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Proceedings

ISLAMIC BANKING

Editors
Dr. C. SAIDALAVI
HASEENA JASMINE C K

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Islamic Banking

Proceedings of the Three Day International Webinar

Editors

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PRINCIPAL'S NOTE

The prospects of Islamic banking

It is worthy to note that our students in the commerce stream are daring enough to discuss a subject to substitute a vital area - banking, in the academic arena of their career. The pivot of discussion hovers around whether Islamic banks can replace the conventional or traditional banking system. Being a growing industry, Islamic banking has around one percent share in the global economy. This means that Islamic banks need to grow faster than the rate at which they are growing now. Our young generation should focus on this new genre for application in their daily life.

Islamic banks are not supposed to be pure financial intermediaries but are strong substitutes to the negative aspects of the current system. It is an ethical alternative to the conventional banking system. Islam forbids taking an interest in both borrowing and lending. According to the rules defined by Shariah, investment should be based on the principle of shared risk. Here, the basic source of earning is on a profit-loss sharing basis. It also relies on tangible assets such as equity, real estate and rent. The risks involved in the Islamic banking system are operational risks, market risks, credit risks, and liquidity risks. These risks are shared between the financial party and the bank. This can prove to be a very healthy approach for the economics and financial sectors which leads to having more stable banks and can help in the prevention of premature bankruptcy. This also saves the parties from severe economic shock.

When we compare between conventional and Islamic system, it can be concluded that the former focus on money as a product besides a medium of exchange but in the latter, the real assets are the products and money in this system is only a medium of exchange. As far as the charging of interest, Islamic banking differs such that the interest is not the real aim while the profit on the exchange of goods and services is targeted. In the inflation scenario, in the conventional system, the entrepreneur increases the price of his goods, but in the proposed method there will be control on inflation. Therefore, no extra price is charged by the entrepreneur.

Terms like RBI, cooperative societies, industrial development banks, agricultural development banks etc. are familiar in the modern era but in the Islamic banking system, all these words are alien. It focuses on a system which will be targeted only on an institution.

Certain terminologies used in the Islamic banking system are Mudaraba (equal skill), Qardh (interest free loan), Ribh (profit), Musharaka (participation), Murababa (trade) and Ujrah(wage) and so on. Islamic banks offer better risk management tools, and since real assets back the system. It is one of the best ways to transform the global economy to become stronger, ethical, and reliable.

Best wishes for the proceedings of the seminar published by the PG Department of Commerce.

Dr. C. Saidalavi
Principal

Editor's Note on the Book

We have great pleasure in publishing the proceedings of the Three Day International Webinar on the topic ISLAMIC BANKING organised by the Post Graduate Department of Commerce, KAHM Unity Women's College, Manjeri on 9th, 10th and 11th February 2021.

The Seminar was inaugurated by Dr. C. Saidalavi, Principal of our college and the programme was presided over by Mr. T. T. Abdul Razak, HOD and Associate Professor, Department of Commerce.

Dr. Shaher Abbas, Founder and Managing Director, IFIN Service (Islamic Finance Initiation Network), Sweden presented a paper on the topic "Myths and Realities of Islamic Finance" in the first plenary session. Mr. T. T. Abdul Razak, HOD and Associate Professor delivered the welcome address and Mrs. Haseena Jasmine C K, Programme Co-ordinator extended the formal vote of thanks.

The second day was handled by Dr. Mohammed Abdul Imran Khan, Assistant Professor of Finance and Entrepreneurship, Dhofar University, Sultanate of Oman by presenting a paper on the topic "Islamic Banking: Key Challenges & Growth". Mrs. T K Fathima Shajitha, Programme Convener & Associate Professor of Commerce delivered the welcome address and Miss. Shilpa P K, Assistant Professor of Commerce extended the formal vote of thanks.

The third day of our webinar was used for the paper presentation session. The session was chaired by Ms. M K Vineetha, Assistant Professor of English, KAHM Unity Women's College, Manjeri. Adv. Abdurrahman Karatt, President, Block Panchayath Malappuram and Lecturer in Law, KAHM Unity Women's College, Manjeri delivered the welcome address and Ms. Juvairiya Sherin N M, Assistant Professor of Commerce expressed the formal vote of thanks.

Many delegates from different countries participated and presented papers in the webinar. The three day International Webinar was a success by the participation and presence of eminent academicians, research scholars and student community.

The main purpose of the International Webinar was to present the myths and realities of Islamic banking in front of academic society and proclaim the outcome of the seminar as an edited book with ISBN. This book has been structured with papers relating to different areas of Islamic Banking. It will be highly useful for the students, researchers, academicians and all others who intend to know the details about the various areas of Islamic Banking.

I express our sincere gratitude to Dr. C. Saidalavi, Principal of the college for the encouragement and support and Er. O. Abdul Ali, the manager of the institution for his guidance and direction for this webinar. I convey our gratitude to Mr. T. T. Abdul Razak, Head of the Department, Mrs. T K Fathima Shajitha, Programme Convener, other staff members and the students for their co-operation. I reveal my special thanks to all the authors for their backbreaking effort in bringing creative research works of their own to produce an edited book of this kind.

Editor

Mrs. Haseena Jasmine C K

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ISLAMIC BANKING: KEY CHALLENGES & GROWTH

Dr. Mohammed Abdul Imran Khan
Assistant Professor of Finance and Entrepreneurship,
Dhofar University, Sultanate of Oman

INTRODUCTION

For the past two decades, Islamic banking has tried to extend its reach to conventional banking levels at least. But the lack of a Shariah-compliant legislative framework — necessary to make interest-free banking acceptable and establish solid financial bodies — is the biggest snag behind its low financial market penetration [1]. It's time to take stock of the challenges facing Islamic banks as several support institutions/arrangements are required to perform functions carried out under the conventional framework by different financial institutions. Attempts to change the existing structure to provide better products and service in the context of Islamic law should be made. The Islamic banking industry has identified some of the most important challenges as follows. Islamic banking is a method of financing that must adhere to Sharia law (Islamic Law). The term can also refer to investments that are permitted by Sharia law (Khan, Jamil, & Syed, 2015). Islamic banking concepts are taken from the Qur'an, Islam's core religious source. All transactions in Islamic banking must adhere to shariah, Islam's legal system (based on the Qur'an's precepts). Fiqh al-muamalat refers to the rules that govern commercial transactions in Islamic banking. Along with the foundation of Islam emerged the common practices of Islamic banking and banking. Formal Islamic banking, on the other hand, did not emerge until the twentieth century. The Islamic banking sector is currently growing at a rate of 15% to 25% per year. Islamic banking was hardly a blip on the radar 30 years ago, but it has grown into a $2.5 trillion sector with hundreds of specialized institutions in over 80 countries. Islamic banks are by far the most powerful actors in the market, accounting for $1.75 trillion in assets, or 70% of total assets. Total sharia-compliant assets are estimated to reach $3.5 trillion by 2024, according to the 2019 State of the Global Islamic Economy report.

ISLAMIC FINANCE GROWTH IN GCC DESPITE CHALLENGES

The potential growth of the global Islamic finance industry still exists, but public awareness is limited. The lack of confidence in the Shariah compliance of Islamic financial products is part of the main challenges facing the industry. There is a need to address these challenges through the development of regulations to support Islamic financial services; continuous training and awareness campaigns for various stakeholders (including customers, regulators, financial institutions, and employees); and targeting the young generation and possibly increasing the use of fintech solutions[3].In the developed Islamic financial markets which include the countries under GCC and Malaysia, where the understanding, confidence and demand for Islamic products are still the highest as compared to the other parts of the World. Today Islamic banking has become systemically important which is evident through the people's awareness and the increasing acceptance rates. There are still many countries where the Islamic-finance markets or the industry has a niche presence, with very low awareness, confidence and demand for Islamic products; which includes many countries with Muslim-majority population like Indonesia, Turkey, Egypt, Algeria and Tunisia[3]. As the majority of the 1.8 billion global Muslim populations lives outside the GCC countries and Malaysia, there is a very high untapped growth potential for the global Islamic finance industry.

RECENT DEVELOPMENT OF ISLAMIC FINANCE AND BANKING

- Islamic finance and banking came into existence along with the foundation of Islam[5]
- the establishment of formal Islamic finance occurred only in the 20th century[5]
- the Islamic finance sector grows at 15%-25% per year[5]
- Islamic finance today is a $2.5 trillion industry with hundreds of specialized institutions located in more than 80 countries[6]
- Islamic finance only represents about 1% of global financial assets but with an 11, 4% growth in 2019, it is expanding quicker than conventional finance[4].
- According to a 2019 State of Global Islamic Economy report, total sharia-compliant assets are expected to grow to $3.5 trillion by 2024[4].
- some of the key sharia-compliant products :

- **Murabaha** or cost-plus selling
- **Ijara** or leasing
- **Mudarabah** or profit share
- **Musharakah** or joint venture
- **Takaful** or insurance

REVENUE GENERATION BY ISLAMIC BANKS WITHOUT PAYING INTEREST

Even though interest and speculation are prohibited, many of the goods offered by Islamic financial institutions are equivalent to those offered by Western or conventional financial organizations. Banks are by far the most important actors in Islamic Banking; some are entirely Islamic, while others offer sharia-compliant goods while remaining largely conventional. Aside from the lack of interest rates, the core premise of Islamic Banking is risk-sharing among parties in all transactions (Khan M. , 2010). Instead of profitably lending money to their clients, they purchase the underlying product the house, car, or refrigerator and then lease or resell it to the client for a fixed fee that is often greater than the initial market value (Khan, Tabook, & Zainab, 2018). The important concept here is risk-sharing: the banks profit from the transaction as a reward for taking on the customer's risk. Rather than profiting from interest rates, Islamic banks invest their customers' money in assets such as real estate or enterprises and benefit when the loan is repaid successfully (Khan M. , 2010).

A fund manager manages the common pool of funds:

- The wakala, in which the fund manager is paid a fee and the surplus, stays the participants' property.
- The mudarabahIs a derivative of the banking system in which the fund management and the participants share gains and losses.
- The hybrid model, which combines mudarabah and wakala elements.
- Waqf, which is a charitable trust.
- Bonds or Sukuk

DIFFERENCE BETWEEN ISLAMIC BANKS AND ISLAMIC WINDOWS

- While an Islamic bank operates solely on Islamic principles, an Islamic window refers to services given by a regular bank that is based on Islamic principles.

- Dedicated windows or sections at certain commercial banks provide Islamic banking services.

DIFFERENCE BETWEEN CONVENTIONAL BANKING AND ISLAMIC BANKING

The main difference between conventional finance and Islamic Banking is that some of the practices and principles that are used in conventional finance are strictly prohibited under Sharia laws **[2]** (Khan M. A. , 2012).Islamic Banking strictly complies with Sharia law. Contemporary Islamic Banking is based on several prohibitions that are not always illegal in the countries where Islamic financial institutions are operating:

1) **Paying or charging an interest:** Islam considers lending with interest payments as an exploitative practice that favours the lender at the expense of the borrower. According to Sharia law, interest is usury (riba), which is strictly prohibited (Khan M. , 2010)
2) **Investing in businesses involved in prohibited activities**: Some activities, such as producing and selling alcohol or pork, are prohibited in Islam. The activities are considered haram or forbidden. Therefore, investing in such activities is likewise forbidden.
3) **Speculation (maisir)**: Sharia strictly prohibits any form of speculation or gambling, which is called maisir. Thus, Islamic financial institutions cannot be involved in contracts where the ownership of goods depends on an uncertain event in the future.
4) **Uncertainty and risk (gharar)**: The rules of Islamic Banking ban participation in contracts with excessive risk and/or uncertainty. The term gharar measures the legitimacy of risk or uncertainty in investments. Gharar is observed with derivative contracts and short-selling, which are forbidden in Islamic finance.

ISLAMIC BANKING'S ADVANTAGES

- **Justice and Fairness:** The Islamic Banking model is built on a profit-sharing basis, in which the bank and the consumer share the risk. This financial intermediation mechanism aids in the distribution of income and wealth in a fairer manner.
- **Banking for All:** Islamic Banking is open to everyone, not just Muslims. It is founded on Sharia principles and is available to both Muslims and non-Muslims.

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- **Transparency is important:** Islamic banking is all about doing business ethically and transparently. It is our highest priority to guide you through the process so that you have a complete grasp of the risks and expenses involved with the products and services.
- **Moral and Ethical Dimensions:** Strong ethical and moral components of doing business and deciding which commercial activities to fund are vital in fostering socially desirable investments and better individual or corporate behaviour.
- **Discouraging Speculation:** Speculative transactions are inherently insecure and result in capital misallocation. Islamic banks are forbidden from engaging in such operations, instead of focusing on capital deployment in the real economy to achieve socio-economic justice.

DIFFERENT CHALLENGES OF ISLAMIC BANKING ARE:

1) Decrease in Profits: Profit is one of the potential information for internal and external banking parties in the financial reports. Information on earnings is part of the financial statements that evaluate the performance of management, the long-term capability of representative earnings, forecast profits and the assessment of investment risk and the credit fund (Khan M. , 2014). When revenues exceed expenses, profit is derived. On the other hand, there is loss when costs are higher than income. Operating profit is the difference between operating revenue and costs when the operating revenue and costs are significant factors associated with an increase or decrease in operating profit the difference between revenue and total operating costs for the time being. It generates an operating profit if the difference is positive. If the difference is negative, the operating loss for the period will be achieved. Some of the things that are behind the drop in profitability in Islamic banks are as follows:

a) Services closure or reduction and hours of work

(b) Increased operational expenses, such as the supply of hand hygienic, multivitamin and disinfectant hygiene equipment to the office environment in large quantities, especially to the staff

(c) Funding and funding selectivity to reduce the risk of inefficiency in financial services

2) Digitalization in banking services: In addition to the various future risks facing the COVID outbreak, the digitization of Islamic bank products and services should be quickly and responsively carried out. The economic theory that technological progress leads to increased productivity and promotes business efficiency will be followed through on the

nt company will enhance its
wever, every bank recognizes the
affects the competitiveness of the
Digital banking is considered less
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s Ordinance 1962, whilst Islamic banks are in reality big and large
Muslim banking has some kind of similarity with universal banking.

The implementa... no Islamic banking laws. Bankin... changes in several countries to ensure that... Moreover, international acceptance of Islamic financial contrac... compatible with and acceptable to Shariah under key legal regimes such as Co... and civil law. Islamic banks do not display on a balance sheet any of the assets funded by Ijara, Murabaha, etc. because Section 7 of the Bank Act 1962 does not allow a bank to own property or assets, which are prohibited under section 9 from entering any form of trade. In their balance sheets, however, are all the assets owned by Islamic banks.

Housing financing is carried out by Islamic banks based on the decrease of Musharakah. The house belongs jointly to the bank and the customer under this model. On an Ijara basis, the bank rents its share to the customer. The Islamic bank uses the term 'Monthly Payment Agreement' when it executes Ijara with its partner/customer instead of the terms Ijara with its customer. It is so named that the interest of the bank is protected if the customer refuses to pay rents. To overcome this risk, the Islamic Bank has no legal coverage. Islamic banks' deposits usually are based on the profit and loss principle (Musharakah or Murabaha). If something happens and the bank loses, it must be transferred directly to the depositor. The worst barrier to mobilizing deposits in the Islamic banks is this fear of loss. In some cases, it results in funds being withdrawn. There must be some type of protection for the depositors.

4) Islamic prudential regulations: Islamic banks are equally important to monitor. At present, one of the weaknesses of Islamic banking is the lack of effective prudential regulation. For example, Ijara, where the nature of both is different, is governed by prudential leasing rules, progress made. The bank owns Ijara and therefore the Ijara contract to convert it to Musharakah, whereas Ijara rules are applied to that contract, which is illegal. And some of the Islamic banks use the term 'Safety,' so making Ijara non-Shariah-compliant will be just Riba, which is strictly forbidden by Islam because the sum deposited under the heading of Ijara Security (Rahn'). In addition, funding for Ijara is subject, in substance, to compulsory insurance.

5) Risks: The nature of risk is different in Islamic banking from conventional banking and therefore it is necessary to apply certain special rules on prudence, accounts and auditing. By using the standard interest benchmarks (Kibor etc.), Islamic banks will be at the mercy of application of digital technology. A productive, efficient company will enhance its competitive ability and dominate the market. In reality, however, every bank recognizes the urgency of the digital banking phenomenon. This naturally affects the competitiveness of the banks, in which digital strategy is a vital strategy. Digital banking is considered less aggressive than conventional banking to be implemented in Islamic banking. The essential functions of banks as intermediaries and financial services providers and outside as financial advisers to their customers can be exercised by digital banking systems. They can interact in real-time using customers' mobile devices. The penetration of the internet and cell phones continues to rise, and banking as well. As a major part of the digital banking population, digital banking needs to provide banks with different experience through digital bank portals and mobile applications. The digital age today needs a rich, personal, secure and secure digital banking experience. When making digital transactions, it becomes a problem in itself because customers don't experience the actual face to face experience of meetings (Khan M., 2011). Face-to-face service is not just about service, but also understanding, comprehension and feeling. Therefore, when conducting face to face transactions, bank digitization requires the same comfort and experience.

3) Legal Support: The framework for executing the trade and financial contracts and transactions is established in Islamic law. However, there is no legal framework for commercial banking and corporate laws applicable to Islamic banking and financial contracts. Islamic banking agreements are treated as property purchases and sales and are therefore taxed twice. Commercial, banking and enterprise laws contain narrowly defined provisions prohibiting the scope of Islamic banking operations within conventional limits. Special laws must be implemented to introduce and practice Islamic banking. The cases of Islamic banks in dispute are subject to the same legal system and are handled as the conventional court and judge, while the legal system of Islam is entirely different. Modifications in existing legislation, which refuse to comply with Islamic injunctions, are required to pass a law compliant with Shariah, for dispute resolution by special courts, to ensure that the Islamic legal system is proper, fast and supportable.

The laws and regulations must be amended to reflect that new concept such as section 7 (forms of business in which the company may participate) and section 9 (banning trade) of the Banking Companies Ordinance 1962, whilst Islamic banks are in reality big and large traders of the market. Muslim banking has some kind of similarity with universal banking.

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The implementation of agreements in courts may require additional effort and cost if there are no Islamic banking laws. Banking and corporation regulations, therefore, require appropriate changes in several countries to ensure that Islamic banks have a level playing field. Moreover, international acceptance of Islamic financial contracts requires them to be both compatible with and acceptable to Shariah under key legal regimes such as Common Law and civil law. Islamic banks do not display on a balance sheet any of the assets funded by Ijara, Murabaha, etc. because Section 7 of the Bank Act 1962 does not allow a bank to own property or assets, which are prohibited under section 9 from entering any form of trade. In their balance sheets, however, are all the assets owned by Islamic banks.

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5) Risks: The nature of risk is different in Islamic banking from conventional banking and therefore it is necessary to apply certain special rules on prudence, accounts and auditing. By using the standard interest benchmarks (Kibor etc.), Islamic banks will be at the mercy of their conventional peers, as a pricing foundation for an Islamic financial product. The customer has a negative perception that the Islamic banking products are not cautious as they also have the same interest benchmark. The long-term financing mechanism could be developed by using the rental system used by private landlords while renting their properties, etc.

6) Shariah-based product: The problem is that every single institution has its groups of Islamic scholars on the Shariah Board to approve the product. The Islamic Financial Institutions offer the same fundamental products (90% Murabaha and Ijara).As a result, the same product may have different characteristics and will in these institutions be subject to different kinds of rules. The absence of standard financial agreements and products can cause ambiguity, dispute and costs. Furthermore, the further development of banking products is hindered without a common understanding of certain basic foundations.

7) Nature of Islamic banking: While leaving the core and the making of Islamic financing instruments such as Musharah and Murabah, Islamic banks provide only Murabah and Yarah. Real Islamic banking activities need to be enhanced and facilitated by promoting risk-sharing via asset-type equity facilities and investment-sharing accounts on the financing side.

8) Lender of last resort facility: The lack of liquidation available in the secondary market means that Islamic banks are reluctant to enter into long-term transactions. Liquidity assistance is available in the form of last resort lenders. To ensure consumer protection as provided by Shariah, there is no proper mechanism of transparency and public disclosure. The Last Resort Lender (LOLR) is the financial system institution acting as a liquidity provider to a financial institution that cannot obtain enough liquidity on the interbank lending market and which has exhausted other facilities or sources. It is a liquidity guarantee for financial institutions by the government. Since the start of the twentieth century, most central banks have been lenders and usually have liquidity assurance on the financial market in general. The goal is to prevent economic disruption from a lack of liquidity in a bank due to financial panics and banks spreading from a bank to another.

9) Islamic future exchange: Long-term finance is provided in the traditional system utilizing long-term bonds and shares. Investment banks, mutual funds, insurance companies and pension funds are, in addition to the general public, the most important source of long-term

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investment. There are no interest-bearing bonds deals with Islamic banks. Therefore, they are much more in need of equity markets. Moreover, Islamic banks' most of their products are based on commodities, whereas prices and exchange rates are frequently rising and dropping, which in reality creates a great risk for them, especially for Salam and Istisna'a. To protect the risk, derivatives and, therefore, future exchanges are required.

10) Shortage of experts in Islamic banking: The provision of skilled or experienced bankers is lagging behind Islamic banking expansion. Training needs not only affect domestic and non-Islamic banks but also foreign banks. Lack of accounting standards for Islamic banks (and of auditing): Uncertainty in accounting principles covers, among others, revenue generation, accounting information disclosures, accounting bases, valuation, income and matching expenses. The results of Islamic banking schemes, especially profit and loss shares attributed to depositors, cannot thus be properly defined.

11) Lack of uniform standards of credit analysis: There is no suitable standard for credit analysis for Islamic banks. Problems may be further aggravated by establishing an Islamic bank in a non-Muslim nation and subject to the rules and requirements of that nation.

12) Instruments that meet the demand of specific investment requirements: The provision of short-term investment instruments is one of the greatest challenges facing institutions. Several institutions have sought to develop high-quality short-term instruments, but their ability to generate assets; credit rating and liquidity have been hampered.

13) Other Challenges of Islamic Banking

- Low level of public conscience
- Need for better regulation, improved collaboration between Islamic and traditional financial standard makers to address complexity and "single industry risks"
- Scarcity of monetary policy instruments compliant with the Shariah policy "

CONCLUSION:

To ensure the financial inclusion of "unbanked" populations excluded from the current financial system, Indian and foreign banks should exploit the potential of Islamic Banking Khan M. , 2012). Government can play a bigger role by creating the Islamic Banking industry and raising awareness among the people of a country (Khan M. , 2012).The fact that Islamic banking is unfortunately misunderstood as a religious charity enterprise restricted to the Muslim community is a major bloc behind the fact that it does not start banks based in Shariah in many countries. Fatwas must be strengthened and Islamic Banking must be regulated and governed. The recent pandemic lock-downs have demonstrated that there is a need to take critical measures like going online; digitalization and Fintech partnerships could contribute to Islamic banks continuity and will open new avenues for future growth (Khan M. , 2011). The public awareness of Islamic banks and a common legal Shariah framework for Islamic banks across the world must be established.

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INTEREST-FREE MICROFINANCE IS AN ADVANTAGES TO SOCIETY:A THEORETICAL OVERVIEW

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ABSTRACT

The major objective of this study is to amplify the advantages of fostering interest-free microfinance (IFM) institutions in Rural society and to analyse the major advantages of Interest Free Microfinance Institutions. Their economic, social, legal, technological and other upper hands over the other institutions are assessed. The results point out that, in developing countries, IFM institutions are more capable than other interest-free banks (IFB) in reducing poverty, increasing financial inclusion, creating employment opportunities, empowering women and boosting local development. Moreover, they are simple to start, easily manageable, community-based by nature, efficient, and necessitate less technology, infrastructure and human resources than banks. Therefore, in parallel to the expansion of the IFB Industry, backing IFM institutions in society can benefit the socio-economic development of Nation.

