	17%	83%	67%	67%
Declining participation	18%	-39%	-39%	-44%	-50%
Total	62%	6%	-8%	-10%	-15%
Major companies:	20%	50%	60%	70%	90%
International Murabaha	31%	13%	13%	23%	29%
Murabaha	-15%	-10%	-8%	6%	62%
Capital Leases	90%	70%	60%	50%	20%
Total	29%	23%	13%	13%	31%

Observed from the above table that the growth rates in Murabaha all kinds decreasing by the year 2011, while real estate funds where the growth had been increasing steadily over the time period with the exception of 2008, and the growth rate was increasing as well as in hire-purchase during the time period. Interpret due to the eagerness of the Jordan Islamic Bank in achieving its goals through a steady increase in investment in the hire-purchase.

The financial analysis of growth rates in earnings the Bank's financial instruments for the time period 2007-2011, are shown in Table No. (5).

Table (5) Growth rates in earnings for each variation of Finance of Jordan Islamic Bank (2007 – 2011)

ITEM / YEAR	2007	2008	2009	2010	2011
Individuals (retail):	23,029,739	2%	19%	26%	36%
Murabaha	10,816,999	13%	64%	77%	89%
Real estate funds	1,046,806	-17%	-21%	-36%	-29%
Declining participation	34,893,544	6%	33%	41%	52%
Total	3,551,441	34%	148%	169%	164%
Small and medium enterprises:	35,873	0%	0%	0%	0%
Murabaha	3,587,314	34%	148%	41%	166%
Declining participation	4,283,708	-27%	-97%	-97%	-98%
Total	14,754,993	41%	66%	99%	114%
Major companies:	4,759,675	153%	279%	371%	493%
International Murabaha	23,798,376	24%	19%	45%	65%
Murabaha	114%	99%	66%	41%	14,754,993
Capital Leases	493%	371%	279%	153%	4,759,675
Total	65%	45%	19%	24%	23,798,376

Note through the above table containing profits formats finance investment in retail: profits were Murabaha to buy something up steadily during the entire period of time, and so on for instruments financing real estate, while the profits of instrument MMP declining steadily during the time period, while profits modes of finance to invest in small and medium enterprises: profits were Murabaha to buy something on a steady increase over the time period, while MMP did not invest in an Islamic bank in the years following 2007, the profits financing instruments to invest in big companies: the Murabaha international volatility towards decreasing, The Murabaha profit to buy something in a steady increase during the time period as well as for leasing ending ownership. Note that growth rates in earnings for each variation of investment funding, which decreased in 2011 from 2007 profits fell by means ratio for the base year, and vice versa for increasing growth rates. With due respect to increasing growth rates of some forms of investments on the one hand and decreasing on the other hand, denotes feature multiple modes of financing Islamic investment and through which the degree of safety is enhanced and diversity in investment funding.

Conclusion

1. Islamic banks own multiple investment financing formats.
2. Funded Islamic banks investment sectors in different structural society.
3. Check investment gains through various investment funding instruments.
4. Check liquidity aware of through multiple investments.
5. The growing financial positions during the study period.
6. The Islamic banks achieve its goals in the competition and avoid risks in achieving the returns to depositors.
7. Islamic banks do not give importance to investment based on the interest rate, which means the loss of some customers who prefer to rely on the interest rate investment.

Recommendations

The study provided a set of recommendations as follows: -

1. Islamic banks create the appropriate environment and the necessary legislation to give effect to the rest of the Islamic modes of investment funding to increase the degree of security has continued to compete and achieve their goals.
2. Islamic banks to tap their surpluses arising from liquidity in development Projects.
3. Islamic banks should give importance to invest based on the interest rate, and trying to find non-traditional ways, which means attracting some customers who prefer to rely on the interest rate investment.

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