Keywords: Interest-Free Microfinance, Interest-Free Bank, Investment opportunities

INTRODUCTION

The concept of microfinance is broadly acquiescing to institutions that provide financial access and release the productivity of the poor. It is also regarded as a tool for financial inclusion. Microfinance institutions vary in scope, structure and ownership. They use a range of techniques to deliver their service to the lower end of the market, including households and enterprises. According to Microfinance Barometer 2019, 139.9 million borrowers benefited from the services of MFIs in 2018, of which 80% are women and 65% are from rural areas. Despite the tremendous growth the sector has witnessed in the past decades, the Muslim community is not accommodated because the service is based on interest (Mbowe, 2020). As a result, IFM emerged as an alternative to conventional microfinance with the aim of providing financial and non-financial service to the poor and low-income clients in accordance with Islamic values (Shafii and Rahman, 2013). Though the IFM service is currently less than one percent of the global microfinance industry, it has a tremendous growth potential (Mbowe, 2020). Given the large numbers of poor within the Muslim community that are in critical need of a source of finance, it is expected that the demand for IFM tends to be high. IFM can play a key role with regards to poverty reduction and enhancing social values (Begum et al. 2019). The sector has witnessed an aggressive momentum towards geographic coverage (Deribe, Nigussie and Mitiku, 2012). Since more than 80% of the population lives in rural areas, the microfinance institutions' services in societies focus on rural households. Despite the increase in the number of the institutions and the demand for them, the supply of the services is very limited (Geremew, 2019). In spite of its rapid growth and geographical coverage, the microfinance service is dominated by conventional products. Among the MFI institutions, little numbers provide interest-free services (NBE, 2019). They provide products such as Murabaha (cost plus finance), Mudaraba (profit sharing), ijara (leasing), Wadia (safe keeping), Salam (advance payment sale) and Qarad Al Hasan (loan). However, the outreach is very low. the inception of many institutions and banks at the same time may have consequential negative and positive impacts on the sector. Besides, the fortune and the overall advantages of the microfinance institutions and the banks may be meaningfully different. Therefore, the main aim of this paper is to descriptively analyze the multidimensional benefits of IFM vis-a-vis interest-free banks services.

OBJECTIVES

- To analyzing the priority of IFM services over the interest-free banking services in societies
- To described the major circumstances in which the microfinance institutions may have better benefits than the interest free banks
- To analyse the major advantages of Interest Free Microfinance Institutions

INTEREST-FREE MICROFINANCE (IFM) MODELS

To indicate about the advantages of IFM institutions over the IFBs, it is important to understand the nature of the existing institutions operating in various countries. By and large, there are three major types of IFMIs;

a. Profit-based

b. Charity-based

c. A composite of both types.

The profit-based IFMIs: It offer services in a similar fashion that IFBs do. They mostly offer micro musharakah (joint venture), mudarabah (profit sharing), salam/istisna (advance payment sale) and ijara (leasing) services. Their principal mission is making profit by offering these products. In some countries, full-fledged IFBs, conventional banks, and conventional microfinance institutions adopt this model to provide IFM services.

The charity-based IFMIs: These are mission-based institutions, which apply zakah (a religious obligation of capable Muslims to assist the poor), sadaqa (donation), waqf (endowment) and qarad Al Hasan (loan) as a source of fund for their transactions. They do not have a profit-making objective; rather, they act as an intermediary between donors and the poor.

The composite of both types: In the third category there are composite institutions, which offer both services at the same time. They offer the charity-based services to the chronically poor and economically inactive citizens. They offer training and consulting services to customers until they become economically active and able to use the profit-based services and products (Obaidullah, 2008).

POTENTIAL ADVANTAGES OF IFMI OVER IFBS

a. Economic Advantages

b. Social Advantages

c. Source of Fund and Management Strengths

d. Legal Advantages

e. Technology and Facilities Requirements

f. Sociopolitical Advantages

g. Ethical Issues

a. Economic Advantages

In a developing economy, the counting of high-income population is small. The majority of the population is poor, and a significant number of people live under the poverty line. As part of the infrastructural status of these nations, financial services are also poor or insubstantial. This makes the financial services' coverage very minimal. In such a scenario, microfinance institutions may have a higher role than banks in general. So, in area like rural population, there are heterogeneous economic justifications for promoting more of IFMIs than IFBs.

Poverty Reduction

The first reason is the power of IFMIs in reducing poverty. Currently, there are billions of people living in dire conditions around the world. Many countries of Africa, Asia and Latin America have significant proportion of their population living under the poverty line. Interest Free Microfinance Institutions (IFMI) can play a higher role than full-fledged IFBs in reducing poverty. This is mainly because the poor need major but micro services. Major micro services includes: micro-credit, micro-equity, micro-saving, micro-transfer, micro-insurance, and micro-enterprises (Iyad, 2015; Obaidullah, 2008). Moreover, the poor need financial services because they are often faced with events: life-cycle events, emergency needs, and investment opportunities.

Life-cycle occasions

It includes those once-in-a-lifetime occurrences such as birth, marriage, death, home building, old age or persistent incidents such as education expenditures, festivals, and harvesting that every household faces.

Emergency needs

This need includes personal crises like sickness or injury, the death of a bread winner or the loss of employment, and theft.

Investment opportunities

This is the opportunity to invest in businesses, land, or household assets also occur periodically (Obaidullah &Tariqullah, 2008; Hasan et al., 2017). The poor need to get various services to satisfy their needs. These include interest-free micro credit and micro-saving services which are usually difficult to get, either from conventional financial institutions or interest-free banks. In this regard, IFMIs play notable functions to address the poor using interest-free banking and financing products such as qardhasan (loan), murabaha (profit sharing), ijara (leasing), salam (advance payment sale) and others. As a result, economically inactive citizens can be engaged in many gainful occupations. Once they become economically active, they need micro-insurance. The IFMIs can provide takaful (Islamic insurance) services for them. Furthermore, the demand for micro-transfer appears. This can also be covered by diverse forms of IFMIs. IFMIs promote micro-enterprises in a society where they are active through the provision of micro-saving, micro-credit, micro-transfer and micro-insurance services.

As a result, they contribute to the poverty reduction efforts of the community. In a country where access to banks in remote areas is almost none, microfinance institutions, in general, have a substantial role to play. Similarly, IFMIs can surge the size of the receivers of microfinance services by enabling millions of Muslim clients to use the financial services assertively. Doing so, they can be a means for poverty reduction and rural development. Such IFM services are very laborious to be covered by the windows and upcoming full-fledged IFBs because of their circumscribed availability in rural localities, insufficient capital and lack of orientation.

Employment Creation

Another explanation is the competence of IFMIs in creating job opportunities for the youth, which is one of the key economic challenges in developing countries. Unemployment is one of the critical economic difficulties considering that unemployed people face various socio - economic hurdles (Ali, 2015). In this regard, IFMIs may play a substantial role. In both models, profit-based and charity-based, they serve the poor. They collect Zakah and charity to make the economically inactive citizens involved in any economic activity they can afford. Moreover, they stimulate the expansion of small and medium-scale enterprises. This creates an employment opportunity for the beneficiaries who are usually out of access to the long-established financial institutions (Ahmed, 2002). This type of employment is a type of self-employment, which also heightens the entrepreneurial capacity, skills and an overall economic capability to compete in the formal sector. Besides, it creates an employment opportunity for the families and communities of the beneficiaries in various direct and indirect ways (Mahmood et al., 2015). Consequently, it promotes social protection, social stability, political stability and all-inclusive economic empowerment of the community (Shahed et al., 2017). The ever-growing youth population , especially in the predominantly Muslim regions, seriously demands socially-compatible microfinance services – IFMIs. Again, we can strongly argue that commercial banks, in general, cannot satisfy this demand because of their inadequate capacity, managerial orientation and narrow coverage.

Economies of Scale and Efficiency

The third reason is the economies of scale that IFMIs have. They can be founded with little capital to serve thousands, of people. For instance, setting up an IFMI needs less than 2% of the total capital required to start a full-fledged bank. This makes IFMIs economically advantageous to address the financial needs of many low-income citizens. As a result of their communication with the residents of the localities, IFMIs have high efficiency of fund mobilization and fund allocation. In addition to this character, the smaller scales of the credits

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they provide to their customers make their credit risks usually low in comparison to banks (Affandi, 2018). However, in some countries, it is indicated that microfinance institutions became inefficient and faced diversified problems. This happens as a result of their business orientation to make a high profit by providing credit to the very poor members of the community who have many socio-economic challenges and fail to repay. In this regard, IFM institutions are efficient and effective because of their balanced business orientation and the acceptance of the moral values they promote by the community (Ali, 2015).

Financial Inclusiveness

Finally, IFMIs are effective in enhancing financial inclusiveness, which is simply expressed by the number of people using financial institutions at any level. This is proven to be a relevant factor in lifting economic conditions of the people by increasing savings, investment, consumption and income. At a macro level, this bears an economic growth, lowers national poverty level and income inequality (Naceur et al., 2015). The borrowing rate from financial institutions is extremely low. Most people use family or friends, sale of an asset, saving clubs and other informal sources to borrow money. The role of these institutions is noteworthy in a country where the number of commercial banks and their coverage are very low. However, the lack of interest-free services has an impact in addressing many parts of the country. Thus, promoting IFM services will have vibrant advantages in the country. Full-fledged IFBs, at least in the short-run, may largely benefit people in urban areas who have access to other financial institutions such as the window services. In practice, lack of high-profit rate, lack of skill of poor clients and various risks have prevented banks, including the IFBs from engaging in microfinance activities (Abdulrahman, 2007).

b. Social Advantages

In addition to the economic reasons, there are also various social or socio-economic reasons, which make promoting IFMIs more gainful than full-fledged IFBs. This includes the capacity to increase social mobilization, creating community participation in development, enhancing community development and creating gender equality.

Social Mobilization

When the economic status of the poor inhabitants improves, they start to engage in diverse social activities. Their well-being increases, they develop assets, work together, share resources, reduce several harmful customs and start to get involved in various developmental activities (Hasan et al., 2017). When microfinance institutions make community members cooperate through their services, they start to share resources and improve their skills and knowledge to effectively utilize opportunities. Specifically, IFMIs have the potential to use

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their religious moral values to mobilize the community for such advantages. As a result, they create active and development-oriented community with healthy and strong social bonds (Riwajanti, 2013). IFMIs can organize the community in rural areas and integrate them with various public and private development actors. They immensely enhance the social relationship, the public institution – community relationships, stimulate settlements, create peace and security and extensively enhance local and national development.

Community Development

The other prominent superiority of microfinance institutions is their role in providing financial services to marginalized societies. These services nurture human capacity and build local institutions which, in return, can reduce poverty, illiteracy and the gender gap. This is known as a social inter mediation role of microfinance institutions which mainly increases the self-reliance of marginalized groups (Dusuki, 2008). IFMIs have proven their role in many countries to get better the living conditions of the poor in terms of income generation, enhancing productivity and capacity building. Their involvement transforms the overall human behaviors of the society and improves the well-being (Usman et al., 2019).IFMIs can play their role in enhancing the development of rural communities through a participatory approach in addressing their microfinance needs.

Women Empowerment

IFMIs can boost the entrepreneurial empowerment of the community. This enhances the assets and capabilities of individuals and diverse groups, including women (Usman &Tasmin, 2015). Besides, their role increases the self-confidence, self-strength, self-power, self-reliance and dignity of women in the society. IFMIs can play a pronounced role in rural areas by training and educating women, magnifying women leadership capacity, shaping the social relations, improving asset accumulation, and so forth (Usman et al., 2019). Above all, in agrarian economies, where poor women are highly engaged, microfinance institutions in general and IFMIs in particular, play a major role through the salam (advance payment sale) and ijara (leasing) services (Anwar et al., 2019).

c. Source of Fund and Management Strengths

IFMIs may have higher capacity to mobilize funds from the masses and higher management competence in comparison to the full-fledged IFBs in developing countries. First, they use different sources of finance by mobilizing the community. In fact, profit-based IFMIs mainly use the investors' or members' fund to function. Nevertheless, the non-profit types primarily use Zakah and sadaqah funds from members of the community (Obaidullah, 2008). IFMIs, under the non-profit model, can organize Zakah and sadaqah fund, which take a central position in the interest-free program of poverty reduction. Zakah is one of the pillars of Islam, and its payment is mandatory on the wealth of every Muslim based on some criteria. The distribution of Zakah has strict rules and regulations. However, these days, the operation of using Zakah as a source of fund for IFMIs, under some circumstances and guidelines, is becoming widespread. Under the sadaqah fund, IFMIs can collect various charity funds or properties in kind – Awqaf. However, Islam strongly encourages charity from the donor side, while it teaches the minimization of dependency on charity from the beneficiary's side. Therefore, IFMIs are advised to promote economic empowerment using the Zakah and Sadaqah funds. In Islam, debt is recommended as a last resort but not a means to finance daily consumption needs Secondly, IFMIs need fewer human resources, expertise, knowledge and skills than the IFBs. . This makes the management of these institutions easier. Thirdly, IFMIs necessitate less expertise and knowledge of sharia than banks. These are mainly because the services and products of the microfinance institutions are limited. They may not be highly engaged in international trade activities, big investment projects and other global activities as the IFBs do. Consequently, they need limited expertise, knowledge and leadership on the few sharia-based products and services.

d. Legal Advantages

One of the critical failure or success factors of IFBs in many countries is the availability or the nature of the legal framework. There is still a similar problem confronting the IFB sector. Taxation, property rights, court issue, and other IFB-related legal aspects are part of the major challenges of the sector. However, as proved in some countries, IFM institutions are less challenged by this problem. Again, this is mainly because of their nature; limited services, limited business engagement, and ownership structure.

e. Technology and Facilities Requirements

Generally, banks need enormous investments in various technologies and facilities. They need huge finance to establish their system. This includes the operational programs, customer service facilities, facilities for every branch, transportation systems, staff services, and so on. In developing economies, since such facilities and infrastructural setup are poor in rural areas, banks cannot operate smoothly. However, community-based microfinance institutions necessitate a little of these infrastructural services and facilities. Therefore, they can serve in a more manageable way than banks.

f. Sociopolitical Advantages

In some countries, the development of IFBs has faced various socio-political challenges. In countries with diversified population, there is a high possibility of facing wrong connotations and religious reputation on interest-free banks. Such sociopolitical pressures happen essentially because of the scale or degree of influence the IFB sector created on the economy and the perceptions of the society. This, in return, generates different interest groups who can challenge or manipulate the policymakers and politicians to rigorously regulate the sector. In this regard, IFMIs may have the advantage to serve the majority without a major socio-political challenge. Because of their scale of influence and the economic level of the society they serve, they have a high chance of getting less attention. Besides, they are too small to attract influential economic interest groups.

g. Ethical Issues

One of the critics in the IFB literature is the ignoring of IFM institutions in the industry. This shows that the majority of the population, which is poor, is ignored. This is mainly because of a few reasons. First, the overall economic system we have today in many countries is not pro-poor. Second, the IFB sector is dominated by a few rich families in the Gulf countries who own the biggest banks with branches in many western countries (Iqbal and Molyneux, 2005). Third, the IFM sector is not developed enough to attract researchers. Finally, the IFM services are quite less profitable than the banks. Consequently, there is less innovation, less investment, and overall development in the IFM sector. Therefore, if the IFB sector, in general, continues to address mainly the rich, this raises ethical questions.

To summarize, interest-free microfinance institutions have various advantages to the economy and the society in developing economies. However, this does not mean they are simple to promote or not face any challenges. They have various challenges too. Global experiences show that high supervision requirements, high customer drop-outs, and misconceptions about their products and services some of the challenges of the IFMIs (Affandi, 2018).

CONCLUSION

Interest-free banking has been expanding in societies as it did globally. Ten conventional banks have window services, and some of them are establishing special branches serving only IFB customers in selected cities and localities. Recently, some full-fledged IFBs and full-fledged microfinance institutions have been also on the way to enter the market. However, the sector is at a young age, and it has various impediments. Lack of product innovation, high dominance of deposit services, lack of awareness, lack of human

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resources, and lack of a legal framework are some of the serious challenges of the industry. Considering this situation, we can draw two major conclusions.

- First, more attention to promoting IFM institutions in societies will help the sector to prosper. Microfinance institutions will be less confronted by the hurdles being faced by the IFBs and the expected further sophisticated obstacles to come when the full-fledged IFBs enter the market. Besides, promoting interest-free microfinance institutions will allow the participation of many people throughout the country in the financial system which directly benefits the economy.
- Second, taking the experiences of many countries that are economically and socially similar to societies and acknowledging several issues of the country, IFM institutions have numerous advantages over any type of interest-free banks. This is because of their potential to reduce poverty, to create empowerment, to generate employment in rural areas, to enhance economic participation, to expand financial inclusiveness, to provide micro-financial demands of the poor, and so on.

SUGGESTIONS

- for the betterment of the economy, adequate attention must be given to the IFM sector in parallel to the IFB industry.
- They have the potential to bring a clear socioeconomic change to the country if they are supported through the governmental structures.
- National policies such as on youth and women, small-scale enterprises, cooperatives, rural finance, and other related affairs must be favorable for the promotion of IFM institutions.

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ISLAMIC INVESTMENT: A STUDY ON INVESTMENT AVENUES IN MODERN ISLAMIC FINANCE

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ABSTRACT

The main theme of Islamic finance, the equity and morality, are the universally accepted principles of justice and fairness. Islamic finance replaces the greed with the accountability to God. Islamic finance may be viewed as a form of ethical investing, or ethical lending, except that no loans are possible unless they are interest-free. Among the ethical restrictions is the prohibition on alcohol and gambling and the consumption of pork. Islamic funds would never knowingly invest in companies involved in gambling, alcoholic beverages, or porcine food products.

Islamic banking refers to a system of banking or banking activity that is consistent with the principles of the Shari'ah (Islamic rulings) and its practical application through the development of Islamic economics. To ensure compliance to the Shari'ah, Islamic banks use the services of religious boards comprised of Shari'ah scholars .Shari'ah prohibits the payment or acceptance of interest charges (riba) for the lending and accepting of money, as well as carrying out trade and other activities that provide goods or services considered contrary to its principles. This paper describes the various investment opportunities in modern Islamic bank based on Islamic sharia.

Keywords: Islamic Bank, Sharia, Ijara, Musharaka, sukuk

INTRODUCTION:

Islamic finance is the system based on the principles of Islamic law (shariah) and guided by Islamic economics. Islamic financial thoughts are originated from the Quran, the holy book of Islam; and Sunnah, the deeds, statements and unspoken approvals of Prophet Mohammed (pbuh). The concept of Islamic finance and banking originated centuries ago, but the modern Islamic banking and finance movement is a recent phenomenon starting from the early 1970s. Now it is in formative stage. It is likely to continue developing in Middle East, South East Asia and Europe. The first full-fledged Islamic financial institution is the Dubai Islamic Bank established in 1975.

Islamic banking is grounded in the tenets of the Islamic faith as they relate to commercial transactions. The principles of Islamic banking are derived from the Qur'an–the central religious text of Islam. In Islamic banking, all transactions must be compliant with shariah, the legal code of Islam (based on the teachings of the Qur'an). The rules that govern commercial transactions in Islamic banking are referred to as *Fiqh al-muamalat.*

Islamic investments are a unique form of socially responsible investments because Islam makes no division between the spiritual and the secular. This means there is much more scrutiny applied to investment practices because religion is factored into all financial decisions. Investments that wish to be in accordance with Islamic Investment Policy need to follow a specific set of guidelines.

REVIEW OF LITERATURE

Islamic finance have been explained by many authors both in books as well as in research papers. Most of these authors have explained Islamic banking, Islamic finance, Islamic economics, their products and services and other related issues.

Usmani, Muhammad Taqi , "An introduction to Islamic finance" Justice Usmani of Pakistan, who chairs several Shariah supervisory boards for Islamic banks, clearly explains the various modes of financing used by Islamic banks and non-banking financial institutions, emphasizing the necessary requirements for their acceptability from the Shariah standpoint and the correct method for their application. He deals with practical problems as they arise in the course of his presentation, and offers possible solutions in each instance.

Islamic finance and prohibition of interest was not founded on the principles of economics but was developed as a result of a decree sent by the Almighty Creator Allah (Ghannadian and Goswami, 2004).

Thani, Abdullah & Hassan (2003) provided a chapter on Islamic financial products where they briefly explained them.

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Haron (1997) provides the overview, philosophy, history and regulation of Islamic banking and finance. He mentioned different types of Islamic financial products including Musharakah or partnership.

Archer, Karim& Al-Deehani (1998) in their paper "Financial Contracting, Governance Structures and the Accounting Regulation of Islamic Banks: An Page | 27 Analysis in Terms of Agency Theory and Transaction Cost Economics" writes that Islamic banks are prohibited from entering into transactions based on riba (interest), they mobilise funds mainly on the basis of the mudaraba (profit-sharing) form of contract

Al-Jarhi & Iqbal (2001) in their book "Islamic Banking: Answers to Some Frequently Asked Questions" explain almost everything related to Islamic banking and finance. In part first, authors have defined interest and its types. In the second part, Islamic modes of finance have been explained, which include more than eight products and services. In part three, Islamic banking has been explained by the authors and so on. The book explains everything in detail and incorporates necessary details which are required to understand Islamic banking and finance.

MunawarIqbal, David T. Llewellyn, in "Islamic Banking and Finance: New Perspectives on Profit Sharing and Risk" They discuss Islamic financial theory and practice, and focus on the opportunities offered by Islamic finance as an alternative method of financial intermediation. Key features of profit-sharing (as opposed to debt-based) contracts are highlighted, and the ways in which they can facilitate improved efficiency and stability of a financial system are explored. The authors illustrate that in addition to some 200 Islamic banks operating in Muslim as well as non-Muslim countries, some of the biggest multinational banks are now offering Islamic financial products.

Nathif J. Adam, Abdulkader Thomas, in the book "Islamic Bonds: Your Guide to Structuring, Issuing and Investing in Sukuk" discuss the nature of sukuk, how they differ from conventional bonds and the development of the sovereign & corporate sukuk market. It also covers how to structure sukuk transactions (eligible assets, investment vehicles, undertakings and credit enhancement Seif I. Tag El-Din15 "The Question Of An Islamic Futures Market" criticizes the tendency to characterize an Islamic futures market mainly in terms of the Salam contract.

Munawar Iqbal, Ausaf Ahmad, in "Islamic Finance and Economic Development" explore the role and significance of Islamic financial system, instruments and institutions in economic growth and development, both theoretically and empirically. As one of the crucial factors in economic development is the saving/investment process. In conventional economic systems, the interest rate mechanism is at the heart of that process, however an Islamic financial system cannot rely on that mechanism.

Bagsiraj, in his project, "Islamic financial institution of India: Progress, Problems and Prospects", stated that in India there are about 300 Islamic financial institutions but very little is known about their functioning, socio-economic performance and potential. He classified those institutions on the bases of their functional model and registration authority in four categories; Islamic financial societies (IFSs), Islamic co-operative credit societies (ICCSs), Islamic investment and financial companies (IIFCs), and financial association of persons (FAPs)

SCOPE OF THE STUDY

The study covers an review on the various tools and techniques used for investment in Islamic finance. The study is relevant because, ethics whether it is Islamic or not, but business operations must be social oriented. Here, this study attempts to bring the relevance of Islamic investment in business which is beneficial to both Muslim and non Muslim community. This study gives more light in to the areas where a business can apply various investment avenues in Islamic perspective

OBJECIVES OF THE STUDY

- To study the major documentary evidences of Islamic Finance
- To examine the role of ethics in Islamic Finance
- To identify the various investment tools offered by Islamic Finance.

DATA USED FOR THE STUDY

The study is mainly concerned with secondary data. Data are collected from research papers, books of references, standard publications, published reports of the reputed institutions, periodicals, internet etc.

SHARIAH COMPLIANT INVESTMENTS

Islamic finance is an equitable mode of finance that derives its principles from the Shariah, the Islamic law. The Shariah is based on the Quran, the sacred text of Islam, and it

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governs all aspects of personal and collective life of Muslims. The most distinctive element of Islamic finance is the prohibition of interest, whether nominal or excessive, simple or compound, fixed or floating. To comply with Shariah, investment must not involve interest (also known as 'Riba')

In addition to risk sharing and the prohibition of interest, under the principles of Shariah, investment is also disallowed in businesses that deal with alcohol, pork, gambling, weapons, tobacco, media, 'conventional' financial institutions, pornography and anything else which it deems 'Haraam' (unlawful). It is also ensured that not only the underlying investments but also the contractual terms agreed between the investors and the investment manager conform to Islamic principles. Islam also disallows certain contracts due to inherent elements which render them 'Haraam' (unlawful). This concept covers particular types of uncertainty or contingency in contracts such as short selling, futures, derivatives and conventional insurance.

Shariah compliant investments must all be certified by experts, generally through a panel or board comprised of respected Shariah scholars who are highly qualified to issue "Fatwas" (religious rulings) on financial transactions. This panel of Shariah experts ensures full compliance of the investments and transactions with Islamic principles.

TYPES OF FINANCING ARRANGEMENTS

Since Islamic finance is based on several restrictions and principles that do not exist in conventional banking, special types of financing arrangements were developed to comply with the following principles:

1. Profit-and-loss sharing partnership (*mudarabah*)

Mudarabah is a profit-and-loss sharing partnership agreement where one partner (financier or *rab-ul mal*) provides the capital to another partner (labor provider or *mudarib*) who is responsible for the management and investment of the capital. The profits are shared between the parties according to a pre-agreed ratio.

2. Profit-and-loss sharing joint venture (*musharakah*)

Musharakah is a form of a joint venture where all partners contribute capital and share the profit and loss on a pro-rata basis. The major types of these joint ventures are:

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- Diminishing partnership: This type of venture is commonly used to acquire properties. The bank and investor jointly purchase a property. Subsequently, the bank gradually transfers its portion of equity in the property to the investor in exchange for payments.
- Permanent *musharkah*: This type of joint venture does not have a specific end date and continues operating as long as the participating parties agree to continue operations. Generally, it is used to finance long-term projects.

3. Leasing (*Ijarah*)

In this type of financing arrangement, the lessor (who must own the property) leases the property to the lessee in exchange for a stream of rental and purchase payments, ending with the transfer of property ownership to the lessee.

***4.Istisna'a*:**

A procurement contract whereby payment is made by a buyer for goods to be delivered at a later date. In the context of project finance, an Istisna'a structure is used to finance the construction period of a project. The Islamic financiers appoint the borrower as their agent to procure the specific project assets to be financed Islamic ally.

INVESTMENT PRODUCTS

Due to the number of prohibitions set by Sharia, many conventional investment vehicles such as bonds, options, and derivatives are forbidden in Islamic finance. The two major investment vehicles in Islamic finance are:

I. Equities

Sharia allows investment in company shares. However, the companies must not be involved in the activities prohibited by Islamic laws, such as lending at interest, gambling, production of alcohol or pork. Islamic finance also allows private equity investments.

II. Fixed-income instruments

Since lending with interest payments is forbidden by Sharia, there are no conventional bonds in Islamic finance. However, there is an equivalent of bonds called *sukuk* or "Sharia-compliant bonds." The bonds represent partial ownership in an asset, not a debt obligation.

Islamic Equity Market Funds

- The Islamic equity market is where sharia-compliant stocks are traded.
- Obviously, for a Muslim, the primary benefit of investing in Islamic equities is assurance that the funds are purchasing only sharia-compliant assets.
- Here are some other advantages of investing in Islamic equity funds:

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- Transparency: Investors in Islamic equity funds expect a high level of transparency. After all, if one of a fund's key objectives is to comply with sharia, the fund managers must be quite open about which industries and companies they invest in.
- Financial screening: Part of the screening process for determining whether an equity asset is sharia-compliant involves considering a company's financials, including how much debt the company carries. Islamic equity funds avoid investing in firms that carry very high levels of debt. Therefore, Islamic funds may be considered more conservative and slightly less risky than some conventional equity funds.
- Diversification: Investing in any fund (Islamic or conventional) that purchases assets from multiple companies reduces the risk of losing capital when disaster strikes and a company declares bankruptcy or closes its doors.
- Liquidity: For the Islamic investor, a benefit of investing in a fund versus putting money into a fixed-term investment is liquidity. When situations change and the investor wants or needs to cash out, doing so is much easier when the investment is in a fund. Keep in mind, however, that overall, Islamic investments, including Islamic funds, tend to be less liquid than their conventional counterparts.

Islamic Equity Funds (IEFs)

Islamic equity funds (IEFs) are similar to traditional equity funds in that investors pool their funds to invest in shares. However, the main difference between IEFs and standard equity funds is that investors in IEFs earn *halal* profits in strict conformity with the precepts of Islamic *shariah*.

These funds are not allowed to invest in certain areas. They cannot, for example, invest in companies involved in areas that are not lawful in terms of *shariah*, such as alcohol, gambling, or pornography. They also have a restricted ability to invest in areas such as financial companies and fixed-income securities, due to the *shariah* ban on usury. These funds generally avoid bonds and other interest-bearing securities, while seeking protection against inflation by making long term equity investments.

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ROLE & STRUCTURE OF ISLAMIC EQUITY FUNDS

Asset Management Through Equity Funds

As compared to a conventional equity fund, in which a fixed return is tied up with its face value, an Islamic equity fund must carry a pro rata profit actually earned by the fund. Therefore, neither the principal nor a rate of profit (tied up with the principal) can be guaranteed. On the basis of the risk profiles of the investors and the investment strategy of the asset management companies, equity funds can be divided into four categories:

1. Regular income funds: the objective of these funds is to earn profit through dividends of investee companies. Such funds provide a regular income stream by way of dividends to their investors who are mostly risk-averse, like old and retired people.

2. Capital gain funds: the objective of these funds is to earn profit through capital gain from frequent sale and purchase of Sharı'ah-compliant stocks. These funds can provide a better return to moderate risk-taker investors by proper management and risk diversification

.**3. Aggressive funds:** these funds invest in high-risk securities to generate abnormal profits for their investors. They do not allow every investor to invest and limit the portfolio to high-risk investors as chances of loss are greater.

4. Balanced funds: such funds invest in high quality securities with less risk and give to the investors a regular income stream based on dividends and capital gain. These funds adopt a "capital proactive" approach.

Islamic Real Estate Investment Trusts (REITs)

Islamic REIT is an investment scheme in real estate whose tenants operate permissible activities that are in line with Sharia principles.

Islamic REIT is a collective investment scheme in real estate whose tenants operate permissible activities that are in line with shariah principles.

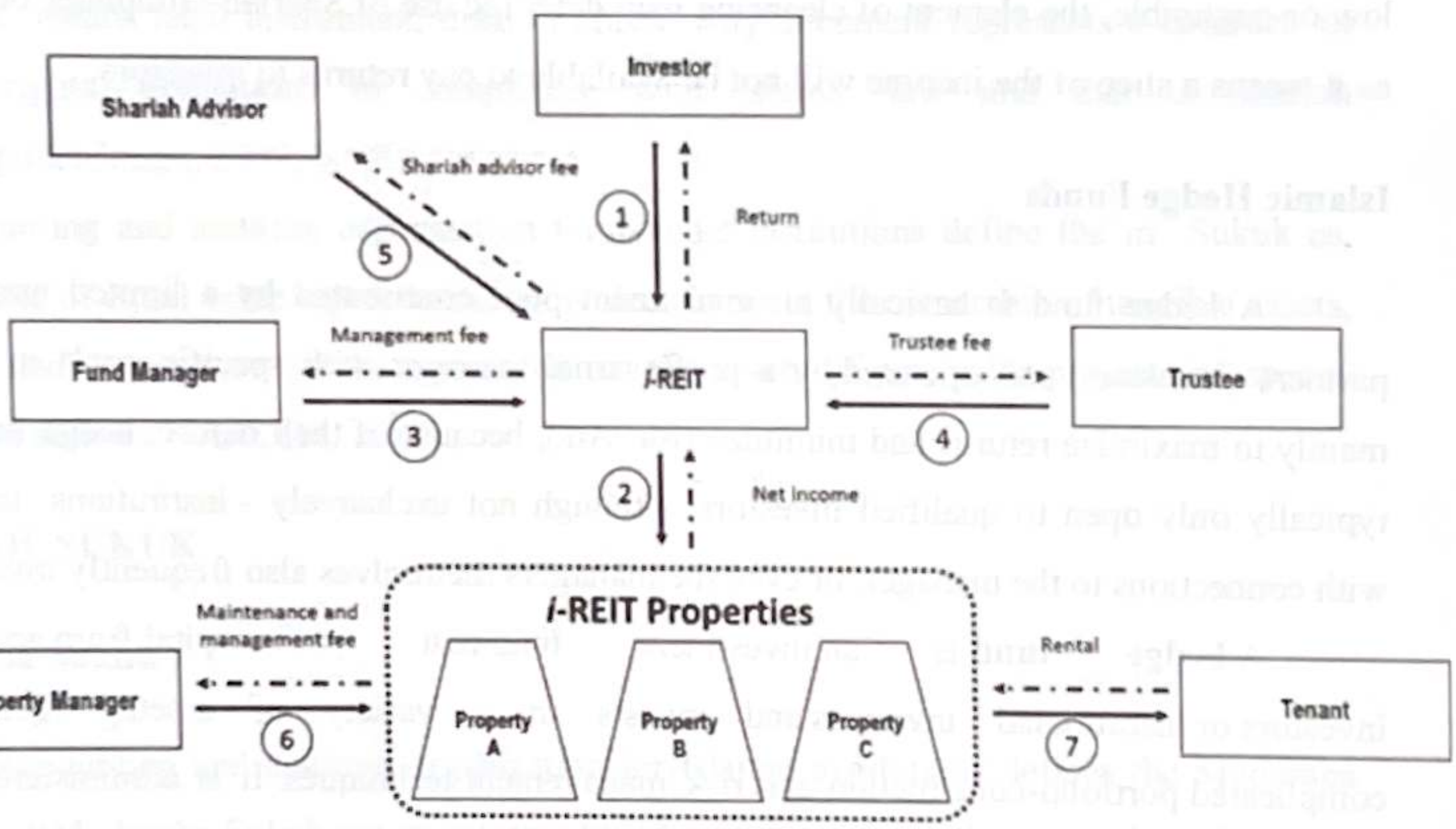
Real estate investment trust (REIT) is a collective investment scheme in real estate that combines the best features of real estate and trust fund. *i*-REIT is the Shariah version of the conventional REIT.

In November 2005, The Malaysian Government, through Securities Commission Malaysia (SC) issued Guidelines for Islamic Real Estate Investment Trusts, setting a new global benchmark for the development of this instrument and making Malaysia the first jurisdiction to introduce such guidelines in the industry. These guidelines provide guidance to market players on Shariah compliancy in developing and managing an *i*-REIT. These guidelines also serve to complement the existing Guidelines on Real Estate Investment Trusts.

The activities below are deemed Shariah non-permissible

a. Financial services based on riba (interest);
b. Gambling/gaming;
c. Manufacture or sale of non-halal products or related products;
d. Conventional insurance;
e. Entertainment activities that are non-permissible according to the Shariah;
f. Manufacture or sale of tobacco-based products or related products;
g. Stock broking or share trading in Shariah non-compliant securities; and
h. Hotels and resorts.

The general structure of an *i*-REIT is as follows:



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Islamic Real Estate Funds

A key consideration for Shariah-compliant real estate financing is the proposed use of the property. Islam forbids the preparation or consumption of certain types of products including pork, alcohol, armaments as well as activities such as gambling and conventional banking. As such, the use of Islamic finance to fund a pork factory or a casino would not be permitted. However, it is less clear cut in the case of a multi-let property such as a large commercial building which may, for example, include a small branch of a conventional bank. While such activities are prohibited, they do not form part of primary usage of the property. In these situations, Shariah scholars have generally accepted that Islamic financing can be used for multi-let properties where the threshold of non-permissible activities is below five percent. However, the income received from such activities must, in a manner of speaking, be cleansed. Such income may be donated to charity and should not form part of the profit distributed to investors. The threshold of non-permissible activities for the SabanaReit (which invests in industrial real estate) has consistently been below that threshold. The income received from these activities will need to be donated to charity before making any distributions to investors. However, unless the income from non-permissible activities is very low or negligible, the element of cleansing may deter the use of Shariah-compliant financing, as it means a slice of the income will not be available to pay returns to investors.

Islamic Hedge Funds

A hedge fund is basically an investment pool contributed by a limited number of partners (investors) and operated by a professional manager with specific goals in mind - mainly to maximize returns and minimize risk. And, because of their nature, hedge funds are typically only open to qualified investors, although not exclusively - institutions, investors with connections to the manager, or even the managers themselves also frequently invest.

A **hedge fund** is an investment fund that pools capital from accredited investors or institutional investors and invests in a variety of assets, often with complicated portfolio-construction and risk management techniques. It is administered by a professional investment management firm, and often structured as a limited partnership, limited liability company, or similar vehicle.

Islamic Venture Capital (IVC)

Islamic venture capital (IVC) investments do not differ from their conventional counterparts, except that they must comply with the principles of the Shariah (Islamic law). Conventional VC funds can exploit any profitable business opportunity, but IVC funds cannot invest in sectors prohibited by Shariah, such as liquor, pork, adult entertainment or other proscribed activities. Also, they can only enter in the contracts permissible by Shariah.

Venture capital here is defined as the provision of seed capital for a new venture in the process of being established, rather than the provision of capital to a small business to facilitate its growth.

In Islam, money is not a commodity and cannot be traded for profits. It is just a medium of exchange and it stores value. Money, therefore, must be invested in projects and ventures for the generation of activities, for the benefit of mankind and in the process, for profit.

SUKUK –ISLAMIC BOND

In terms of terminology, 'Sukuk' is a classical Arabic word which is plural of 'Sakk'. The 'Sakk' means legal instrument, deed or check. Any document represents a contract or conveys rights, obligations in compliance with Islamic law and that is Shariah (Shanmugam&Zahari, 2009, p. 47).

Accounting and auditing organization for Islamic institutions define the m Sukuk as, "Certificates of equal value representing undivided shares in the ownership of tangible assets, usufructs and services or (in the ownership of) the assets of particular projects or special investment activity" (AAOIFI, 2008).

TYPES OF SUKUK

Mudaraba Sukuk

Accounting and auditing organization for Islamic institutions defines the Mudaraba Sukuk as, ''Mudaraba Sukuk are investment Sukuk which represent the ownership of units of equal value in the equity of the Mudaraba. The Sukuk holders provide the capital for the Shariah compliant investment activity that is undertaken by the investment agent. The investment agent is paid an agreed fee out of any profits derived from the business activity''

(AIMS, 2010,p.1-4).

Musharaka Sukuk

Accounting and auditing organization for Islamic institutions defines the MusharakaSukuk in the following way. ‘‘MusharakaSukuk is investment Sukuk that represent ownership of musharaka equity. The musharaka agreement is a form of joint venture agreement between the issuer and (usually) the originator to engage in a Shariah compliant investment activity in accordance with a business plan that is appended to the musharaka agreement. Any profits received from the musharaka arrangements are distributed between the issuer and the originator as agreed’’ (Academy for International Modern Study, 2009,p.1-4).

Accounting and auditing organization for Islamic institutions define the MusharakaSukuk in the followingway.‘‘These are Sukuk that represent ownership of equal shares in a rented real estate or the usufruct of the real estate. These Sukuk give their owners the right to own the real estate, receive the rent and dispose of their Sukuk in a manner that does not affect the right of the lessee, i.e. they are tradable. Holders of such Sukuk bear all cost of maintenance of and damage to the real estate” (AIMS, 2009,p.1-4)

Murabha Sukuk

According to Luxemburg Tax Authorities Murabha is “Transaction allowing the client (the investor) to buy property without having to subscribe to an interest-bearing loan? The equity contributor (for example a bank) the financier buys the property and then sells it to the investor on a deferred basis. This is a financial scheme to be used for any type of Shariah compliant asset, but principally for real estate (or stocks, commodities or such like)” (Rabia & Dascotte, 2010, p.13). The holder of murabha Sukuk or the capital provider purchases the specific asset/commodity from the third party and then sells it to the buyer or capital users at cost plus profit basis (Pollard &Samers, 2007, p.315-316). The capital users then pay price of the asset/commodity in installments as agreed between them (Usmani, 1998,p.1-14).

Salam Sukuk

Salam Sukuk is issued to raise Salam capital. The holder of slam Sukuk is the purchaser of the commodity from the issuer of the Sukuk, the seller at an agreed price paid at

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spot for the consideration of the commodity whose delivery will be made at agreed future dated (Usmani, 1998, p.1-14).Salam is way to replace the traditional future/forward contracts by considering the Islamic laws and basic principles.

Istisna Sukuk

Luxemburg Tax Authorities defined Istisna as "Consists of the financing of the production of property via an advance of payment for future delivery or a future payment for a future delivery" (Rabia & Dascotte, 2010, p.13). Istisna Sukuk certificated issued to raise capital for the production of a specific asset. Holders are the owners of that asset which is to be produced or manufactured at future date. The Sukuk holders are entitled to the sale proceeds from the certificate or the asset manufactured.

Hybrid Sukuk

This type of Sukuk is structured by combining the principle of multiple Sukuk structures like Ijara, Mudaraba and Istisna which comprised by a pool of assets. Diversified pool of asset comprised on different structures of Sukuk provided more attractiveness to the investors in the market.

Risk associated with Sukuk

- Rate of return risk
- Risk of default
- Foreign exchange risk .
- Shariah compliance risk
- Liquidity risk
- Asset related risks
- Regulatory risk
- Staff related risk
- Managing sukuk associated risks

CONCLUSION

Islamic finance plays a unique role in the socio economic development. It provides more importance to human life and social development than concentrating upon the wealth and extra ordinary profit making life. Islamic finance encourage the investments making social and economic developments such as house hold priority, education, health etc instead of a mere investment for profit making enterprises.

This study concludes that Islamic finance has come out in practice from theory during the last thirty years. Islamic capital market is growing and it has established its position in the World financial market now. This thesis identifies the various instruments which emerges as an icons of Islamic capital market.

That being a major component propelling the market, sukuk can be structured in many ways that are shari'ah-compliant and stand as a better alternative to the conventional bond which is contrary to the Islamic principles. In structuring the various products of the ICM, there are a number of ethical norms enshrined in the Islamic legal system that must be followed.

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IFRS' ADOPTION IN ISLAMIC COUNTRIES

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ABSTRACT

Nowadays, Islamic accounting and finance stimulates the professional curiosity of many researchers. The key entity involved in the regulation of the Islamic financial institutions is Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). The main objective of this paper is to identifying some of the determinants which led to Islamic accounting specificities, including its institutional framework; and to understand preference of IFRS adoption in an Islamic accounting frame work. using a dataset of 38 Islamic countries inside the framework of a Discrete and Limited Dependent Variable Model, it have obtained robust evidences of a negative association between IFRSs adoption and the weight of Muslim population. In order to evaluate the robustness of the results we considered as control variable the Index of Economic Freedom. The control variable appears to have a statistically significant positive impact on IFRSs adoption, so full adoption of IFRSs is more likely to occur for countries with a higher degree of economic freedom.

Keywords: *Islam, Accounting, IFRSs, Economic Freedom, AAOIFI*

INTRODUCTION

Nowadays, Islamic accounting and finance stimulates the professional curiosity of many researchers, which consequently led to more in-depth studies on this topic. In this paper the research objectives include: firstly, providing a synopsis of Islamic accounting characteristics; secondly, identifying some of the determinants which led to Islamic accounting specificities, including its institutional framework; thirdly, to understand preference of IFRS adoption in an Islamic accounting frame work.

The study focus on religious background of the accounting regulations and the consequent attitude towards the use of the International Financial Reporting Standards (IFRSs) the Muslim population represents 25% of World's population with around 2.1 billion in the year 2011, being widely spread all around the globe but mainly concentrated in the Middle East, South East Asia, Africa and Central Asia. With a banking sector becoming one of the fastest growing financial sectors globally (Rad, 2006), Islamic Accounting and Finance become more and more difficult to ignore by the Western business environment.

LITERATURE REVIEW

Nair & Frank's (1980:429) classification using clustering includes, for example, Pakistan in the British Commonwealth model; whereas Doupnik & Salter (1993), in testing Nobes classification (1983), suggest a general model about the causes of accounting differences, posing 10 variables, and including in the study a group of Arab countries.

However, the development of Islamic financial institutions contributed significantly to the emergence of a modern literature on Islamic accounting. To this has added also the development of well-funded universities in Muslim countries, such as the International Islamic University of Malaysia (IIUM), where it is a significant group of accounting scholars with a vast interest in the progress of the Islamic accounting literature. Moreover, the contributions of the Muslim and non-Muslim scholars operating within Western universities have become considerable –since, in the last decades, in a quest for better fulfilling the needs of investors, no matter their state of origin or religion, the Great Britain and United States became operating centers for Islamic financial organizations and research institutions, without denying the role of Malaysia and Indonesia in promoting Islamic finance globally (Warde, 2005). In general, contemporary Islamic finance, banking and accounting have been described as an interesting alternative to conventional or "capitalist" accounting; while international organizations and Western governments support the contemporary Islamic banking sector. Essentially, the growing body of literature related to Islamic accounting focuses on:

The history of accounting developments in Muslim countries since the early days of the Islam (Hamid *et al.*, 1995; Zaid, 2000a, 2000b, 2001; Solas & Otar, 1994; Farag, 2009). For instance, Zaid (2001: 216) addresses the topic of the double-entry system, and underlines the possibility that Muslim traders developed it and "lent" it to their Italian counterparts. Farag (2009) presents a historical review of the evolution of accounting and accounting

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profession in Egypt since the ancient Egyptian civilization to the modern accounting practices. Egyptian accounting practice is divided into three stages: record keeping (1883–1939); financial reporting under changing economic regimes (1939–1975); and the move to adopt

OBJECTIVE OF THE STUDY

- Providing a synopsis of Islamic accounting characteristics;
- Identifying determinants which led to Islamic accounting specificities, including its institutional framework;
- To understand preference of IFRS adoption in an Islamic accounting frame work

THE KEY GUIDING PRINCIPLES TO ISLAM AND THE APPROACH TOWARDS ACCOUNTING

Islam implies a series of principles that can basically be resumed as:

- Unity of God *(tawheed)* which implies a comprehensive worldview;
- Trusteeship implies that people are given a special role in relation to the environment;
- Community principles. According Al-Gazzali, an eminent Muslim philosopher of the XI[th] century (quoted in numerous authors including Ibrahim, 2000: 62), the purpose of Shari'ah is "to promote the welfare of the people, which lies in safeguarding their faith, their life, their intellect, their prosperity and their wealth". In economic terms, these principles have to do with social responsibility and public accountability;
- The importance of knowledge (*ilm*), especially self-knowledge is connection to the notion of developing a sustainable community, by promoting developments of the intellect, wisdom and knowledge (Tinker, 2004).
- The holistic approach to life has to do with the wider environment, having a significant influence on economics (Chapra, 1992; Gambling & Karim, 1991). This approach has to do the notion of the fair distribution of wealth through zakah/ zakat. This is one of the Five Pillars of Islam, is the giving of a small percentage of one's possessions to charity. The Muslims have the duty to collect zakat and to fairly distribute it.

In respect to the parallel between conventional and Islamic accounting, many authors attempted such comparison in general or for specific standards (see for instance Baydoun & Willett, 2000; Haniffa & Hudaib, 2001). According to them, main differences between conventional and Islamic accounting have to do with the following:

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- *Conservatism*: apply prudent valuation methods and avoid using the most favourable impact on owners versus most favourable to community;
- *Ongoing concern*: business goes forever versus based on contractual agreement between parties;
- *Measuring unit*: monetary value versus quantity and monetary based (according to zakat calculation);
- *Consistency* based on the standards/regulations used by the entity versus consistency with Islamic law;
- *Materiality*: decision making usefulness versus fulfilling all duties before Allah;
- *Users of financial information*: identifying economic events and transactions versus identifying socio-economic and religious events and transactions.

In addition, some (Razik, 2009) consider that Islamic accounting and IFRSs differ in five issues that are related to leases, restricted contracts, and specialty investment account (where the investors bear part of the business risk), related party transactions; whereas others (Baydoun& Willett, 2000) analyze the contents of Islamic corporate reports suggesting that a current value added statement should also be part of Islamic corporate reports in order to provide greater awareness of the social impact of company's activities. Sulaiman (2000) supports the use of both current value balance sheets and value added statements as part of Islamic business enterprises' corporate reports.

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is a standard setting body based in Bahrain. AAOIFI's fields of interest include accounting, auditing, governance, ethics and Shari'ah standards for Islamic financial institutions and industry. AAOIFI is supported by institutional members (200 members from 45 countries, so far) including central banks, Islamic financial institutions, and other participants from the international Islamic banking and finance industry, worldwide. Despite that the AAOIFI standards are not mandatory; it has been successful in promoting its standards to Islamic countries (Kingdom of Bahrain, Dubai International Financial Centre, Jordan, Lebanon, Qatar, Sudan and Syria). Moreover, the relevant authorities in Australia, Indonesia, Malaysia, Pakistan, Saudi Arabia, and South Africa have issued guidelines that are based on AAOIFI's standards and pronouncements. For example, Indonesia plans to currently maintain its national GAAP (Indonesian Financial Accounting Standards, IFAS) and converge it gradually with IFRSs. However, since the '70, Indonesia has continuously developed guidelines for Islamic banking sector and Shari'ah transactions based on AAOIFI's

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standards and other local Islamic regulations (Fatwa of the Indonesian Council of Ulemas; Conceptual Framework for the Preparation and Presentation of Financial Statements for Shari'ah transactions).

DATA AND RESEARCH DESIGN

In assessing the preference for International Financial Reporting Standards (IFRSs) adoption in Islamic countries it must first construct an appropriate sample. Thus, it have a look at the link that may exist between the interference of religion in the matters of state based on constitution and the use of IFRSs, by selecting the countries in which Islam is the religion of the majority of people (over 50%). The respective percentage shows the proportional amount of Muslims out of the total population of each country. In total, there are currently 48 Muslim majority countries, though, due to the available information on the use of IFRSs, the sample consists in 38 countries.

Table 1
The sample of Islamic countries

Albania	Iran	Mali	Sierra Leone
Algeria	Iraq	Mauritania	Syria
Azerbaijan	Jordan	Morocco	Tajikistan
Bahrain	Kazakhstan	Niger	Tunisia
Bangladesh	Kuwait	Nigeria	Turkey
Brunei	Kyrgyzstan	Oman	United Arab Emirates
Burkina Faso	Lebanon	Pakistan	Uzbekistan
Egypt	Libya	Qatar	Yemen
Gambia	Malaysia	Saudi Arabia	
Indonesia	Maldives	Senegal	

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PREFERENCE OF IFRS ADOPTION IN AN ISLAMIC ACCOUNTING FRAME WORK

In assessing the preference for IFRSs, some remarks must be made:

- sometimes, the jurisdiction's local GAAP is not in English;
- often, even if many jurisdictions that maintain their own local GAAP claim that these is "based on" or "similar to" or "converged with" IFRSs, not all IFRSs have been adopted;
- often, there is a time lag in adopting an IFRSs as local GAAP;
- the following observations are based on the direct use of IFRSs as reported in the basis of preparation note and the auditor's report;
- the syntax "all companies" refers to all listed and not listed companies. In the sample, many of the countries have officially "embraced", in a form or another, the principles promoted by IFRSs, showing a preference for this set of standards.

It considers the sample of 38 countries with significant Muslim population and the status of IFRSs adoption at November 30th, 2011. Prevalence of Islamic population is a proxy for the importance of Islamic views in the considered countries and it should be able to predict the situations of full IFRSs adoption and to discriminate between such situation and other stages of adoption. In order to perform such test, it constructs a binary variable designed to reflect the cases of full IFRSs adoption in country *i* accordingly to the next rule:

$$IFRSs_i = \begin{cases} 1 \; in\ case\ of\ full\ adoption \\ 0 \; otherwise \end{cases}$$

Furthermore, the study testing for the existence of a linkage between this variable and the Muslim predominance in the framework of a Discrete and Limited Dependent Variable Model (aML-Binary Extreme Value specification). For such approach, a control variable should be considered in order to evaluate the robustness of the negative connection between the predominance of Muslim population and the relative preferences for IFRSs adoption. For instance, it can be argued that the IFRSs adoption is straightforwardly connected to the degree of economic freedom since an improvement in transparency in IFRSs-adopting countries tends to reinforce the comparability effect, to mitigate the information asymmetry and to facilitate the business decisions (Márquez-Ramos, 2008). Thus, it considers the *Index of Economic Freedom* as a transparency proxy. This index is built upon analysis of 10 specific components of economic freedom (Business Freedom; Trade Freedom; Fiscal Freedom; Government Size; Monetary Freedom; Investment Freedom; Financial Freedom;

Property rights; Freedom from Corruption; Labour Freedom), some of which are themselves composites of additional quantifiable measures by assigning a grade in each using a scale from 0 to 100, where 100 represents the maximum freedom. The 10 component scores are equally weighted and averaged to get an overall economic freedom score for each country. The index is provided by Heritage Foundation - http://www.heritage.org/Index/. Table 2 reports the empirical evidences for the existence of a significant negative effect at 1% of Muslims predominance on IFRSs adoption. In the meantime, the economic freedom appears to have a positive impact significant at 1% (in the case of OLS estimation) and, respectively 5% (in the case of *ML-Binary Extreme Value* model) on full IFRSs adoption.

Table 2

IFRSs adoption in Islamic countries

(Dependent: binary IFRSs variable)

	OLS	**ML-Binary Extreme Value**
Muslim population (% of total population)	-0.009*** (0.003)	-0.04*** (0.01)
Index of Economic Freedom	0.02*** (0.004)	0.05** (0.02)
McFadden Pseudo R-square	0.22	**0.24**

Notes: ***, **, and * represent statistical significance at 1%, 5%, and 10% level. Figures in bracket represent the standard errors; Optimization algorithm: *Quadratic Hill Climbing*.

The binary specification of the dependent variable allows an estimation of the model predictor capacity through the so-called *classification table*. The fraction of *dependent variable = 1* observations that are correctly predicted is termed *sensitivity*, while the fraction of *dependent variable = 0* observations that are correctly predicted is labeled as *specificity*. The content of such classification is displayed in Table 3 with prediction results based upon expected value calculations.

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Table 3

Expectation-prediction evaluation for binary specification

	Estimated Equation			**Constant probability**		
	Binary IFRSs dummy=0	Binary IFRSs dummy=1	Total	Binary IFRSs dummy=0	Binary IFRSs dummy=1	Total
E(Binary IFRSs = 0)	**21.71**	**4.47**	**26.18**	**19.88**	**6.12**	**26**
E(Binary IFRSs = 1)	**4.29**	**3.53**	**7.82**	**6.12**	**1.88**	**8**
Total	**26**	**8**	**34**	**26**	**8**	**34**
Correct	**21.71**	**3.53**	**25.24**	**19.88**	**1.88**	**21.76**
% of correct	**83.51**	**44.09**	**74.23**	**76.47**	**23.53**	**64.01**
% of incorrect	**16.49**	**55.91**	**25.77**	**23.53**	**76.47**	**35.99**
Total Gain*	**7.03**	**20.56**	**10.22**			
Percent Gain**	**29.90**	**26.88**	**28.39**			
Hosmer-Lemeshow Statistic		2.98			Prob. Chi-Sq(8)	**0.94**

Notes: *Change in "% Correct" from default (constant probability) specification; **Percent of incorrect (default) prediction corrected by equation; For Goodness-of-Fit Evaluation tests: Grouping based upon predicted risk (*randomized ties*); Success if probability is higher than 80%.Such expected values are computed in the left-hand table. For instance, E (*Binary IFRSs = 0*) is computed as:

$$\sum_i Pr\,(IFRSsi = 0|x_i, \beta) = \sum_i F\,(-x_i\beta)$$

Here the cumulative distribution function *F* is for the *extreme value distribution*:

$$\sum_i Pr\,(IFRSsi = 1|x_i, \beta) = 1 - (1 - \exp(-e^{x_i}\beta)) = \exp(-e^{x_i}\beta)$$

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In the lower right-hand table, it compute the expected number of *Binary IFRSs=* and *Binary IFRSs=*1 observations for a model estimated with only a constant. For this restricted model, E (*Binary IFRSs= 0*) is computed as *n(1-p)*, where *p* is the sample proportion of *Binary IFRSs=*1 observations. A classification is labeled as "correct" when the predicted probability is less than or equal to the cut-off (80% in the estimation) and the observed *Binary IFRSs= 0*, or when the predicted probability is higher than the cut-off and the observed *Binary IFRSs=* 1. Overall, the estimated model predicts 74.23% of the observations (83.51% of the observations with dependent = 0 and 44.09% of the observations with dependent =1) correctly. It appears that the levels of *sensitivity* and, respectively, *specificity* for the model are almost the same, implying that it can discriminate both extreme and regular cases. The gain in the number of correct predictions obtained by moving from the right table to the left table provides a measure of the predictive ability of the model. Roughly, there is an improvement of 28.39% over the constant probability model with the estimation. The Goodness-of-Fit *Hosmer-Lemes how* tests compare the expected fitted values to the actual values by group. If these differences are "small enough", the model is fitting the data adequately. The values of these tests, also reported in Table 2 suggest that this is the case with the binary specification.

CONCLUSIONS AND FURTHER RESEARCH

The main objectives of this paper are to provide a synopsis of the Islamic accounting characteristics, to identify some factors which led to its specificities, and to test a research hypothesis regarding the preference for IFRSs adoption in Islamic countries. Thus, it have noticed that the Islamic accounting framework shows particular features generated by the appeal to Islamic community and ethics principles. These particularities are reflected by the core accounting principles and structures involved. In addition, a significant determinant of the Islamic accounting recent developments is the expansion of the Islamic financial sector and its structural transformation. From the institutional point of view, the key entity involved in the regulation of the Islamic financial institutions is AAOIFI. While its objective is to promote the use of accounting and auditing principles relevant to Islamic financial institutions in accordance with the precepts of Islamic Shari'ah, its activity in practice is modulated by the diversity of implementation conditions of these principles and by the consequences of the interactions with non-Islamic financial institutions and organizations. The predominance of Islam oriented norms and behavior in society tends to reduce the

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preference for IFRSs adoption, in favor of an Islamic accounting framework. In order to test, it have considered a dataset of 38 countries with significant Muslim population and the status of IFRSs adoption and constructed a binary variable designed to reflect the full adoption cases. Thus, it has tested the capacity of the model to predict the extreme cases (full adoption of current IFRSs) and to discriminate between such situation and other stages of adoption. Overall, the estimated model predicts correctly 74.23% of the observations and it discriminates both „extreme" and „regular" cases. Moreover, in order to evaluate the robustness of the results it included the Index of Economic Freedom as a control variable. Therefore, it consider that in spite of the inherent research limits, the provided evidences can contribute to enhance a broader explanatory framework of Islamic accounting's complexity, which influences greatly the preference of regulatory bodies for limiting IFRSs adoption, in favour of an Islamic-based accounting.

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THE CONCEPT OF TIME VALUE OF MONEY IN ISLAMIC FINANCIAL SYSTEM

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ABSTRACT

The time value of money, a fundamental concept in finance, draws from the idea that rational investors prefer to receive money today rather than the same amount of money in the future because money has the capacity to grow in value over a given period. This concept is the key notion behind the recognition of interest in conventional finance.

At the same time, Islamic finance prohibits giving and taking of interest. This is presumed by many scholars as a denial of the concept of Time value of money. Therefore, the question of whether Islamic finance rejects Time Value of Money in and out is being examined. This article seeks to explore whether any value can be attributed to time while determining money's value under an Islamic financial framework. How Islamic Finance perceives Time Value of Money in relation to Preference is also closely evaluated in the light of special nature of the money concept in Islamic Financial System.

As Islamic finance introduces itself as not a mere agency of profit, but a manifestation of justice system in the financial framework, this paper tries to extract the essence of social and economic time values which enables interest-ridden sale transactions and encourages interest-free-loans and waqf.

Keywords: *Time Value of Money, Time Preference, Interest, Social Time Value, Deferred* Transactions.

INTRODUCTION

Islamic Economy concept is based on Shariah (Islamic Law). The word 'Shariah' literally means "a way". Shariah in Islamic terminology refers to a "Legal System", or "The Law of Islam". Prohibition on collection of interest and its utilization for the business purposes forms the main concept of the Islamic finance. Two fundamental standards behind Islamic banking concepts are the sharing of profit as well as loss. This can be enumerated better as the principles of cooperation and responsibility.

Cooperation indicates that an economic exchange shall be beneficial to both parties involved. Islamic finance does not permit transactions in which one party wins at the expense of the other. Thus monopolistic dealings, usury, and exploitation are out of place in Islamic Economic concept. By the principle of Responsibility, it means that each individual is entitled for reward or return based on his effort and contribution. Thus gambling and speculation are not permissible under Sharia Law.

This paper attempts to understand Islamic financial framework more evidently in light of Time Value of Money. Every finance enthusiast is familiar with the maxim *"A bird in hand is worth two in the bush."* Time value of money (TVM) refers to the concept that money at hand today is worth more than its equal sum in the future. This accounts to money's potential earning capacity. Hence, cash in hand today has more value and utility than cash or credit one may receive in future. Because, there is a default risk in choosing to receive money in future. Therefore, in modern financial system an investor has a price of waiting until his money is repaid. It is inherent for any rational investor to recognize Time Value of Money (TVM). Viability of this concept in Islamic Banking can be understood only in light of understanding some of the Fundamental Principles (pertaining to the topic) of Islamic Banking and Finance.

They are :

1. **Profit And Loss Sharing**

It is the most important principle of Islamic finance where the partners will share their profit and loss according to the part they played in the business. There will be no guarantee on the rate of the return and the parties would play the part of a partner and not a creditor.

2. **Shared Risk**

When two or more parties will share the risk following the principles of Islamic banking the burden of the risk will be divided and equally distributed among the parties. This has a positive impact on the economic activity of the State.

3. **Paying or Charging of Interest**

Islam considers lending with interest payment as an exploitative practice that favours the lender at the expense of the borrower. Therefore, interest is strictly prohibited. Regardless of the outcome of economic activity the person who gets the loan has to return the money and riba (interest) to the lender. Principles of Islamic banking consider it unjust for one to take advantage of the issues that others face.

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4. Gharar

This includes participation in ambiguous and uncertain transactions like, contracts where the terms and subject matter are uncertain and therefore bear excess risk. This includes prohibition on selling something one doesn't own. This dismisses derivative contracts and short selling. There should be transparency of information between the parties so that the profit and loss will be equally shared.

5. Gambling

Any form of speculation or gambling is strictly forbidden. . Any business that involves gambling do not get financial aid from Islamic banks. Islamic financial institutions also cannot involve in contracts where ownership of goods depend on an uncertain event in the future. Hence, majority of Islamic scholars consider futures and options prohibited in Islamic Finance.

6. No Investment In Prohibited Industries

Islam prohibits any industry that is harmful to a society or threatens the social harmony. They include: Pornography, Prostitution, Alcohol, Pork and Drug. In addition to this, anything that the Shariah considers unlawful or undesirable also comes under the purview of prohibited industries.

7. Zakat

Zakat is a property tax which is imposed inorder to promote justice in relation to the distribution of wealth. Zakat allows a balanced distribution of wealth. According to the Islamic banking principles the fair amount of Zakat is deducted from the accounts of subjects annually. Islamic banks are keen to distribute the amount among the needy and thereby fulfill its social responsibility. Generation of wealth should be from authentic trade practices and asset based investments. It lays great emphasis on equity and investment in the real economy and not mere financial transactions.

Islamic law observes that lenders are favored over borrowers on whose expense, interest is charged in loan transactions. According to Islamic law, money is a measuring tool for value and it cannot be considered as an asset in itself. Therefore, it requires that one should not be able to earn from money alone, and such practice is forbidden under Islamic law.

Time Value of Money in Islamic Finance is totally different from the conventional one. This will be deeply examined in light of Islamic Finance System and the Sharia compliance pertaining to the same in this paper.

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The organization of the paper is as follows: Section 1 gives a short introduction to the core topic. Section 2 presents a review of previous literature on the subject. Section 3 discusses how Islam perceives money and time value and the concept of Time Value of Money in Islamic Finance and determines where exactly TVM is approved by Shariah, and where is it rejected. The two aspects of Time Value of Money namely economic and social time values are evidently alienated to explain time value of money in Islamic finance. This section also examines the relationship between Time Value of Money and Time Preference. Section 4 concludes the study.

REVIEW OF LITERATURE

Though the concept of time value of money has been rejected by some feeble voices, it has been recognized by majority of Islamic scholars. Some contemporary Islamic thinkers such as Mawdudi (Mawdudi, n.d) and Akram Khan (Akram Khan, 2005) have disapproved the concept of TVM because it is the rationale for payment of interest in a capitalist economy. The classical discussion of the above mentioned issues in Islamic jurisprudence (Al-Kasani, 2000; al-Shirazin.d.; Ibn Muflihn.d.; Ibn Qudamah, n.d.) provides a strong argument for Islam's recognition of TVM and that deferment does have an effect on price.

Another scholar namely Kahf has a different argument regarding TVM. He stresses that time preference in real life is an investment phenomenon more than a purely consumption phenomenon (Kahf, 1994) because people will not forgo the present consumption of their money unless the future investment gives higher return. The positive time preference is recognized in Islam though under certain conditions. The question is raised whether Positive Time Preference identified in Islamic Finance is same as that of conventional finance which justifies interest (*Riba)*.In this respect, classical scholars have defined neither the source nor the causes of interest, but presented the concept as a mechanism which avoids interest. Contemporary scholars have made an attempt to differentiate between the acceptance of TVM in Islam and *Riba*in conventional finance.

However, many scholars disagree with the positive time preference. Khan (2005) argues that there is a contradiction if we advocate that positive time preference does not necessarily legitimize interest (*Riba*). Zarqa (2005) notes that neither is positive time preference a fixed rational principle nor is it empirically a predominant tendency among consumers. Indeed, both positive, zero or negative time preference are rational and observable depending upon individual situations. The preference for the future or the present is not *Sharia* rule (Zarqa, 2005). According to Siddiqi (2006), people may not generally have a pure positive time preference.

Therefore, this study seeks to determine the Islamic viewpoint on the concept of Time Value of Money in light of the Time Preference emphasizing the differentiation of time value of money in terms of social and economic views

TIME VALUE OF MONEY IN ISLAMIC FINANCE SYSTEM:

In order to study the Time Value of Money in Islamic Finance System, one should understand that unlike conventional finance, value of time as well as money is perceived differently in Islamic finance.

1. Value of Time is treated differently in Islamic Finance.

Moral and religious dimensions of Islam distinguish Islamic system. Every economic decision depends on the ethical principles formulated by the Sharia, which one should consider, beyond profitability and efficiency targets, while making a transaction or investment decision. Islamic Finance absorbs the concept of success in materialistic world as well as success in the hereafter (Kahf, 1996). The distinction of time on the present life on one hand and on the hereafter on the other hand influences the Time Value of Money in the Islamic finance. Therefore, economic decision making depends on a lengthier time horizon. Furthermore, present period and the hereafter have different considerations in terms of objectives and rewards.

As understood, financial transactions are of two types: Sale Transactions and Loan Transactions. From Sharia point of view a Sale Transaction is based on justice and mutual interest (Musharakah). Musharakah is a system where the parties involved agrees to share the profit and loss of their venture. They contribute their capital and labor into the venture together, and they share the profits and losses in the future. Here, both parties are willing to profit from each other as much as possible. While the seller benefit by increasing the price, the buyer benefit by deferring the payment and thus fairness is achieved in such a transaction. In short, there is a difference between deferred sale price and spot price. In such a transaction, time value of money is observed. This consideration is not seen in Loan Transactions. In Islamic Finance perspective, Loan transactions are based on benevolence (Ihsan) which means doing good without waiting for anything in exchange. The Shariah objective of the principle of benevolence behind the loan contract will be violated, if the lender charges the borrower an interest on the loan.

Likewise, time value of money in a productive venture would be recognized only when that money is invested in it and thus becomes a capital. It means there should be a real transaction. In a loan contract, as the lender has not undertaken to share the risk involved in the venture the money he has lent to the borrower (which is invested in a venture) is not a capital in any sense. In addition, the entrepreneurial expertise and risk undertaken to run a venture or business is more important than the money that is used to finance it. Thus, time value of money would not apply in a loan transaction as it involves interest as well as the money being lent out is not yet qualified to be considered a capital.

To sum up, the evaluation of time is possible if there is an exchange of goods (sale transaction), but not money or loan transaction.

Exception:

If the sale transaction involves the exchange of one of the 6 usurious categories (gold, silver, wheat, barley, salt, and dates), then Time Value of Money is disregarded here. This is because, these 6 items were considered as money during early Islamic period. These conditions are mentioned in the *hadith* of the Holy Prophet, peace be upon him: "Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, and salt for salt, like for like, equal for equal, and hand-to-hand; if the commodities differ, then you may sell as you wish, provided that the exchange is hand-to-hand" (Muslim, 4/98).

In Islamic Finance concept, money is just a means of transaction and a unit of account. Money is meant to be used for acquiring goods. If any of these 6 usurious categories is used against this property of money, that is, say, gold is traded against gold unequally, this would destabilize the economic system which uses gold as only a means of transaction and not goods itself

2. within the Islamic Framework, money is perceived differently.

Similar to time value, Islamic finance views money also differently from the conventional finance. In Islamic finance, Money has no intrinsic value. It cannot be used to fulfill human needs directly. Money is a medium for exchanging goods and benefits. It is not a commodity which can be utilized directly without exchanging it for some other things. (Mohsin 2009). Money cannot be sold at a higher value than its nominal value. When money is used to purchase a thing which brings value only it becomes an asset. Any increase in a loan is a forbidden interest.

Islam considers that money is sterile as long as it is not combined with work to undertake a productive activity. When money is invested, it is paid not by a fixed amount but by a predetermined share of the investment return. In this view, Iqbal and Mirakhor (2006) indicate that money is transformed to a capital only when it is invested to undertake a productive activity.

TIME VALUE OF MONEY

In conventional finance, when more money is produced by borrowing and lending arrangements, there observes a time value of money. This is a clear indication of interest, which is prohibited in Islamic finance.

Islamic finance identifies Time Value of Money, assuming that this value is derived from a real activity. The return available from investment in trade or business represents the time value of money (Mohsin, 2009). So, in order to accept time value of money there should be a transacted commodity in the trade or business.

In a deferred sale, buyer enjoys the right to use as well as possession of the commodity. The additional payment may be justified as a return for enjoying the right to immediate use. This increment is associated with the spot price of the commodity. A financial counter-value incorporated in the price is recognized by the Shariah only if it is associated with the original price of the commodity (Khir, 2013).

Time Value of Money in Islamic Finance is better understood when it is distinguished as Economic Time Value as well as Social Time Value. (Ben, 2017)

ECONOMIC TIME VALUE :

Economic Time Value is related to the monetary value of money in the present life in the conventional sense. Economic time value of money exists only in sale transactions. As conventional loan with interest is prohibited in Islam, its economic time value also is prohibited.

SOCIAL TIME VALUE:

Social Time Value denotes non-monetary value of money which intervenes in the Islamic concept of hereafter, the next world for which each Muslim strives to win. An Islamic economic agent considers the reward in hereafter in his economic transactions as well. Social Time Value takes into consideration, an interest-free-loan which is considered as a donation contract. The donation amount is received when the economic value of money paid by the creditor is deducted from the money received after a period of time. If the lender had kept his money with himself, he might enjoy some unsecured gains: He could use the money for some investment purpose. Also, there can be possibility of lender not receiving the money from the borrower in case the latter come across any financial difficulty. Then, this would cause opportunity cost as well, in addition to the loss of liquidity. But in Islamic viewpoint, such a loss faced by the lender would be compensated, if not now, then from the hereafter. Thus, an Islamic economic agent will accept social time value instead of economic time value. It brings a new opportunity that while the economic time value of money opposes the loan with *riba*, the social time value of money encourages the interest-free-loan. Another concept pertaining to Social Time Value of Money is Waqf. The *waqf* of an amount of money is a voluntary endowment of property to be held in trust and used for a charitable purpose. It is disbursed for Sharia complaint projects. The reward of the

Interest-free-loan indicates a social time value of money.

Consequently, the prohibition of interest in Islamic economics reduces the role of loans in financing and promotes the Profits and Losses Sharing financing. In short, the combination of economic and social time value of money widens the time value of money in the Islamic perspective. (Hamza & Ben, 2017)

THE NOTION OF TIME PREFERENCE IN FINANCE

Time preference constitutes the essential basis for Time Value of Money in conventional finance. Time Value of Money in conventional finance is deeply rooted in the concept of Positive Time Preference (PTP).

The term Positive Time Preference was coined by the Austrian Economist Eugen von Böhm-Bawerk in his book *Capital and Interest* which explained that the value of goods decreases as the length of time needed for their completion increases, even when their quantity, quality, and nature remain the same. Subjective value of present goods is higher than future goods of like kind and number. Böhm-Bawerk names "three reasons for the inherent difference in value between present and future goods: the tendency, in a healthy economy, for the supply of goods to grow over time; the tendency of consumers to underestimate their future needs; and the preference of entrepreneurs to initiate production with materials presently available, rather than waiting for future goods to appear." Thus according to the author, positive time preference is a normal pattern of behavior. For a decline to the marginal utility of saving to happen, the rate of interest must be high enough to balance the positive time preference. This means that in the conventional perspective, a positive interest rate is required in order to offset the marginal disutility of saving associated with positive time preference (Ariff, 1982). Although the theory became influential, its critics sought to contradict it with two contrary concepts: zero time preference and negative time

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preference. If consumers expect a future decrease in their income, or a future increase in their need with constant income, in order to maintain their past level of consumption, they would show a future time preference rather than present time preference. This is called Negative Time Preference.

TIME PREFERENCE IN ISLAMIC FINANCE

An increment in a deferred contract is permissible on the ground that deferment earns a portion of price. Therefore, in exchange contracts, in order to strike a balance of justice the value of a deferred thing should be discounted. Apart from the field of deferred sales, time preference play a role also in the field of feasibility studies and projects evaluation. It can be said that the future value of an investment is to be discounted at the Time Value of Money rate to determine the present value of the investment. Thus the time preference concept in Islamic perspective is different pertaining to Time Value of Money. In Islamic Finance, Time Value of Money can also be observed in terms of economic value (increasing wealth) as well as social value (reward in the hereafter). (Hamza & Ben, 2017).

In Economic Time Value, monetary sums at different time points have different values, even if they are equal in amount. Therefore, economic agents express a time preference. In conventional sense, this observes the monetary value of money in the present life. In addition Islamic finance identifies rewards in hereafter as well, in this transaction. While it is forbidden in case of loan transactions (with interest), Economic time value of money exists only in sale transactions which may have deferred payments.

In contrary, if there is no time value of money, the preference becomes only for the present and there is no incitation for the future. Time preference behavior is based on the time value of money through the reward level during a period of investment. Obviously, the time preference is a preference for the present over the future due to some factors related to risk and liquidity

In the social Time Value, the time preference is not related to monetary. It is based on anticipated rewards which the economic agent cannot precisely quantify and benefits in the future (in the hereafter). Nevertheless, the *Sharia* indicates that Interest-free-transactions and waqf affect the well-being of not only the economic agents but also of the society as a whole.

TIME VALUE OF MONEY AND TIME PREFERENCE

In Islamic finance, Positive Time preference is recognized, as long as the transaction does not include interest rate. In Islamic economics, the positive time preference does not justify the loan (Siddiqi 2006). A loan contract, (with interest), which has no time value, leads to zero-time preference. This turns positive, considering the hereafter. In the case of Interest-free-loan, there is apparently a negative time preference if we consider the economic view. While considering social view of Interest-free-loan, a positive time preference is observed since the reward in the hereafter compensates the donation contract. This differentiation of the time preference behavior into economic and social views is important to understand time value of money.

Also, in the Islamic framework, in the case of Zakat, a positive time preference is preferred by the economic agents as money should be invested on time. Amassing the mandatory property tax namely Zakat is prohibited. This is contradictory to a negative or zero-time preference. Therefore, the practice of Zakath affects the time preference in investment decision.

The change in the economic time value of money brings a change in time preference. For instance, if the economic time value of money decreases, positive time preference is observed.

The social time value of money helps to understand with more clarity, the time preference in the Islamic perspective. A preference for future is being stimulated as a result of consideration for social time value. It also triggers a postponed consumption for exploring better opportunities in future than the present. Islamic perspective of Time Preference is better explained with the concept of social time value of money.

CONCLUSION

Time Value of money which observes interest (riba) is prohibited in Islamic Finance. Islamic Finance conceives Time Value of money in a different manner. Islamic Finance perceives value of time as well as money differently. Social and economic elements of time value of money are considered to understand its Islamic perception.

In conventional finance, interest rate (riba) explains time value of money. Islamic finance recognizes time value of money if the transactions are real and not mere financial transactions.

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In Islamic Finance, Time Value of Money can be observed in terms of economic value (increasing wealth) as well as social value (reward in the hereafter).

Economic Time value is observed in deferred sale transactions, not in loan transactions. Time preference behavior is positive as long as it does not include interest rate. Social time value concentrates on Al-Ihsan, (benevolence) the success in the hereafter, which is the foundation of Islamic teachings. It elucidates the application of interest-free-loans (donation contract) and waqf which concentrates on the well-being of not only the economic agents but also of the society as a whole. Thus, the social time value of money reinforces the preference for the future. For better decision making it is recommended to consider economic and social aspects.

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ISLAMIC BANKING VS. CONVENTIONAL BANKING

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ABSTRACT

Islamic banking is a concept where in very few have ever read about. It is same as normal banking but there are certain rules and regulations laid by the Muslim law. The main difference between Islamic and Conventional banking is the treatment of risk, and how risk is shared. Whatever the profit, it is shared with depositors. If there is a loss it will also be shared. Islamic banking offers its services that lead to socio-economic development of a community, country, region, continent and the world.

***Keywords:** Islamic Banking, Conventional Banking, Shariah, Riba, Zakat*

INTRODUCTION

Bank is a financial institution and a financial intermediary that accepts deposits and channels those deposits into lending activities, either directly by loaning or indirectly through capital markets. A bank links together customers that have capital deficits and customers with capital surpluses. There are various types of banks. The necessity for the variety among these banks is because each bank is specialized in their own field. Each bank has its own principles and policies. Different rates of interests are also noted among these banks.

Islamic Banking is a system based on Islamic Law (Shariah). It follows the Shariah, called Fiqh Muamalat (Islamic rules on transactions). The rules and practices of Fiqh Muamalat came from the Quran and the Sunnah, and other secondary sources of Islamic law such as opinions collectively agreed among Shariah scholars, analogy and personal reasoning.

As per the Dubai Islamic bank which is considered as the oldest IB, the definition of Islamic banking is as follows: "Islamic banking, enlightened with the guidance of Islamic Shariah principles, emerged as an alternative financial system that neither gave nor took interest, thereby introducing a fair system of social justice and equality, while fulfilling the financial needs of people and maintaining high standards of ethics, transparency and a sense of responsibility". Islamic banking depends on trade which enables to profit making instead of interest, which is prohibited by Islamic religious law.

HISTORY OF ISLAMIC BANKING

The practices of Islamic banking are usually traced back to businesspeople in the Middle East who started engaging in financial transactions with businesspeople in Europe during the medieval era. At first, businesspeople in the Middle East used the same financial principles as the Europeans. However, over time, as trading systems developed and European countries started establishing local branches of their banks in the Middle East, some of these banks adopted the local customs of the region where they were newly established, primarily no-interest financial systems that worked on a profit and loss sharing method. By adopting these practices, these European banks could also serve the needs of local business people who were Muslim.

In the beginning of 1960s, Islamic banking resurfaced in the modern world, and since 1975, many new interest-free banks have opened. While the majority of these institutions were founded in Muslim countries, Islamic banks also opened in Western Europe during the early 1980s. In addition, national interest-free banking systems have been developed by the governments of Iran, Sudan, and Pakistan.

ROLE OF ISLAMIC BANKING

It is true that individuals, government and non-government agencies have conducted many studies to understand benefits of Islamic banking and the challenges faced by Islamic banking. Since this system of banking is grounded in Islamic principles, all the undertakings of the banks follow Islamic morals. Therefore, it could be said that financial transactions within Islamic banking are a culturally distinct form of ethical investing Islamic bank, formed in 1975. Islamic banking refers to a system of banking or banking activity that is consistent with Islamic law (Shariah) principles and guided by Islamic economics. In particular, Islamic law prohibits usury, the collection, and payment of interest commonly called Riba. Generally, Islamic law also prohibits trading in financial risk (which is seen as a form of gambling). In addition, Islamic law prohibits investing in businesses that are considered unlawful, or haram.

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PRINCIPLES OF ISLAMIC FINANCE

Islamic finance strictly complies with Shariah law. Contemporary Islamic finance is based on a number of prohibitions that are not always illegal in the countries where Islamic financial institutions are operating:

1. **Paying or charging an interest**

Islam considers lending with interest payments as an exploitative practice that favors the lender at the expense of the borrower. According to Shariah law, interest is usury (*Riba*), which is strictly prohibited.

2. **Profit And loss sharing**

It is one of the best principles of Islamic finance where the partners will share their profit and loss according to the part they played in the business. There will be no guarantee on the rate of the returns that the Muslims will play the part of a partner and not a creditor.

3. **Shared risk**

In the economic transactions, the risk sharing is promoted by the Islamic banking. When two or more parties will share the risk following the principles of Islamic banking the burden of the risk will be divided and reduced in the parties. So it will improve the economic activity of the state.

4. **Uncertainty and risk (Gharar)**

According to the Islamic finance principles, Muslims are not allowed to participate in the ambiguous and uncertain transactions. According to Islamic rules, both parties should have a proper control over the business. As well as the complete information should be shared with both parties so that the profit and loss will be equally shared. *Gharar* is observed with derivative contracts and short-selling, which are forbidden in Islamic finance.

5. **Speculation (*Maisir)***

Sharia strictly prohibits any form of speculation or gambling, which is called *Maisir*. Thus, Islamic financial institutions cannot be involved in contracts where the ownership of goods depends on an uncertain event in the future.

6. **No investment in prohibited industries**

The industries that are harmful to society or have a threat to the social responsibilities are prohibited in Islam. They include pornography, prostitution, alcohol, pork and drug.

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According to the Islamic finance principles, you are not allowed to invest in such industries. You cannot even participate in the mutual funds that will help the industry to flourish.

7. **Zakat**

There is a property tax included in the rules of Islam that it known as Zakat, which allows the balanced distribution of wealth. According to the Islamic banking principles the fair amount of Zakat is deducted from the accounts of Muslim in the holy month of Ramadan. Islamic banks promote this social responsibility and distribute the amount among the needy.

8. **Material finality of the transaction**

Each transaction must be related to a real underlying economic transaction.

MODES OF ISLAMIC BANKING FINANCE

a) Murabaha

Murabaha, also referred to as cost-plus financing, is an Islamic financing structure in which the seller and buyer agree to the cost and markup of an asset. As a financing technique, it involves a request by the client to the bank to purchase certain goods for him. The bank does that for a definite profit over the cost, which is stipulated in advance.

b) Ijarah

Ijarah means lease, rent or wage. It refers to selling the benefit of use or service for a fixed price or wage. Under this concept, the Bank makes available to the customer the use of service of assets / equipment such as plant, office automation, motor vehicle for a fixed period and price.

c) Istisna

It is a contractual agreement for manufacturing goods and commodities, allowing cash payment in advance and future delivery or a future payment and future delivery. A manufacturer or builder aggresses to produce

d) Mudarabah

A form of partnership where one party provides the funds while the other provides expertise and management. Any profits accrued are shared between the two parties on a pre-agreed basis, while loss is borne only by the provider of the capital.

e) Takaful (Islamic insurance)

Takaful is an alternative form of cover that a Muslim can avail himself against the risk of loss due to misfortunes. Takaful is based on the idea that what is uncertain with respect to an individual may cease to be uncertain with respect to a very large number of

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similar individuals. Insurance by combining the risks of many people enables each individual to enjoy the advantage provided by the law of large numbers.

f) Musharakah (Joint venture)

Musharakah means a relationship established under a contract by the mutual consent of the parties for sharing of profits and losses in the joint business. The profit is distributed among the partners in pre-agreed ratios, while the loss is borne by each partner strictly in proportion to respective capital contributions. This is often used in investment projects, letters of credit and purchase or real estate or property.

g) Bai Salam

Bai Salam is an Islamic contract in which full payment is made in advance for specific goods to be delivered at a future date. It is necessary that the quality of the commodity intended to be purchased is fully specified leaving no ambiguity leading to dispute. It is also applied to a mode of financing adopted by Islamic banks. It is usually applied in the agricultural sector where the bank advances money for various inputs to receive a share in the crop, which the bank sells in the market.

BALANCE SHEET OF ISLAMIC FINANCIAL INSTITUTION AND CONVENTIONAL FINANCIAL INSTITUTION

Table 1

Balance Sheet of Islamic Financial Institution and Conventional Financial Institution

Balance Sheet of Islamic Financial Institution	**Balance Sheet of Conventional Financial Institution**
Assets	**Assets**
Cash and cash equivalents Investment in securities Sales receivables Investments in leased assets Investments in real estate Equity/ profit sharing financing Investment in subsidiaries Fixed assets Other assets	Cash and cash equivalents Investment in securities Loans and advances Statutory deposits Investment in subsidiaries Fixed assets Other assets
Liabilities	**Liabilities**

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Current accounts	Current accounts
Other liabilities	Saving and time deposits
Equity of Profit-Sharing Investment Account (PSIA)	Other liabilities
PSIA (Unrestricted)	
Profit equalization reserve	
Investment risk reserve	
Owner's equity	**Owner's equity**
PSIA (Restricted)	Off-balance sheet
Off-balance sheet [letters of credit/ guarantees]	[letters of credit/ guarantees/ derivatives]

DIFFERENCE BETWEEN CONVENTIONAL BANKING AND ISLAMIC BANKING

Table 2

Difference between Conventional Banking and Islamic Banking

Conventional Banking	**Islamic Banking**
Conventional banks are based on fully man-made principles.	Islamic banks are based on principles of Divine law.
Aims at maximizing profit with only legislative restrictions.	Aims at maximizing profit but subject to Shariah and legislative restrictions.
The relationship of the bank with its client is that of creditors and debtors.	The relationship of the bank with its client is that of partners, investors & entrepreneurs and buyer & seller.
Depositors are guaranteed a predetermined rate of return (interest).	Profits are shared between the bank and the depositors according to a pre-agreed ratio and these profits are not guaranteed.
Lending money and getting it back with interest is the fundamental function of the conventional banks	Participation in partnership business is the fundamental function of the Islamic banks
Does not deal with Zakat.	It has become one of the service oriented function of the Islamic banks to be a Zakat collection centre and they also pay out their

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	Zakat.
Its scope of activities is narrower when compared with an Islamic bank.	Its scope of activities is wider when compared with a conventional bank. It is, in effect, a multipurpose institution.
It can charge additional money (compound rate of interest) in case of defaults.	The Islamic banks have no provision to charge any extra money from the defaulters.
For interest-based commercial banks, borrowing from the money market is relatively easier.	For Islamic banks, it is comparatively difficult to borrow money from the money market.
In it very often, banks own interest becomes prominent. It makes no effort to ensure growth with equity.	It gives due importance to the public interest. Its ultimate aim is to ensure growth with equity.
Conventional banks give greater emphasis on credit-worthiness of the clients.	Islamic banks, on the other hand, give greater emphasis on the viability of the projects.

CONCLUSION

Islamic banking is a very young concept in modern times yet it is emerging as one of the fastest growing areas of international finance. Islamic Banking is based on Shariah Laws. Shariah covers every aspect of our life; it provides principles how to live at individual level, in the society, legal and economic system, etc. The main difference between Islamic and conventional finance is the treatment of risk, and how risk is shared. In Islamic finance interest is prohibited. If an enterprise is financed by debt with an obligation to pay interest, the risk of the business is not being shared fairly. The relationship of the bank with its client is that of partners, investors & entrepreneurs and buyer & seller. Under *Shariah* law finance can be provided through several types of contract. Each type specifies how risk is shared between the enterprise and the supplier of finance.

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ISLAMIC MICROFINANCE IS A BEST PRACTICE: A GLOBAL PERSPECTIVE

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ABSTRACT

The Islamic approach puts overwhelming emphasis on micro enterprise development through financial and non-financial assistance and adherence to principles of transparency, empathy and cooperation. Islamic approach to alleviate poverty involves a charity based interventions inherent in the institutions of zakah and sadaqa to take care of consumption needs of the extremely poor and the destitute and create a social safety net. The other institution of charity, the awqaf, is ideal for creation and preservation of assets that can build capacity and provide technical assistance for skill improvement and development of human resources. The social safety net and technical assistance are then linked to financial assistance. This paper intended to familiarize the Arabic terms related to micro finance and to analyse the benefits of Interest free micro finance in different countries and also to adhere the best practices of islamic micro finance in Globel perspective .

Key Words: Zakah, Sadaqa, Charity, Poverty Alleviation

INTRODUCTION

Islamic microfinance institutions display wide variations in the models, instruments and operational mechanisms. While, in terms of reach, penetration and financial prowess, Islamic microfinance institutions lag far behind their conventional counterparts they certainly score better in terms of richness and variety. It is similar to conventional microfinance institutions, use group financing as a substitute to collateral, have a high concentration of women beneficiaries and aim at alleviation of poverty in all its forms. While poverty eradication remains a cherished goal of Islam and microfinance "best practices" is there a degree of commonality too in their approaches and strategies to poverty alleviation. Experiences reflected in the microfinance best practices advocate a dual approach – use of charity as well as for-profit microfinance. A charity-based approach is also needed for providing social safety net to the extremely poor and the destitute and therefore, un bankable. Islamic approach to alleviate poverty involves a charity based intervention inherent in the institutions of *zakah* and *sadaqa* to take care of consumption needs of the extremely poor and the destitute and create a social safety net. The other institution of charity, the *awqaf,* is ideal for creation and preservation of assets that can build capacity and provide technical assistance for skill improvement and development of human resources. The social safety net and technical assistance are then linked to financial assistance. The financial assistance aims at wealth-creation using Shariah-compliant for-profit modes with free pricing. The entire process needs to be completely transparent with proper documentation, accountability and responsibility with a time-bound schedule. It seeks to bring economic empowerment for families as integrated units.

OBJECTIVES OF THE STUDY

- To familiarize the Arabic terms related to micro finance.
- To analyse the benefits of Interest free micro finance in different countries.
- To adhere the best practices of Islamic micro finance in Global perspective

DEFINITION OF ARABIC KEY TERMS

Zakah

The amount payable by a Muslim on his net worth as a part of his religious obligations mainly for the benefit of the poor and the needy. It is an obligatory duty on every adult Muslim who owns more than a threshold wealth.

Murabaha

Sale at a specified profit margin. The term, however, is now used to refer to a sale agreement whereby the seller purchases the goods desired by the buyer and sells them at an agreed marked-up price, the payment being settled within an agreed time frame, either in installments or in a lump sum. The seller bears the risk for the goods until they have been delivered to the buyer. *Murabaha* is also referred to as *bay muajjal*

Mudaraba

A contract between two parties, capital owner(s) or financiers (called *rabb al-mal*) and an investment manager (called *mudarib*). Profit is distributed between the two parties in accordance with the ratio upon which they agree at the time of the contract. Financial loss is borne only by the financier(s). The entrepreneur's loss lies in not getting any reward for his services

Musharaka

A *musharaka* contract is similar to a *mudaraba* contract, the difference being that in the former both the partners participate in the management and the provision of capital, and share in the profit and loss. Profits are distributed between the partners in accordance with the ratios initially set, whereas loss is distributed in proportion to each one's share in the capital.

Riba

Literally, it means increase or addition or growth. Technically it refers to the 'premium' that must be paid by the borrower to the lender along with the principal amount as a condition for the loan or an extension in its maturity. Interest as commonly known today is regarded by a predominant majority of *fuqaha* to be equivalent to *riba*.

Qard Hasan

A loan extended without interest or any other compensation from the borrower. The lender expects a reward only from God.

Takaful

An alternative for the contemporary insurance contract. A group of persons agree to share certain risk (for example, damage by fire) by collecting a specified sum from each. In case of loss to anyone of the group, the loss is met from the collected funds.

Wadia

A contract whereby a person leaves valuables with someone for safe keeping. The keeper can charge a fee, even though in Islamic culture it is encouraged to provide this service free of charge or to recover only the costs of safekeeping without any profit.

Wakala

It is contract of agency. In this contract, one person appoints someone else to perform a certain task on his behalf, usually against a fixed fee.

Waqf

Appropriation or tying up a property in perpetuity for specific purposes. No property rights can be exercised over the corpus. Only the usufruct is applied towards the objectives (usually charitable) of the *waqf*.

BEST EXPERIENCES IN INTEREST FREE MICRO FINANCE INSTITUTIONS

Bangladesh

Bangladesh is a country renowned as a pioneer of microfinance. Grameen Bank, which was launched by Nobel Laureate Muhammad Yunus, has promoted micro-credit to the poor and has changed the life of many people. IFM, a recent phenomenon, is striving to take some market share in the sector. In an environment where conventional microfinance institutions cover 95% of the market share, IFMs take the remaining 5%. Bangladesh has a meager size of IFM market consisting of 6 Interest-free banks, 20 small IFM institutions and IFM program of conventional microfinance institutions. The first Interest-free bank in South Asia, Islami Bank Bangladesh Limited (IBBL), is the leading IFM provider in the country with more than 78% of the market share. It has developed the Rural Development Scheme (RDS), a ground breaking IFM approach, to respond to the needs of poor Muslims in rural areas in Bangladesh who were ignored by the conventional micro financing because of religious beliefs (UNDP, 2012). At the end of March 2019, Bangladesh's 8 full-fledged Islamic banks have been operating with 1,198 branches out of total 10,387 branches of the whole banking industry. In addition, 19 Islamic banking branches of 9 conventional commercial banks and 35 Islamic banking windows of 7 conventional commercial banks are also providing Islamic financial services in Bangladesh. Islamic banking industry held almost one-fourth share of the entire banking industry in terms of deposits and investments at the end of 2019 (Central Bank of Bangladesh, 2019). More than 37 million people were the beneficiaries of conventional microfinance in 2015, as compared with 1.70 million IFM clients. When we compare the amount of disbursements between the two, IFM institutions hand out approximately 38 billion Bangladeshi Taka whereas the conventional ones give out 829.16 billion Bangladeshi Taka (Nabi et.al, 2017).

Pakistan

The IFM sector is dominated by Non-governmental organizations (NGOs) in Pakistan. The most notable NGOs providing the services are Islamic Relief Pakistan (IRP), Akhuwat, Karakoram Cooperative Bank (KCB), National Rural Support Program, Wasil Foundation, Kashf Foundation, Naymet Trust, Kawish Welfare Trust, Esaar Foundation and Muslim Aid. All NGOs provide microfinance services based on murabaha (profit sharing) mode except Akhuwat, which extends interest-free credit using the Qard Hasan mode (Mahmood, 2019). The total market share of IFM is beneath one percent in the country. According to the draft guidelines by the State Bank of Pakistan (SBP), IFM services and products can be delivered by numerous sorts of financial institutions in diverse systems: establishing full fledged Islamic Microfinance Banks (IMFB), IFM services by full-fledged interest-free banks, IFM services by conventional banks and IFM services by conventional microfinance banks (SBP, 2006). By the end of June 2019, 22 Islamic Banking Institutions (5 full-fledged Islamic banks, 16 conventional and one specialized bank, i.e. Zarai Taraqiati Bank Limited having Islamic banking branches) were offering numerous Shariah compliant products and services through their network of 2,913 branches across 113 regions throughout the country.

The IBI added 228 branches to its branch network during the period under review to provide better access to its clients. In addition to branches, 1,348 Islamic banking windows are being operated by conventional banks having standalone Islamic banking branches were also serving faith sensitive clients (State Bank of Pakistan, 2019). Currently, close to 5.5 million people are being served with microfinance in Pakistan. The share of IFM segment in active borrowers and gross loan portfolio were 16% and 7%, respectively, in 2017. One of the recent achievements has been the Qard-e-Hasan model of Akhuwat financing serving 3.4 million clients with a nearly 99% recovery rate as of May 31, 2019. Kashf Foundation is another organization with a sizable outreach with 237,573 clients, with a staff of 2,210 and a micro credit loan portfolio of $57 million in the end of 2016. Wasil Foundation provides financing for nearly 4,537 clients with a 91% recovery rate. . Islamic Relief is the other microfinance institution with a micro credit portfolio of $0.36 million, and it has helped more than 11 million families over a 25-year period as of 2014 (Shaikh et.al, 2020).

Sudan

In Sudan, banks are divided into two: Commercial and Specialized. There are 7 foreign, 1 Government and 22 jointly owned banks. In addition, there are 3government and 3 jointly owned specialized banks. The Sudanese microfinance industry currently delivers services all over the country through 501 windows. Of these, 466 are financial service windows and 35 are non-financial services. The Central Bank of Sudan's policy for 2018 made it obligatory for commercial banks to at least 15% of their actual financing portfolio to microfinance, medium and small-scale financing as retail or wholesale financing. Although Sudan had a small number of institutions in 2006 serving the microfinance market and a small base of 9,500 clients, it became the second leading market in 2013 in terms of outreach next to Bangladesh with 426,694 active clients.

Geographically, the IFM institutions in Sudan are segregated into Federal –which comprises Al– Amal, Al-Shabab, Al-Ebdaa, Al-Mashier, Al-Watania, Al-Usra and Al-Iradaa, whereas the remaining ten institutions belong to the states with six in Khartoum, two in Red Sea State and two in South Kordofan. Islamic Development Bank, one of the external partners in the microfinance sector, offered US$ 59.5 Million support facility and brought in capacity building of Bank AlUsrah (converted into a full- fledged MFI bank). In addition, it has engaged in IT training programs and supported the formation of four centers for business development and five business incubators with a cost of US$ 160,000 and US$ 500,000 respectively.

Indonesia

The Indonesian Financial Services Authority (OJK) noted that the market share of Islamic finance in Indonesia, excluding Islamic microfinance institutions, which play an indispensable role in the Indonesian economy than Islamic banks stood at 8.69% in 2019. About 76% of the Indonesian population remains un banked (ICD, 2019). According to the report released by Fitch Ratings (2019), Indonesia has the largest number of Islamic banks in the world, with a total of 75 banks at the end of 2018 comprising 14 Islamic banks, 20 Islamic bank units and 41 Waqf banks. The formation of interest-free financial institutions in Indonesia was instigated by IFM institutions. The small-scale experiment of interest-free banking was tried under the umbrella of IFM institutions called Bait At-Tamwil Salman ITB in Bandung and Ridho Gusti cooperative. The first interest-free cooperative in Indonesia, Ridho Gusti, was founded in 1990 in Bandung. After five years, in 1995, PINBUK commenced to promote interest-free cooperatives using a new brand termed BMT. A great number of IFM organizations in the country pursue the cooperative system to operate their business (Finato and Gan, 2017). The leading suppliers of IFM services in Indonesia are 150 interest-free rural banks (BPRS) and above 3,000 BMTs (Baitul Maalwat Tamwils), which are a setup of interest-free financial cooperatives. Bank Rakyat Indonesia Syariah (BRI Syariah), a subsidiary of Indonesia's prevalent microfinance institution Bank Rakyat Indonesia (BRI) is also a decisive actor in offering microfinance services (Ang, 2013)

Middle East North Africa (MENA)

It was a microfinance initiative in Egypt - the MitGhamr project that laid the foundation of modern Islamic banking, not withstanding the short life span of the project. In the Middle East North Africa (MENA) region several successful experiments have been undertaken recently:

(i) the Sanadiq project at Jabal al-Hoss in Syria;

(ii) the Mu'assasat Bayt Al-Mal in Lebanon;

(iii) Hodeidah Microfinance Program in Yemen.

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The Jabal Al Hoss "Sanadiq" (village-banks) in Syria is an excellent model worth replication. Some of the unique features of this model are:

- *musharaka*-type structure owned and managed by the poor;
- financing based on the concept of *murabaha* – high profit rates with net profits shared among members;
- good governance through committees with sound election and voting procedures;
- project management team responsible for creating awareness of microfinance practices, training of committee members;
- financial management of the funds based on standardized by-laws and statutes for each of the village funds resulting in "fair" credit decisions and low transaction costs.
- financially viable operations with repayment rates close to cent percent
- equal access to both men and women as owners and users;
- Sanadiq Apex Fund for liquidity exchange and refinancing; and
- support from UNDP in the form of matching grant equal to minimum share capital of village fund.

The Mu'assasatBayt Al-Mal in Lebanon is an affiliate of a political party – the Hezbollah and comprises the Hasan Loan Institution (*AlQard Al-Hasan*) and its sister organization called Al-Yusor for Finance and Investment (*Yusorlil-Istismarwal Tamweel*). The former provides *qard-hasan* financing while the latter provides financing on a profit-loss-sharing mode. The uniqueness of the Mu'assasat *Bayt Al-Mal* is its emphasis on voluntarism. It has maintained a very close relationship with the people and is seen as a very creditable organization with volunteers entirely taking care of collection and disbursal of funds. It has a network of donors with complete confidence in the activities of the Institution and also enjoys high repayment rate. Financing is backed by collateral in the form of capital assets, land, gold, guarantor and bank guarantee.

The Hodeidah Microfinance Program in Yemen predominantly uses group and graduated financing methodology that was successfully pioneered by Grameen. Unlike Grameen however, it uses a *murabaha* mode for financing.

South Asia

Among South Asian countries Bangladesh leads the group with organizations like Islami Bank Bangladesh, Social and Investment Bank, Al Fallah and Rescue. Akhuwat in Pakistan is notable for its unique mosque-based model. India with its second largest Muslim

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population in the world has witnessed some experiments largely outside its formal financial system, such as, AICMEU and Bait-un-Nasr.

- The Islamic microfinance institutions in Bangladesh have been primarily using deferred-payment sales (*baimuajjal*) mode of financing. They have been facing tough competition from conventional giants like Grameen Bank and BRAC. Though according to some studies, Islamic microfinance institutions have displayed better financial performance than their conventional counterparts, the latter have a far greater outreach. Indeed, institutions like Grameen and BRAC have pioneered models of microfinance that are replicated across the globe.
- In Pakistan a model of micro-financing that has generated considerable interest among observers is Akhuwat. The financing is in the nature of small interest free loans (*qardhasan*) in a spirit of Islamic brotherhood where most activities are performed by volunteers. There is no funding from international donors or financial institutions. All activities revolve around the mosques and involve close interaction with the community. There are no independent offices; loans are disbursed and recovered in mosque and therefore involve low overheads. It uses collateral-free group and individual financing based on mutual guarantees. Loans are disbursed in a mosque, which also attaches a religious sanctity to the oath of returning it on time.

South East Asia

In South East Asia Malaysia made an early beginning with Tabung Haji aimed at financing the Hajj related expenditure of poor Malaysian farmers who used to sell their only source of livelihood, agricultural land, for the purpose. Tabung Haji was primarily a savings-and-investments-institution and has since grown into a large specialized finance house. Indonesia has largely followed Malaysia in the development of the Islamic financial sector including the microfinance sector. Cases of Islamic microfinance projects have also been documented for Thailand, Brunei and Philippines.

With its rather developed Islamic banking system and capital markets, Malaysia has established several organizations under the aegis of government agencies to finance small and medium scale enterprises using a wide range of Islamic financial instruments.

Sub-Saharan Africa

In Sub-Saharan Africa the only Islamic microfinance program that has been documented well operates in Northern Mali. It was borne out of a development project by the GTZ (German Technical Cooperation) and KfW (German Financial Cooperation) in the former civil war areas of Timbuctu', Mali. The aim of the project, inter alia, was to provide financial services to all the tribes of the area, the Moors, the Tuareg and various black African groups. It was felt that a bank that would be acceptable to all previous civil war opponents had to be an Islamic one and this led to establishment of the Azaouad Finances plc. The bank operates primarily on a PLS basis, is linked with the SWIFT international payments system, thus giving a fillip to local trade and commerce in a big way.

Central Asia

Out of the countries with large Muslim populations in Central Asia - Afghanistan, Azerbaijan, Kazakhstan, Tajikistan, Uzbekistan, Kyrghizstan only the former two have witnessed experiments in Islamic microfinance. The only Islamic microfinance program being run in Afghanistan is by FINCA. The program involves *qard-hasan* with service charge that is not related to amount of financing as a percentage and that is charged upfront as a fee. FINCA's Village Banking methodology targets the working poor with its "solidarity" group guaranteed loans.

CONCLUSION

The Islamic approach to poverty alleviation is more inclusive than the conventional one. It provides for the basic conditions of sustainable and successful microfinance, blending wealth creation with empathy for the poorest of the poor. It also follows that the Islamic approach is a composite of mission based and market-based interventions. It favors equity-based and cooperation based models in contrast to mechanisms that create and perpetuate debt. The global observation reviled that Islamic micro finance is a best solution of poverty alleviation and it will lead to the economic empowerment.

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ISLAMIC PERSPECTIVE OF INVESTMENT IN STOCK MARKET

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ABSTRACT

It is certain that the whole world will radically fluctuate from what it was before Covid-19 pandemic. One of the most certain of these is a drastic economic crisis that nations are facing. The Supply Chain Crisis in the global market may significantly affect the economic growth of nations. The stock market is also feeling the effects of the downturn. The Sensex and Nifty stocks have declined in several stages. In this scenario, there are many who are keeping an eye on the stock market in view of the possibility of the stock index going up in the future. At the same time, as a religious Muslim, due to some unsatisfactory provisions of Islamic law (Shariah), the present form of stock market restricts a Muslim to making investments. This study leads to the framework under which circumstances the Islamic Shariah permits investments to be made on the stock market. Also, giving ideas about investment, those who do not have time to invest directly in the stock market can opt for mutual funds. In India, Complete Shariah-compliant funds are also accessible in present days in mutual funds. These are the Tata Ethical Fund and the Taurus Ethical Fund. This study will serve as a guideline for investors and brokers to figure out the actual perspective of the Shariah resolutions and the criteria for investment or establishing full-fledged Islamic stock markets, indexes, and mutual funds.

Keywords: *Shariah Investment, Ethical Investment, Share market, Islamic Banking, Shariah Index.*

INTRODUCTION

The idea of goods trading dates back to the earliest civilizations. Early companies will pool their funds to send ships to other nations around the sea. These transactions have been carried out for thousands of years by either trading groups or individuals. Merchants gathered in the middle of a city in the middle ages to exchange and trade goods from countries worldwide. Since these merchants came from various countries, a money exchange had to be set up, so trading transactions were fair.

In Amsterdam, when the Dutch East India Company was the first publicly traded company, the first modern stock trading was established. The company agreed to sell stock and pay dividends on the shares to investors in order to raise money. Then, the Amsterdam stock exchange was founded in 1611. The only trading operation on the exchange for several years was the trading of shares of the Dutch East India Company. At this point, similar companies began to be formed by other nations, and buying stock shares was all the rage for investors. Many investors were blinded by the enthusiasm and they bought into any business that began to be available without researching the company. This resulted in financial instability and investors finally became afraid in 1720 and attempted to sell all their stock in a hurry. However, no one was buying, so the stock market crashed.

One of the earliest business modes used by pre-Arabs for trading operations is *Mudarabah* (profit sharing). This was an arrangement between one or more investors and an agent where the investors entrusted capital to an agent who then traded with it in hopes of making a profit. Both parties received a previously settled portion of the profit, though the agent was not liable for any losses. Equity financing instruments for Islamic commercial contracts are based on the *Mudarabah*(profit sharing) and *Musharakah* (profit loss sharing) principles.

Investing, with the expectation of generating an income or profit, is the act of allocating resources, usually money. In hopes of reselling it later at a higher price, you can invest in endeavors such as using money to start a business, or in assets such as buying real estate. Investment deals with risk and return go hand in hand; low risk usually means low expected returns, while higher returns usually come with higher risk. While the universe of investments is a vast one; Bank deposit, Stocks, Bonds, Mutual Funds, Investment trusts, Commodities, Options and Derivatives are the most common types of investments.

When you buy a share of a company you become a shareholder in that company. Shares are also known as Equities. Equities have the potential to increase in value over time. It also provides your portfolio with the growth necessary to reach your long term investment goals. Research studies have proved that the equities have outperformed most other forms of investments in the long term. Even though there are so many investment opportunities for the

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savers of money. It may of them lack the acumen the deploying their savings. Those ordinary people who cannot do investment in directly in stock market due to the ignorance and high risk portfolio mutual funds are of great help to them. Those who do not have time to invest directly in the stock market can opt for mutual funds. Muslims are the second one biggest religion in the world. These humans have plenty of wealth to invest; however, there are only some of Islamic opportunities to investing. This situation offers a terrible effect in Muslims due to the fact Muslims every day activities must be within the restrict of *shari'ah*. There for an alternative choice of investment to be opened for such a category will avoid there reluctances to invest. It helps to the development of the individual and the country.

Islamic fund management is a solution for Muslim investors; this gives more chances for Muslim to invest according to *shari'ah*. This fund is basically similar to conventional fund except in the compliances with *Shari'ah* rules and regulations. Islamic fund, it is prohibited to invest in the companies which are involved in prohibited activities.

BASIC PROHIBITIONS IN ISLAMIC FINANCE

Prohibition of *Riba*

Riba means as "to increase; to grow; to grow up, to exceed, be more than. The *Shariah* i.e. the Holy Qur'an and *Sunnah*, strongly condemn Riba. Any return on cash or a converted form of cash without delivering obligation in terms of the result of disposed cash or capital is prohibited.

Prohibition of *Gharar*

Gharar is defined as "something which its consequences are undetermined". It refers to any transaction of presumed objects whose existence or description is not calm, due to lack of information and knowledge of the ultimate aftereffect of the contract or the nature and quality of the subject matter of it. The Prophet Muhammed (s.a.w.) has disallowed the purchase of the awaited animal in the mother's womb, the sale of the milk in the udder without evaluation, the acquisition of spoils of war prior to distribution, the purchase of endowments prior to their receipt, and the purchase of the catch of a diver. Moreover, *Gharar* in practice reveals apparently to issues such as pricing, delivery, quantity and quality of assets that are transactional-based and would affect the grade or quality of authorization of the

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parties to a contract. For example, one cannot buy an 'option' at an assured price to have the right to purchase its underlying shares, as an 'option' is not ascertainable and is thus ambiguous. An option is just right. It is not an asset whose designations are fair and obtainable.

Prohibition of *Maysir* (Games of Chance)

Maysir, literally means gambling. Islam has also prohibited all modes of gambling. Maysir indicates the easy acquisition of wealth by chance, whether it dispossesses the other's right. Allah (s.w.t) in the Quran, clearly prohibits gambling.

For example, uncertainty of the timing of gains of a pure life insurance contract establishes an element of *Maysir*. Casinos are also a common example of *Maysir*, where simply transfer of wealth takes place from flops to champs without creating a new accumulation of wealth. In brief, contracts concerning pure speculation, conventional insurance and derivatives are examples of *Maysir*.

SHARIAH-COMPLIANCE INVESTMENT IN SHARE MARKET

Capital investment institutions and Shariah scholars associated in Islamic investment fund management come up with distinct methods and instructions for defining the Shariah compliance of an investment. Logic behind these characteristics is the multiplicity of modern capital markets with the existence of complex investment instruments and the multi disciplinary and global involvement of companies. Conventional interest and speculation-based financial instruments such as bonds, options, futures, forwards and swaps are either not permitted under *Shariah* or have to be restructured in a *Shariah*-compliant manner. *Sukuk* is an example of a conventional financial instrument that has been restructured to comply with *Shariah*.

Although generating investments in the stock market is allowed in Islamic principle, *Shariah* sets out assertive rules and regulations for it which separate a *Shariah* compliant stock market from a conventional stock market. These guidelines are summarized below. Basically two types of Screening required finding Shariah Conformity Stocks.

1. Industry Based Criteria.
2. Financial Ratio Based Criteria.

Industry Based Criteria

Those companies conducting their business ethically that cannot harm their product or service to any society, emotionally or physically, are complying with *Shariah* Law. All those companies will be considered as *Shariah* compliance, which means investing in these companies is *Halal*.

According to Islamic *Shariah*, Muslims are not allowed to invest in something that will increase immorality, increase drugs or alcohol or even invest in companies which promote weapons of mass destruction etc.

Some Examples for Non Shariah-compliance Industries:

- Banking
- Non-Banking Financial Institution
- Insurance
- Housing Finance
- Film Production & Entertainment
- TV Broadcasting & Software Production
- Breweries & Distilleries
- Cigarettes/Tobacco
- Investment Finance
- Term Lending
- Recreation/Clubs/ Amusement Parks
- Weapon Product
- Post Office scheme

Financial Ratio Based Criteria

The Second process is a number of quantitative or financial screens are studied to further clean the asset universe of non-Shariah-compliant assets. The argument for using quantitative screening on top of qualitative screening is the fact that *Shariah* bans the engagement in *riba* and the exchange of money for money and thus it is needed to analyze how deeply companies are involved in such habits. Here, the engagement in *riba* is measured by how much interest-based income the firm receives and how much interest the company pays for its debt. Since money in itself is not a permissible asset in Islam that can be traded for money, the degree of cash and cash equivalents of a company has to be measured and measured to a maximum allowable threshold.

This is a relaxation of the juristic application of the *riba* ban and attribute paid to today's complex financial world in which it is almost impossible to find any company that is not involved in any interest payments owing to the existence of cash deposits, loans or credits; with the consequence that if Islamic scholars are extremely dogmatic and intolerant, Muslim investors would not be allowed to participate in the capital market at all (Wilson, 2004).

These are the screenings under financial ratio based criteria

Liquidity screens:

Liquid assets are current asset components and may include cash and cash equivalents, short-term investments and account receivables. For conventional investigators, a high liquidity ratio is commonly a positive indicator showing that the company is able to cover its short-term financial constraints more easily than a company with a lower ratio. But since from a *Shariah* perspective, returns should be gained from the illiquid assets only, assets of a *Shariah*-compliant company should be, to a high degree, in illiquid form.

An example of a *Shariah* screen assessing the maximal permissible liquidity level of a company is: The sum of account receivables, cash and short-term investments may not represent more than 33 percent of the total assets of a company.

Interest screens:

As defined above, earnings from interest are normally not permissible. Yet, since all companies are contributing with banks and this relationship might bring about interest, Islamic scholars defined thresholds indicating to which extent interest is permissible.

Interest admissibility is determined in two distinct ways. Either the amount of interest made or the amount of liquid assets (cash and short-term investments) that could make interest income limited. Interest income may not represent more than 5 percent of the total revenue of a company.

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Debt screens:

Since not only receiving interest is banned but also payments, the level of interest payments for debt is also assessed and limited by a threshold level. Here, Islamic and conventional scrutiny coincide and facilitate lower debt ratios, since in general a smaller leverage level is clarified as a positive investment sign.

An example of a debt screen is: The portion of total debt from the total assets of a company may not exceed 33 percent.

Non-permissible income screens:

Separate less-frequently used financial screens determine the level of income achieved from non-*Shariah*-compliant schemes. The screens are important in the case that the industry based screens which are used eliminate only those companies whose primary business is not *Shariah*-compliant. Such screens can be covered, for example, to determine for a hotel whose primary business is Shariah-compliant, how much income has been made by alcohol sales and an associated casino. If this income exceeds a given threshold, then the hotel is identified as being non-*Shariah*-compliant.

An example of a screen is, for detail: Non-permissible income from any *Shariah* non-compliant activity has to be less than 5 percent of the total revenue made by a company. Notwithstanding, Islamic investors are demanded to purify the impure income portion, resulting from the banned activities, by giving it away to charities.

For example, the input of Shariah non-compliant activities to the overall revenue and profit before tax of the company will be calculated and analyzed against the relevant business activity benchmarks.

The 5% benchmark would be applicable to the following business activities:

Conventional banking, Conventional insurance, Gambling, Pork and pork-related activities, Non-*halal* food and beverages, Shariah non-compliant entertainment, Interest income from conventional accounts and instruments, Liquor and liquor-related activities, Tobacco and tobacco-related activities and other activities deemed non-compliant according to Shariah.

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The 20% benchmark would be applicable to the following activities:

Hotel and resort operations, Share trading, Stock broking business, Rental received from Shariah non-compliant activities; and other activities deemed non-compliant according to Shariah.

SOME SHARIAH INDICES OUTSIDE INDIA

Islamic Indices	Index Family
Dow Jones Islamic Market Index	Dow Jones
FTSE Shariah All-World Index	Financial Times
S&P 500 Shariah Index	Standard & Poor's
MSCI Global Islamic Indices	Morgan Stanley

SHARIAH INDEX IN INDIA

SHARIAH INDEX (Subset of the Parent Index)	PARENT INDEX	STOCK EXCHANGE
CNX Nifty Shariah Index	CNX Nifty Index	National Stock Exchange (NSE)
CNX 500 Shariah Index	CNX 500 Index	National Stock Exchange (NSE)
BSE TASIS Shariah 50 Index	BSE Sensex	Bombay Stock Exchange (BSE)
S&P BSE 500 Shariah Index	S&P BSE 500 Index	Bombay Stock Exchange (BSE)

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SHARIAH EQUITY BASED INVESTMENT OPTIONS (MUTUAL FUNDS)

Tata Ethical Fund

Tata Ethical Fund is an open-ended equity fund which invests in an assorted equity portfolio based on the principles of Shariah. The investment design of the scheme is to arrange medium to long-term capital gains by investing in Shariah compliant equity and equity-related instruments of well-researched value and growth-oriented companies. Up to 100% investment in equity & equity Shariah Compliant listed, to be listed and unlisted securities of companies and other instruments if allowed under Shariah principles. The investment objective of the Scheme is to provide medium to long-term capital gains by investing in Shariah compliant equity and equity related instruments of well-researched value and growth-oriented companies.

Features:

- Investments in well-researched value and growth oriented companies from Shariah compliant sectors.
- Evade investments in firms involved in activities like alcoholic beverages, gaming/casinos, non halal food products and conventional financial institutional based on Riba (interest).
- Evade companies with stiffer debt to equity ratios and thereby invests in low leverage businesses.
- Purification of any prohibited income on a yearly basis as instructed by Shariah advisor.

Taurus Ethical Fund

Taurus Ethical Fund is an Open Ended Equity aligned scheme that will invest in companies which are in conformity with the Shariah norms. The scheme will first and foremost invest in Equity and Equity related instruments. The fund is actively dominated and invests in diversified portfolios. To provide capital enhancement and income distribution to unit holders through investment in a diversified portfolio of equities, which are based on the principles of Shariah.

Features:

- The investment appears only in Listed Indian stocks.

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- Uses S&P BSE 500 Shariah Index as the Benchmark Index.
- The Fund ensues into an active and disciplined investment process with sufficient risk controls.
- Actively Managed Fund.
- The fund is also open for subscription to specific overseas investors.
- Repurchase of units by the scheme.

CONCLUSION

The most remarkably distinctive feature of the Islamic economic and finance system is to get rid of *riba, gharar, maysir* and *Shariah*-impermissible businesses. Therefore, from a *Shariah* point of view, the *Shariah* investment screening processes reiterate sector and financial screening criteria to assure admissibility of the investment. In non-Muslim countries like India,In such manner, fully Shariah compliant firms are rare, most of all businesses are deals with *Riba, Gharar,Maysir* that all are prohibited in Islam. Consequently, some scholars relax some Islamic constraints, by allowing investment in companies (even if they have Shariah-impermissible activities), as long as their primary business is Shariah-permissible. However, the Shariah impermissible activities must not beat the tolerable level, and the impure income portion should be purified by giving it away to charities. Shariah compliant equity is not limited to Muslim investors but it is an investment option convenient for all communities.

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INTERNET OF THINGS (IoT) AND ITS POTENTIAL IMPACT ON ISLAMIC BANKING AND FINANCE INDUSTRY

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ABSTRACT

Advanced technologies like Block chain, internet of things (IoT's), artificial intelligence (AI), and robotics have become mature enough to create disruption in banking and finance industry both conventional and Islamic finance industry. The main purpose of this study is to investigate the potential impact of internet of things (IoT) on the Islamic banking and finance industry. The results clearly show that IoT has great potential impact on both conventional and Islamic finance industry. This potential impact is in both ways i.e. positive and negative. And, the response and reaction of Islamic finance industry towards the emergence of IoT and its potential impact seems very slow as compared to their conventional counterparts. This study has indicated important points which include the necessity for the Islamic financial institution to cope with the growth of IoT.

Keywords: IoT, Potential Impact, Islamic Banking and Finance, Opportunities.

INTRODUCTION

The present age is witnessing large scale changes in all industries and as old models are being replaced by new, the interim period is wrought with unforeseen disruptions and instability. Among the new technologies that are creating and will go on creating both disruptions and opportunities for the financial sector is Internet of Things (IoT), which will prove to be as revolutionary in nature as the World Wide Web. A better understanding of these technologies is essential for the Islamic finance sector to counter the problems that arise with them and seize the new opportunities to further their growth and development, as well as provide financial services to the 1.5 billion underbanked and unbanked to gain a strong foothold.

UNDERSTANDING IoT

IoT can be understood more easily as a concept that essentially captures the connectivity of the digital economy. It implies connecting any device with an 'on' and 'off' switch to the internet or to each other. It can be visualised as a giant network of connected things including people, by way of people-people, people-things and things-things relationships. The amount of data generated by interactions between objects in such a huge network would be staggering. It has been predicted that by 2020 the world would have around 50 billion to 75 billion, some even predict more, connected devices amounting to a global economic benefit of nearly $2 trillion. These connected objects would consist of smartphones, wearable devices, smart homes, headphones, washing machines and everything one can think of. The data available from always 'on' IoT devices can be utilized by banks as they are generated, to enable banks to act on them immediately. IoT is a reality of present times and the sooner the Islamic finance sector acts to utilize it for its benefit the better position it would be in coming times.

Banking of Things (BoT)

IoT is the interconnection of uniquely identifiable embedded computing devices within the existing Internet infrastructure. IoT is expected to offer advanced connectivity of devices, systems, and services that goes beyond machine-to-machine (M2M) communications and covers a variety of protocols, domains, and applications. In the financial services space, the interconnection of these embedded devices is expected to usher in automation in several legacy processes.

As IoT led digitization begins to take root, new business models and products are emerging. This is opening up new frontiers of innovation that can potentially reshape customer experiences, and throw up clear winners or losers in the financial services sector.

IoT has the potential to impact traditional business processes in banking such as KYC, lending, collateral management, trade finance, payments, PFM, and insurance. Coupled with other emerging technologies, such as digital identity and smart contacts, IoT can create new P2P business models that have the potential to disrupt banking in a few areas. Listed below are 12 use cases that may be adopted in banking in a time span ranging from near-term to long-term.

IoT - OPPORTUNITIES FOR THE ISLAMIC FINANCE SECTOR

Takaful: The Takaful industry can benefit from the data generated from smart homes and cars via telematics to offer customized premiums to customers based on the amount of risk or loss they can encounter derived from their usage statistics. This would also enable the Takaful Operator to be better prepared for the amount of money that would be needed by a certain individual in the future. A certain person is irresponsible and can face frequent losses while another might not be so and there is less likelihood of him suffering a major loss by means of an accident at home or a car accident. So home insurers or car insurers would be aware of the amount of damage a certain person could encounter and have funds accordingly so that they are prepared in case more than one individual suffers a loss at the same time. This would also promote a sense of justice and harmony between customers.

Payments: The Islamic finance industry is also battling with the use of credit cards which are against the Shariah. Muslim consumers are using credit card services that do not follow the Shariah standards and are prohibited. IoT offers a wonderful opportunity to deal with this situation by introducing Islamic debit cards with a certain allowance to exceed the bank balance in case of necessity based on the past account details of the customer. So a loan would immediately be granted in real time, in case of necessity based on Shariah principles instead of the individual going into the usage of a conventional credit card and falling prey to the evil of interest. This would also curb unnecessary spending and offer a kind of budgeting tool to the customers.

Retail: Consider the company Edo that offers analytics based on location to help banks offer discounts in real time. When a customer swipes his debit or credit card the IoT technology uses data to provide deals and offers from nearby merchants. Data and location based analytics can enable banks to understand the customer needs, offer them financial advice, products and services suited to their current finances and enhance their savings. This kind of analytics can also help banks to identify ATM usage and frequency and determine the optimum location for future installations based on foot traffic.

Apart from similar uses as discussed for the Islamic finance sector another example of IoT usage in the conventional financial sector is in investment banking, where it has been envisaged that high-frequency trading should not only happen in dark pools but with IoT could include storms that might delay air traffic, transatlantic shipping etc. Banks who are aware would warn the population about the impending storm and simultaneously indulge in safe investments. The data available can thus be used for all kinds of dealings. To safeguard against dubious transactions and ensure transparency, which is the cornerstone of the Islamic finance industry it is essential to be aware of the potential use cases and the impact of the new technologies. Combining IoT with blockchain would be a good initiative for Shariah principles as blockchain would bring about the needed transparency.

The opportunities are endless. The time to act is now. As a Deloitte leaflet states- "*Another major challenge will be to change the face of banking—literally. The bankers of tomorrow will be programmers who can develop algorithms and code to capture valuable data and provide useful analysis and advice to consumers.*" As Brett King, CEO and Founder of *Moven*, a mobile banking application provider and one of the world's leading FinTech commentators says-"*We need to be teaching young people coding*" and that "*Technology is changing human behaviour.*" These statements show the great emphasis that the thought leaders of the world today are placing on technology, as the coming times will be dominated by a population grown up in technology who would utilize banking services in ways starkly different from their parents.

SMART BANKS

Smartphones, smart systems, smart homes, smart cities all together would make a smart world. It is but logical that the financial sector implements the needed changes to provide smart Shariah compliant financing. A methodical and structured approach to adapt to the changing times is needed which can be understood by the following points:-

1. Recruitment of programmers with knowledge of the financial sector.

2. Incorporation of a digital department in every IFI.
3. Development of courses in Islamic finance with subjects like coding and emerging technologies as an obligatory part of the curriculum.
4. Understanding of data mining to be able to store, track, analyse and understand the vast amounts of data that would be generated.
5. Recruitment of data security experts to tackle the existing and new security threats to the digital data that would be generated.
6. Reaching out to business transformation consultants to revamp existing models.
7. Identification of employees with creative thinking for innovative ideas and review of these ideas by the entire staff for idea generation and innovation.
8. Involvement of customers and youth through an open forum for their suggestions and ideas with a reward system for the best input.
9. Having a problem resolution team that tackles all unprecedented issues arising out of the new technologies and keeps track of the changing digital trends.

CONCLUSION

These are a few suggestions that could be thought of to deal with the disruptions going on. More points can be added or subtracted as per an institution's need. What is vital is that the Islamic finance industry gets involved in the changes happening in the world by increased awareness and analysis of the potential impacts on the masses. It is time to embrace the 'Fin'-ternet of Things and grow and develop with one of the greatest technological and social shift of our times.

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RISK ASSOCIATED WITH ISLAMIC BANKING

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ABSTRACT

Islamic finance is one of the most rapidly growing segments of the global financial system. The emergence of Islamic finance can be traced back to 1963 in Egypt, while its importance comes to the global financial system only after the global financial crisis occurred in 2008. The use of financial services and products that comply with the Sharia principles cause special issues for supervision and risk management. Efficient risk management in Islamic banking has assumed particular importance as they try to cope with the challenges of globalization. This paper highlights the special and general risks surrounding Islamic banking. As the developing of managing risks tool becomes very essential especially in Islamic banking as most of the products is depending on PLS principle, so identifying and measuring each type of risk is highly important and critical in any Islamic financial based system.

Keywords: Islamic banking, Modes of Islamic, Risk in Islamic banking.

INTRODUCTION

Islamic banking is a finance management system that is based on the Islamic rules of Sharia. The main concept of the Islamic banking is the prohibition on collection of interest and its utilization for the business purposes. Banking in Islam is a saving money framework that depends on the standards of Islamic law, additionally known as Sharia law, and guided by Islamic financial matters. Two fundamental standards behind Islamic banking concepts are the sharing of benefit and misfortune. Gathering interest or Riga isn't allowed under Islamic law.

Islamic banking concepts have an indistinguishable reason from traditional managing an account aside from that it works as per the guidelines of Sharia, known as Fiqh al-Muamalat. Banking in Islam as an account exercises must be polished reliable with the Sharia and its pragmatic application through the improvement of Islamic financial aspects. A significant number of these standards whereupon banking in Islam is based are regularly acknowledged everywhere throughout the world, for quite a long time as opposed to decades. These standards are not new but rather their unique state has been changed throughout the hundreds of years.

DEFINITION

Islamic banking refers to a system of banking or banking activity that is consistent with the principles of Islamic law (Sharia) and its practical application through the development of Islamic economics. Sharia prohibits the payment of fees for the renting of money (Riba, usury) for specific terms, as well as investing in businesses that provide goods or services considered contrary to its principles (Haram, forbidden). While these principles were used as the basis for a flourishing economy in earlier times, it is only in the late 20th century that a number of Islamic banks were formed to apply these principles to private or semi-private commercial institutions within the Muslim community.

According to Islamic Banking Act of Malaysia, an Islamic bank is a "company, which carries on Islamic banking business, Islamic banking business means banking business whose aims and operations don't involve any element which is not approved by the religion Islam."

It appears from the above definition that Islamic banking is systems of financial intermediation that avoids receipts and payments of interest in its transactions and conduct its operations in a way that it helps achieve the objectives of an Islamic economy. Alternatively, this is a banking system whose operation is based on Islamic principles of transactions of which profit and loss sharing is major feature, ensuring justice and equity in the economy. That is why Islamic banks are often known as profit and loss sharing banks.

MODES OF ISLAMIC FINANCE

Murabaha

It means a sale on mutually agreed profit. It is a contract of sale in which the seller declares his cost and profit. Islamic banks have adopted this as a mode of financing. As a financing technique, it involves a request by the client to the bank to purchase certain goods for him.

Ijara

Ijara is a contract of a known and proposed usufruct against a specified and lawful return or consideration for the service or return for the benefit proposed to be taken, or for the

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effort or work proposed to be expended. In other words, Ijara or leasing is the transfer of usufruct for a consideration which is rent in case of hiring of assets or things and wage in case of hiring of persons.

Istisna'a

It is a contractual agreement for manufacturing goods and commodities, allowing cash payment in advance and future delivery or a future payment and future delivery. A manufacturer or builder aggresses to produce.

Mudarabah

It is a type of partnership where one party has the right to invest in the business and the other has the right to manage it. Any profits earned are shared between the two parties as per the profit ratio agreed during the agreement, while the financial loss is only suffered by the investor.

Musharakah

Musharakah means a relationship established under a contract by the mutual consent of the parties for sharing of profits and losses in the joint business. It is an agreement under which the Islamic bank provides funds, which are mixed with the funds of the business enterprise and others.

Bai al-Salam

This term refers to advance payment for goods which are to be delivered later. Normally, no sale can be affected unless the goods are in existence at the time of the bargain. But this type of sale forms an exception to the general rule provided the goods are defined and the date of delivery are fixed.

RISKS IN ISLAMIC BANKING

Islamic banks carry different types of risks, some of them exists only on any Islamic banking. And others are common between both Islamic and conventional banks.

Credit Risk

Credit risk is the loss of income arising as a result of the counterparty's delay in payment on time or in full as contractually agreed. Such an eventuality can underlie all Islamic modes of finance. For example, credit risk in murabaha contracts arises in the form of the counterparty defaulting in paying the debts in full and in time. The non-performance can be due to external systematic sources or to internal financial causes, or be a result of moral hazard (wilful default). Wilful default needs to be identified clearly as Islam does not allow debt restructuring based on compensations except in the case of wilful default. In the case of profit-sharing modes of financing (like mudaraba and musharaka) the credit risk will be non-

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payment of the share of the bank by the entrepreneur when it is due. This problem may arise for banks in these cases because of the asymmetric information problem where they do not have sufficient information on the actual profit of the firm.

Market Risk

Market risks can be systematic, arising from macro sources, or unsystematic, being assertor instrument-specific. For example, currency and equity price risks would fall under the systematic category and movement in prices of commodity or asset the bank is dealing with will fall under specific market risk.

Mark-up Risk

Islamic financial institutions use a benchmark rate to price different financial instruments. For example, in a murabaha contract the mark-up is determined by adding the risk premium to the benchmark rate (usually the LIBOR). The nature of a murabaha is such that the mark-up is fixed for the duration of the contract. Consequently, if the benchmark rate changes, the mark-up rates on these fixed income contracts cannot be adjusted. As a result Islamic banks face risks arising from movements in market interest rate. Markup risk can also appear in profit-sharing modes of financing like mudaraba and musharaka as the profit-sharing ratio depends on, among other things, a benchmark rate like LIBOR.

Commodity/Asset Price Risk

The murabaha price risk and commodity/asset price risk must be clearly distinguished. As pointed out, the basis of the mark-up price risk is changes in LIBOR. Furthermore, it arises as a result of the financing, not the trading process. In contrast to mark-up risk, commodity price risk arises as a result of the bank holding commodities or durable assets as in salam, ijara and mudaraba/musharaka. Note that both the mark-up risk and commodity/asset price risk can exist in a single contract. For example, under leasing, the equipment itself is exposed to commodity price risk and the fixed or overdue rentals are exposed to mark-up risks.

Liquidity Risk

Liquidity risk arises from either difficulties in obtaining cash at reasonable cost from borrowings (funding liquidity risk) or sale of assets (asset liquidity risk). The liquidity risk arising from both sources is critical for Islamic banks. For a number of reasons, Islamic banks are prone to facing serious liquidity risks. First, there is a fiqh restriction on the securitization of the existing assets of Islamic banks, which are predominantly debt in nature. Second, because of slow development of financial instruments, Islamic banks are also unable to raise funds quickly from the markets. This problem becomes more serious because there is no

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inter-Islamic bank money market. Third, the lender of last resort (LLR) provides emergency liquidity facility to banks whenever needed. The existing LLR facilities are based on interest, therefore Islamic banks cannot benefit from these

Operational Risk

Operational risk is the risk of direct or indirect loss resulting from inadequate or failed internal processes, people, and technology or from external events. Given the newness of Islamic banks, operational risk in terms of personal risk can be acute in these institutions. Operation risk in this respect particularly arises as the banks may not have enough qualified professionals (capacity and capability) to conduct the Islamic financial operations. Given the different nature of business, the computer software available in the market for conventional banks may not be appropriate for Islamic banks. This gives rise to system risks of developing and using informational technologies in Islamic banks.

Legal Risk

Legal risks for Islamic banks are also significant and arise for various reasons. First, as most countries have adopted either the common law or civil law framework, their legal systems do not have specific laws/statutes that support the unique features of Islamic financial products. For example, whereas Islamic banks' main activity is in trading (murabaha) and investing in equities (musharaka and mudaraba), current banking law and regulations in most jurisdictions forbid commercial banks undertaking such activities. Second, non-standardization of contracts makes the whole process of negotiating different aspects of a transaction more difficult and costly. Financial institutions are not protected against risks that they cannot anticipate or that may not be enforceable. Use of standardized contracts can also make transactions easier to administer and monitor after the contract is signed. Finally, lack of Islamic courts that can enforce Islamic contracts increases the legal risks of using these contracts.

Withdrawal Risk

A variable rate of return on saving/investment deposits introduces uncertainty regarding the real value of deposits. Asset preservation in terms of minimizing the risk of loss due to a lower rate of return may be an important factor in depositors' withdrawal decisions. From the bank's perspective, this introduces a 'withdrawal risk' that is linked to the lower rate of return relative to other financial institutions.

Fiduciary Risk

Fiduciary risk can be caused by breach of contract by the Islamic bank. For example, the bank may not be able to comply fully with the shari'a requirements of various contracts.

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Inability to comply fully with Islamic shari'a either knowingly or unknowingly leads to a lack of confidence among the depositors or hence causes withdrawal of deposits. Similarly, a lower rate of return than the market can also introduce fiduciary risk, when depositors/investors interpret a low rate of return as breaching an investment contract or mismanagement of funds by the bank.

Displaced Commercial Risk

This is the transfer of the risk associated with deposits to equity holders. This arises when, under commercial pressure, banks forgo a part of their profit to pay the depositors to prevent withdrawals due to a lower return. Displaced commercial risk implies that the bank may operate in full compliance with the sharia requirements, yet may not be able to pay competitive rates of return as compared to its peer group Islamic banks and other competitors. Depositors will again have the incentive to seek withdrawal. To prevent withdrawal, the owners of the bank will need to apportion part of their own share in profits to the investment depositors.

CONCLUSION

Islamic banks face various types of risks due to the nature of their balance sheet and sharia compliance. Non-availability of financial instruments to Islamic banks is a major hindrance in their way to manage market risks as compared to the conventional banks. This paper analyzes the various types risks related with Islamic banks. The obligations of Islamic banks towards depositors (investment account holders) are different from those of conventional banks and hence they face different risks. Islamic banks still may face extra risks because of the complexity of Islamic modes of finance and limitations in their funding, investment and risk management activities. On the other hand, customers of Islamic banks are expected to be more concerned about their religious beliefs.

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ACHIEVING INCLUSIVE GROWTH IN INDIA THROUGH ISLAMIC BANKING

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ABSTRACT

The Indian economy is growing, but paradoxically the proportion of poor people is also increasing. The country must strive to create an equal society. However, most Indian citizens do not have access to credit. The current banking system does not help protect the interests of all parts of the population. The Islamic banking system under Islamic law (Sharia) has been institutionalized in many parts of the world over the last few decades. Islamic banks share risk between borrowers and borrowers based on partnership, co-ownership, leasing and sales mechanisms in a real asset-based interest-free banking system. Unlike existing banks that trade money with interest as their primary commodity, money is only considered as a means of exchange. Islamic banks have the potential to improve vulnerable groups such as farmers and small and medium-sized enterprises (SMEs), which can promote acceptable economic growth. In addition, there is a strong claim that interest-free finance can attract investment in the Gulf region. Finally, it provides the impetus for the socialist goals envisioned by the Constitution. There are several studies, including the 2008 Planning Committee report, which favors Islamic banks in India. It is impossible to build such a banking system with the current legal system, except for the rationale and the opposite of its behaviour. But recently, the trend in India is to encourage religious law to develop the goals of secular law. In this context, the Kerala High Court upheld the constitutional validity of Islamic finance in the Kerala & Ohers state case of Dr. Subramaniam Swamy. Attempts have been made to verify the validity of Islamic banks.

Keywords: *Financial Inclusion, Islamic Banking;Islamic Finance, Inclusive* Growth

INTRODUCTION

Under the scheme of distribution of wealth, the State should ensure the supply of basic necessities to all citizens, and must also give them an opportunity for achieving the highest possible perfection to their respective aptitude. However, even the prosperous countries of the world failed to achieve this goal. A slight concentration of wealth in the hands is a hallmark of all societies. Several mechanisms exist by which resource accumulation inequality can occur. The interest-lending process is one of the most notorious tools ever developed by man to create the gap, but it is institutionalized to an unavoidable degree in the functioning of the economy as part of its day-to-day transactions. However, the theory of interest, however, does not convincingly justify the payment of interest. The central argument of most theorists is that concern is the reward for the painful act of saving or giving up present gratification. Or some argue that capital deserves a reward because it is productive in the sense that land produces crops. It's important to note that in general, people don't struggle with saving at the expense of basic necessities, but in real life savers are wealthy.

The second discussion does not take into account that the loan, along with interest, is allocated for the purchase of a house or car, as well as for productive purposes. Therefore, it does not apply to consumer loans. In fact, less than 2% of wealth is used for production purposes, with the rest being used for derivatives, consumer credit, and asset price bidding. The traditional banking system replaced by political colonies and economic colonies is one of them. The main player's in this regard. In countries like the UK, 97% of money comes from banks. It became clear that only 3% of the total money was in debt and the rest was debt-rich with no real thing. The interest system is legally done through banks, and the privilege of creating credit adds insults for injuries. In short, a complete money factory has developed in the form of a bank that concentrates on the central part for the past 400 years or so. The two basic flaws in understanding the setting of money are:

Banking institutions are only an intermediary between borrowers and the perception that money is limited. The Islamic Banking system can be considered in place of a country like India, with an atmosphere of widespread unequal distribution of departments. The purpose of this treatise is to promote constitutional commands in a better way, above all, to track the rationale for experimenting with Islamic banks in India, and in some respects compare traditional banks with Islamic banks.

How Islamic Banks Operate the Islamic banking system prohibits interest transactions and backs business operations with real assets, so lenders and borrowers share the risk. We consider money to be an intermediary for exchange, unlike traditional banks that are traded as commodities. Apart from this, banks cannot carry out certain transactions such as mainstream business, speculation or gambling in Shariah. In general, Islamic banks agree to Shariah's basic principles and operate on these principles. However, in actual work, it may occasionally differ due to variables such as national law, banking objectives, and requirements for interaction with existing banks. Islamic banks have three types of accounts, Checking accounts or deposit accounts, investment accounts and savings accounts. Islamic bank checking deposits are similar to traditional bank checking deposits. The investment account is not capitalized and investors agree to share profit or loss at a pre-agreed rate. Finally, the savings account is operated in several ways.

In some systems, the initial deposit is guaranteed and profits are shared, in some cases the bank is treated as an investment account without securing capital, and the bank invests only in the risk free project. Therefore, depositors get lower yields. Islamic banks also offer services such as money transfers and bill collection. The traditional method of the Islamic trading system still dominates banking transactions, trade-based (buyer-seller relationships and co-ownership), lease-based (lesser relationships) and stock-based (joint venture relationships with partnerships). Can be broadly classified into trade based and rental based. These modes also consist in the form of Islamic bonds (Sukuk) and Islamic insurance (Takaful).

Partnership: Three types of partnerships are recognized. The first is "Musharaka", which literally means to share. In this type of partnership, two or more people agree to share the profit or loss in a certain proportion, and the principles of other general partnerships apply. Another form of partnership is called "mudarabah". In this case, one partner invests the capital (Rabbulmal), the other (Mudarib) applies his entrepreneurial abilities and efforts and has the exclusive responsibility for the work. Banks enjoy both places. A bank is an entrepreneur who receives deposits, and if it invests, it is an investor. In the third form, entrepreneurs invest a small amount of capital and are combined with no shale car like no dull in transactions that apply their management skills. In addition to benefiting from entrepreneurial technology in these types of transactions, entrepreneurs may be eligible to benefit from a certain percentage of their investment. Parties are free to agree on the rate of return The rate of return of a sleeping partner must not exceed the rate of return.

Sales: Sales are also divided into three categories. A common type of sale is called "Murabahah". In a Murabahah transaction, the seller exposes the actual cost, including the freight and tariffs of the item, to the buyer and gives the purchaser an item with a certain profit (profit may be a lump sum or a percentage) added to his cost. I agree to provide. Commonly referred to as a "cost plus" transaction. Murabahah's transactions are conducted in three stages. First, the bank and the customer enter into a contract whereby the former strives to sell the product at a certain profit and the latter agrees to purchase the same. Next, a customer who has purchased a product from a vendor by a bank applies for a purchase

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Alternatively, the client purchases from a supplier on behalf of the bank and acts as a mere fiduciary or agent of the bank and ownership reverts to the bank. Finally, the transaction is completed upon execution and acceptance of the proposal. Therefore, the bank must have ownership of the subject of the transaction and must have actual or constructive ownership. Murabahah transactions must comply with certain rules and are mostly similar to regular sales.

In connection with the subject, Murabahah can be used when a customer needs funds to actually purchase some goods, paying the price of the goods already purchased, paying electricity bills or employees It can be used for other purposes such as employee salary. In addition, Murabahah has real or intrinsic value that occurs only in existing merchandise, not in future merchandise, and the merchandise can be measured in currency. Murabahah should be used for raw materials, inventory, equipment, asset loans, import loans, export loans (shipments), consumer goods loans, mortgages, car loans, land loans, shop loans, short-term / medium-term / long-term finance for tourism. In connection with collateral and guarantees, banks require customers to provide collateral in the form of mortgages, hypotheses, detention rights or fees. Security could be more than the theme of Murabahah itself or the value of the theme. Alternatively, banks may require a third-party guarantor. Banks also sometimes acquire checks or promissory notes from clients later. Also, that products are purchased from third parties is a necessary condition for Murabaha's effectiveness. Sharia does not allow customers to purchase products under "repurchase" agreements. The purchaser may not raise the price without payment until the agreed-upon date. Buyer is obligated to pay the maximum amount for charitable purposes if the purchaser has entered into the contract, and the amount so recovered does not form part of the bank's revenue and is used for the charitable purposes of which bank has maintained another copy

The second type of sale is called "baisalam" and actually excludes Murabahah. This category strives to supply a particular product to the bank one day in the future when the seller is paid in full. The reason this kind of sales is introduced is to meet the needs of farmhouse imports, exports. You can sell your product in advance. Farmers may need money to grow crops until harvest and support their families, and import and export money because it usually takes months for them to realize the cash for their sale. Salam is useful to everyone involved. The seller recognizes the cash immediately and the bank can buy it at a lower price. The difference between the two prices is the bank's profit. Under the prerequisites, the bank must pay the full amount at the time of sale in order to avoid any debt obligations arising in the case of some payments meeting the seller's immediate requirements. Also, certain commodities or products from certain fields or farms cannot be subject to Salam because unexpected things happen. Also, if the item must be of quality and quantity, it does not have to belong to the group where Sharia demands immediate shipment. Banks can benefit from Bai Salam's contract in two ways. First, the product may be sold at "Parallel Salam". In this mode, the bank enters into two separate contracts with two others. A bank is a buyer from one contract (Salam contract) and sells under another contract (parallel Salam contract), and the two contracts are independent of each other. The difference in price between the main salam and the parallel sallam is the bank's profit. Second, the prospective buyer does not have to pay the price in advance, because the bank makes a one-sided promise to buy from a third party, and if it is a simple promise to fix a higher price. The third form of sale is called "Istina" and is the second exception to Murabaha. This is a kind of selling in which a company strives to produce a specific product for the buyer, taking into account a specific price. Istisna's subject must be manufacturable. Work may be terminated at any time by either party giving notice to the other prior to commencement of work. Even if you don't have an exact delivery date, it's enough just to check the maximum period for which the manufacturer will deliver the product. Penalty clauses may be added to the contract to ensure on-time delivery.

Istisna can be used to build houses, legs or highways where banks can build houses for their customers through agents or by entering into Parallel Salam contracts with third parties. In both cases, the bank calculates the cost and fixes the price so that it can give a reasonable profit. Contracts for payment can be agreed by the parties in any way, including payment at the time of delivery or payment in instalments. The bank can keep a proof of ownership of the property as collateral until the final allocation is paid.

Rent Islamic leases are lexicographically called "Ijarah" which means to provide something for rent. In the present context, ijarah refers to an asset or usufruct (profit) of an asset and refers to the transfer of usufruct over a period of time in exchange for a specific rent or price. The terms and conditions of a valid lease are the same as for a regular rental. Some banks, especially in Western countries, have leased facilities to customers instead of offering bearing loans. The bank calculates the total cost of the asset's purchase, adds the stipulated interest it is likely to charge, and converts the latter into monthly rent for the duration of the lease.

Co-ownership is called "reduced musharakah". In this mode, the bank and the client enter into a joint ownership of the property. The share of the property is divided by the number of units, and the client regularly purchases units from the bank one by one, increasing his share

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until all units are purchased and makes him sole proprietor. The procedure for reducing Musharakah is as follows:

Step 1 - The first step is to create a share of the property.

Step 2 - Bank provides market share in client rent.

Step 3 - The client's promise to purchase a unit of bank stock and pay the rent.

Step 4 -Actually buys and pay rent for multi-stage units depending on the percentage of shares in the real estate bank.

Step 5-The transaction is complete when the customer pays for the entire bank.

Used for main housing finance. For example, suppose a customer wants to buy a house worth 10 million rupees and he only has 1 million rupees. So he can only afford 10% of the actual value of the house. That is, 10% of the amount is paid by the client and 90% of the amount is paid out by the bank. In the initial stage, the customer owns 10% of the house, the bank owns 90% of the house, and the bank's share is divided into nine equal units. Each represents 10% ownership. Current customers commit to buying 1 unit per year and also to pay rent at a percentage of the bank's share that continues to decrease each year. If you consider the rent, it's rupees. 1000 per year at the end of the first year, the client has to pay Rs. 900 for rent and rupees to the bank. From 1/10 of the price of a house to 10,000 rupees. The client's share increased by 10%, he owns 20%, and the bank's share is from 90% to 80%. Similarly, in the second year, the client pays 10% ownership and Rs again 10,000 rupees. 800/ as rent as the bank owns only 80% of the shares in 2 years.

The process then ends up with the customer buying shares of the entire house nine years later, which makes the customer the sole owner and once the transaction is complete, rents to a further bank. No need to pay. This means that the bank can charge the rent according to the ownership ratio and at the same time can return the principal on a regular basis. Therefore, from a banking perspective, Islamic financial methods can be divided into fixed returns and variable rates of return. Electronic includes sales and rental, the latter consists of partnerships and co-ownership.

Reasons for introducing Islamic banking in India Although India has never experienced an Islamic banking system, Islamic banking has been experimented with from time to time by non-banking financial institutions, and Shariah complaint products are also offered by the company. But lately, some have been doing their best to spread the idea of Islamic banks. It is interesting to note that some of the early studies on Islamic finance from a global perspective belong to scholars from the University of Osmania in Hyderabad and Allahabad University in Uttar Pradesh.

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Inclusive Growth With a fair distribution of wealth, India's economy is growing significantly, and the financial sector's share of gross domestic product (GDP) has been increasing recently. But as poverty continues to rise, it is supporting the business sector more than most of the population living below the poverty line. The expansion of commercial banks' debt finance and the interest rate sensitivity of inflation are well known. Islamic banks, unlike traditional banks, encourage equities and finance to support fair distribution of income. This actually helps to promote negative concentration. In the current situation, providing collateral is an important criterion for making money, so you can request a loan only for the rich. If the entrepreneur (borrower) makes a profit, he is to give the smaller percentage to the bank, and the bank is to give the smaller percentage to the saver (depositor).

The cost of the goods includes the amount of interest paid to the bank. This means that the saver will have to pay interest to purchase any product, since interest is included in the cost of production. It is not beneficial to the average person. This riddle can be explored with the help of the following picture. The situation of the total number of depositors can be explained in the case of only one depositor, since all depositors are depositing in the same banking system operated across the country.

FINANCIAL INCLUSION OF MUSLIMS

The Sachar Commission report, which includes Muslim finance, noted the importance of credit access for individuals, households and businesses for consumption, production and investment purposes. A committee investigating the socio-economic status of Muslims in India compared to other ethnic minority communities has shown that Muslims are a disadvantaged community in the financial sector. According to the Commission report, Indian Muslims have a 7.4% share from their savings account and get 4.7% of their credit (in terms of priority sector prepayment). Compared to the standard ratio of deposits and credits stated in the 200708 RBI Annual Report, Indian Muslims lose about Rs per year. 63.7 million won. Similarly, according to a survey conducted by Reliance Money, 35% of Muslims live in urban areas, 80% of whom live because of illiterateness, ignorance or faith. Do not use banking facilities at the end, which play an equally important role. Another study found that 80% of Muslims in Indian cities are willing to deposit or invest in Islamic financial institutions based on profit / loss sharing. 67% of Muslims in Indian cities intend to borrow from Islamic financial institutions on a profit / loss basis.

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The current system has paved the way for exploiting and deceiving Muslim funds. Some Muslims have not invested in profit-based organizations. Financial institutions have been set up in NBFC to manipulate Islamic funds. In the current scenario, Muslims could be victims of such cunning people or invest in unproductive investments such as buying real estate. Or you can keep your money idle at home and wait for the monetary value to drop every minute. Thanks to inflation. This impedes Islamic savings mobilization and impedes economic growth. Islamic banking could be the solution. In this regard, the time has come for India to introduce it, as the 2005 RBI report describes it as an attractive offer for interest-free banks to acquire global currencies. 1.2.1.3. The uplift of peasant agriculture is still the mainstay of the Indian economy to serve as a basic livelihood for over 50% of Indian workers. These workers have had to sustain the growth rate of the service sector, but the developing world has a suicide economy for them. According to BBC News, 200,000 farmers have committed suicide in India since 1997. Aside from the threat of globalization, the main reason for this tragic end of life is not paying interest-heavy debts. For improvement, an interest-free scheme may play a big role. In this regard, Islamic products such as Baisaramu and Istisna may be used for the benefit of farmers.

Porter's Five Forces Model is a business strategy consisting of five forces dealing with external and internal forces to ascertain the intensity and attractiveness of business competition. In other words, it uses the power to serve customers and ensure the feasibility of a project of the ability to profit.

i) Customer bargaining power - What is the nature of the customer's ability to put pressure on the business?

ii) Supplier's bargaining power - How strong is the seller's position? Are there many potential vendors, or only a few potential vendors or monopolies?

iii) Competition between existing players - Is there fierce competition between existing players? One player is very dominant, they are all equal in strength and size.

iv) Threat of Substitutes - How easily can a product or service be substituted?

v) Immigrant Threat –

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CONCLUSION

The current banking system maintains the tempo of wealth concentration by replacing the historical role of money as a mere commodity as the judge of the product. It's not encouraging most people, it's protecting the vested interests. Besides, for the economy as a whole, it's not a healthy strategy because it encourages the public to use it beyond their means. Therefore, the national debt burden continues to increase day by day. We live in a land of paradoxes. One of the purposes of policies and legislation is to eradicate poverty by promoting equitable and sustainable economic growth. The paradox exists for constitutional purposes of fair distribution of wealth and exploitative banking. As it repeats, justice calls for active action to elevate the vulnerable class, but paradoxically, the better go up the ladder and the worst go down. This is possible if all rights to the bargaining power of the supplier are not being properly granted or exercised. There is a shortage of particularly expert staff on the low. Indians will certainly enter this industry Threat of immigrants: low chances of new entrants right now as it is a very niche product in the context of India. Alternative Threat: Islamic finance under NBFC is the only option, as low-remaining financial institutions are interest-based. Customer Bargaining Power: Usually firmly Islamic customers certainly use Islamic banks, but liberals are still trading on the basis of existing banking transactions. For fixed income Muslim customers have a choice other than willing to take risks on the stock market and investment trusts, but people with a traditional approach prefer to deposit in existing banks.

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ISLAMIC MICRO FINANCE AS A TOOL FOR FINANCIAL INCLUSION AND WOMEN EMPOWERMENT

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ABSTRACT

Micro Finance play a vital role to improve the socio-economic condition of woman force by developing thrift benefit and providing microfinance in times of need and also encouragemicroentrepreneurs.Womenthebasisunitinthefamilya ndsheisshouldering all most the responsibilities in the family. In any program of economic empowerment through zakah, satisfying immediate basic needs of the poorest of the poor must always be accorded top priority. Zakah funds may also be provided as start-up capital for their micro-enterprises. The study focus on Measuring the role of Islamic Micro finance and self-help group in financial inclusion and also examine the benefit derived by the member of Self-help group. The paper also intend to analyse the level of satisfaction on the financial service among the units. Through financial inclusion we can achieve equitable and inclusive growth of nation.

Keywords: *Microfinance, Islamic Microfinance, Women Empowerment, Zakah Funds*

INTRODUCTION

Micro Finance is an important tool which is eradicates poverty and empowers women. The overall empowerment of women is closely leaked to economic empowerment. One of the potential benefits of microfinance in Muslim societies is the empowerment of Muslim women. While the ability of microfinance institutions to deliver financial services to rural women in gender-segregated societies is commendable, working with Muslim women is a sensitive issue that often raises accusations of meddling with social codes. Some Islamic microfinance (IsMF) institutions seek to overcome this through a shift in their focus from "women empowerment" to "family empowerment". In a few other IsMF programs, a culturally appropriate way has been found of empowering women through gender-segregated ownership of the financing entity and involving separate appraisal of loan applications by women who develop their own gender sensitive products and strategies for the future. One may note here that apart from weakening the institution of family, the "women only" approach of a few flagship microfinance institutions is fraught with grave risks.

In traditional male-dominated Muslim societies the funds provided to women end up with the male members in the family while the women themselves end up carrying the business and financial risk. In this paper we discuss the Islamic approach and its various institutions and instruments to address the challenge of poverty. Predictably, safety nets cost-less financing and skills improvement targeted at the "economically inactive" assume greater significance in the Islamic scheme of poverty alleviation. Women through self-help group work on a range of issues such as health, nutrition, agriculture etc. Besides income generation activities and seeking microcredit.

REVIEW OF LITERATURE

Pallavi Chavan and BhaskarBirajdar2010:"Microfinance and Financial Inclusion of women: An Evaluation: Financial inclusion has been defined as the "provision of affordable financial services" to those who have been left unattended or under-attended by formal agencies of the financial system. These financial services include payments and remittance facilities, savings, loan and insurance services. Micro finance has been looked upon as an important means of financial inclusion in India. The observations made in this note reflect the considerable scope for micro finance to evolve as a means of financial inclusion that is accessible and affordable for the excluded groups/regions and that can help loosen the grip of informal sources of finance and bring the excluded sections permanently into the ambit of formal finance.

Guha and Gupta2005: Microfinance should be considering linking vehicle between financial inclusion and improving standard of living. There should be deliberate platform to improve the income and earning of the member through participative productive activities.

K. Manoharan Nair and Girija B 2005:"Micro Finance – The New Development Paradigm for Poverty Eradication and Women Empowerment" states that experience has shown that many of the poverty alleviation programmers through organized credit channels have not achieved the required success. Hence to bridge the gap between the demand and supply of funds in the lower rungs of rural economy, the micro finance schemes of NABARD have made a smooth foray into the role played by micro finance in eradicating poverty and

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empowering women to manage the enterprises.

Meenakshi Malhotra 2004:"Empowerment of Women" deals with the issues leading to empowerment of women with particular reference to rural women. Volume one deals with issues like gendering qualities in labor market and in entrepreneurship. Volume two focuses on micro finance options for women empowerment. It looks into micro credit schemes for rural women and microfinance movement in India. Third volume describes the various programmers introduced to empower women and bring the min to the orbit of development network.

OBJECTIVES OF THE STUDY

- Measuring the role of Interest free Micro finance in financial inclusion
- To analyse the features of Islamic micro finance
- To examine the benefit derived by the member of Self-help group.
- To examine the level of satisfaction on the financial service among the units.

RESEARCH METHODOLOGY & DESIGN

The study conducted in valanchery municipality, focused on the women members of micro finance and self-help group. It is descriptive in nature and is based on primary and secondary data. Primary data were collected from the members through questionnaire. Secondary data were collected from websites, books, journals, etc. A sample size of 50 members was selected for the study through random sampling method. This study is based on convenience sampling method. The period of the study consist of 3 weeks (21days). Percentage bar diagram, Pie diagram and bar diagram used to depict the results.

LIMITATIONS OF THE STUDY

- The reliability of the study in restricted to the data provided by the respondents.
- Sample study is based on 3 wards and hence the findings cannot be generalized.
- The cooperation of respondents is very much required for a survey based research.

SPECIAL FEATURES OF ISLAMIC MICRO FINANCE

Economic Empowerment

While Islam strongly encourages charity from the giver's point of view, it seeks to minimize dependence on charity from the beneficiary's point of view and restricts the benefits to flow to the poorest of poor and the destitute, which are not in a position to generate any income and wealth. Micro finance demonstrates how to design and implement a strategy of poverty alleviation through economic empowerment. .

Charity

Charity occupies a central position in the Islamic scheme of poverty alleviation. The broad term for charity in Islam is sadaqa. When compulsorily mandated on an eligible Muslim, sadaqa is called zakah. When sadaqa results in flow of benefits that are expected to be stable and permanent (such as, through endowment of a physical property), it is called sadaqa jariya or waqf. Zakah is the third among five pillars of Islam and payment of zakah is an obligation on the wealth of every Muslim based on clear-cut criteria.

Rules of Shariah are fairly clear and elaborate in defining the nature of who are liable to pay zakah, at what rate zakah must be paid and who can benefit from zakah. The primary issue with a zakah or sadaqa-based solution to the challenge of poverty is the issue of sustainability. These zakah funds are meant mostly for the extremely poor and function as a safety net for meeting their immediate and basic needs. Benefits from waqf assets are of course, meant to flow to the community at large and also on a sustainable basis.

Debt Avoidance

Islam permits debt. However, it recommends debt only as a last resort and not as a means to finance one's growing lifestyle needs. Muslims are warned against extravagance. Muslims are also warned against the dangers of incurring heavy debt. The Prophet Muhammad used to regularly supplicate "Allah, I seek refuge with you from sin and heavy debt". When someone remarked, "how often you seek refuge from heavy debt", he replied, "when a man gets into debt, he speaks and tells lies, and he makes a promise and breaks it" (Bukhari and Muslim)

Co-operation

Mutual co-operation and solidarity is a norm central to Islamic social behavior and collective ethics. The holy Quran says: "Assist one another in the doing of good and righteousness. Assist not one another in sin and transgression, but keep your duty to Allah" A hadith by the Prophet reinforces the principle of co-operation and mutual assistance. "Believers are to other believers like parts of a structure that tighten and reinforce each other." (Al-Bukhari and Muslim) Following the above, an Islamic basis may be provided in favor of equity and partnership-based financing rooted in cooperation in contrast to debt based financing. Islam discourages debt. While Shariah-compliant debt-based modes are permissible, equity-based modes of financing are clearly preferred.

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Family Cohesiveness

Islam gives utmost importance to family as nucleus social institution that plays a major role in shaping the future of mankind. It also sees a balanced role for men and women in ensuring the economic and social well-being of the family. The Quran declares that all human beings are created in pair. "And everything have we created in pairs that you may reflect" As stated earlier, the "women only" approach to micro enterprise development and poverty alleviation is alien to Islamic religion and culture. The Quran promotes the concept of "family empowerment" by exhorting men and women to play their respective roles in seeking economic and social well-being of all members of the family.

Zakah and Economic Empowerment

The primary objective of zakah is to pull a Muslim out of economic distress by providing for his/her basic needs. Basic needs by definition are recurring in nature. It is therefore, pointed out by some that zakah proceeds must aim for economic empowerment and not for meeting their immediate consumption needs. The latter may indeed encourage dependence and make the poor permanently dependent on zakah. Financing of micro enterprises resulting in drying up of funds for meeting immediate consumption needs of the poorest of the poor.

Economic empowerment and meeting basic consumption needs need not be mutually exclusive. In any program of economic empowerment through zakah, satisfying immediate basic needs of the poorest of the poor must always be accorded top priority. In a subsequent phase, the beneficiaries may be made to go through skill-improvement programs through meeting their cost of education and training with zakah funds. Zakah funds may also be provided as start-up capital for their micro-enterprises either in the form of outright grants or loans (qard hasan) or micro-equity without expectation of returns depending upon the degree of their vulnerability. This would enable the poor to generate a sustainable means of livelihood and transform them from the category of zakah recipients (mustahiq) into that of zakah payers (muzakki). Such ambitious poverty alleviation and economic empowerment projects through efficient collection and distribution of zakah can be undertaken by the state or a not-for profit organization like Zakah Fund.

FINANCIAL INCLUSION

Financial services are the economic services provided by the finance industry which encompasses a board range of business that manage money including credit union, banks credit card companies and some government sponsor enterprises etc. But these financial inclusion is to end the scope of activities of the organized financial system include within its

Ambit servicesarenotaccessibleforruralpeople.Theobjectiveoffinancialinclusion is to extend the scope of activities of the organized financial system include within its Ambit people with a low incomes.

Financial inclusion has become an essential part of economy for development of the society as economy of the nation. Through financial inclusion we can achieve equitable and inclusive growth of nation. Weaker section that lack to access to even the most basic banking system. An inclusive financial system is necessary to reduce informal financial system where people borrow money from neighbors, relatives and village money lenders. By paying high rate of interest in the rural areas, large number of population does not have it. Interest Free Micro Finance, Self Help Group (SHG) and SHG bank linkage program help extensively to strengthen the poor especially womenfolk.

Micro Finance play a vital role to improve the socio economic condition of woman force by developing thrift benefit and providing microfinance in times of need and also encourage micro entrepreneurs. In the independence period so many laws and legislation were implemented for the development of women by the effort of social reforms.

To put in one simple sentence, the specific objective of Women empowerment, and the eradication of absolute poverty from the State of Kerala, obviously the task ahead is not as simple as the sentence sounds. The means, approach and methods for the realization of the goal are of paramount importance. To attain the goal, the holistic development of the poor families through self-help, people's participation and group action should be achieved. This is sought to be achieved through the following measures.

- Identification of the poor families through risk indices based surveys, with the active participation of the poor and the communities to which they belong.
- Empowering the poor women to improve the productivity and managerial capacities of the community by organizing them into Community Based Organizations (CBOs).
- Encouraging thrift and investment through credit by developing CDSs to work as informal banks of the poor.
- Improving incomes of the poor through improved skills and investment for self-employment.
- Ensuring better health and nutrition for all.
- Ensuring basic amenities like safe drinking water, sanitary latrines, improved shelter and healthy environment.
- Ensuring a minimum of 5 years of primary education for all children, belonging to risk

families.

The very motto of self-help group is based on women empowerment; reach out to the family through women, reach out to the community through family ".Naturally, the empowerment of women through community-based organizations is counted as the first and for most objective of the mission.

a. Empowerment of Women through Community Based Organizations.

Status of women in the society is still secondary and their role in developmental process is deplorably marginal. The Program proposes to enable and enlighten the women to realize their own latent potentials, and strengthen them to contribute to the development of their families and community. Improved economic status of the women gained through CDS thrift and self-employment will boost their status in their own families and community.

b. Thrift and Credit Operations and Informal Banking

The system will promote thrift habit among the poor women and encourage them to use the pooled resources to meet the immediate needs of the members. The CDS will therefore start functioning as informal bank of the poor women. If the resources in any NHG are enough to encourage loan for income generating activities, these loans will be appraised and sanctioned.

c. Decision Making by the Poor

Kudumbashree mission believes in encouraging community-based bottom up planning. The ultimate aim is to hand over the decision-making and implementation power to the empowered women. ,

d. Convergent Community Action

Apart from the latent potential and will of the community itself, initiatives, resources, programme and commitment of various governmental organizations, non-governmental organizations and local governments are expected to converge through this system. Social Welfare Programme directed at poor in the areas of education, literacy, health, human resources development, empowerment of women, skill up gradation, vocational training, eradication of social evils, environmental improvement and such other areas will be implemented through the system.

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ANALYSIS AND INTERPRETATION

Table 1

AGE WISE CLASSIFICATION OF RESPONDENT

Factor	No of respondents	Percentage
30-40	20	40
40-50	10	20
Above50	6	12
TOTAL	50	100

From the above table it is clear that 28% respondent are below 30 age group 40%respondent are the of between 30-40 20% of respondent are between 40-50 age groupand the remaining 12%respondent areabove50agegroup.

EDUCATIONAL QUALIFICATION

Table 2

EDUCATIONAL QUALIFICATION

Factors	No of respondents	Percentage
Below SSLC	3	6
SSLC	8	16
Plus two	9	18
Under graduation	20	40
Post graduation	10	20
TOTAL	50	100

Above data reveals that the 6% of numbers have below SSLC, 16% of members have SSLC education 18% have plus two, 40% of member's under graduation and 20% members post-graduation.

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OCCUPATION OF RESPONDENTS

Table 3

OCCUPATION OF RESPONDENTS

Factors	No of respondents	Percentage
Occupation	4	8
Professional	14	28
Agriculture	6	12
Self employed	10	20
Housewife	16	32
TOTAL	50	100

FINANCIAL INCLUSION

Table 4

FINANCIAL INCLUSION

Options	No of respondents	Percentage
5	31	62
4	13	26
3	4	8
2	1	2
1	1	2
TOTAL	50	100

From the above table it is clear that 62% respondent rated 5, 26% respondent rated 4, 8% respondent rated 3, 2% respondent rated 2.

FINDINGS

- The majority of respondents (40 percent) belong to the age group 30-40
- Education-wise Qualification reveals that 40% of the respondents have under graduate.
- As to occupation 32% of the respondents are house wife's, 28% of the respondents followed by profession, the remaining respondents are of 20%self-employed and12% agriculture.
- It is observed that majority of the respondents (96%) have a bank account.

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- The awareness of members about the service providers among the selected respondents Shows that members having education Degree & above have better awareness.
- The awareness of members about the usage of various financial products and service Among the selected respondents shows that members having education Degree & above And self-employed have better awareness.

SUGGESTIONS

- There are some personal problems for respondents like lack of proper guidance, and Timely guidance must be provided to them according to their needs.
- Education plays a prominent role in the empowerment of women. A s majority of the Respondents and their spouses are having an educational qualification of higher secondary, sufficient opportunities must be provided to the min the form of seminars, conferences Etc., to impart additional knowledge on various issues related to them.
- Eradication of illiteracy is the first step towards empowerment of women. Still there are NHG members who do not have even primary education.

CONCLUSION

Financial Inclusion is critical to the process of development of the economy. It plays a Crucial role in the alleviation of poverty and in the all round progress of the nation. In any program of economic empowerment through zakah, satisfying immediate basic needs of the poorest of the poor must always be accorded top priority. Zakah funds may also be provided as start-up capital for their micro-enterprises. Organization of women into micro finance is an effective way to achieve financial Inclusion. Micro finance has now liberated Poor women from the clutches of private money lenders. Banks that initially hesitant to provide financial assistance to women from poor families have changed their Attitudes as this group effectively strengthened the Community Based Organizations. Now banks have started to compete with each other offering special Services to attract the accounts of this women micro finance group. Poor women are now in a Comfortable position to avail bank loans on easy terms and conditions. The micro finance unit members got opportunity to understand the banking operations and acquired the confidence to visit the bank and availing the bank. It is evident from the present study that the women empowerment through microfinance supports the economic, political, social/cultural, personal and familiar empowerment of members. In spite of the different constraints and challenges, the microfinancing has the potential to transform the entire economy of the state.

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ISLAMIC BANKING: OPPORTUNITIES AND CHALLENGES

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ABSTRACT

Islamic Banking is a Shariah compliant (Islamic law) banking system that works with the practical application through the development of Islamic economics. Shariah encompasses the holistic view of Islam and integrates the code of conduct, life of individual and society as a whole. It is based upon the principle that interest(riba) is prohibited. Because Muslims cannot receive or pay interest. They are unable to conduct activities with conventional banks because of the existence of interest. There by an idea of Islamic banking has emerged. An Islamic banking window will persuade people from Muslim population to invest their money which they may not be willing to put in banks. Islamic banking has the potential to uplift people from backward areas, farmers and Small and Medium Enterprises (SMEs) and can promote inclusive economic growth. However Islamic banking organizations need to frame a good and effective communication strategies to increase awareness among people

Key Words: Islamic Banking, Islamic Finance, Shariah, Riba

INTRODUCTION

In the development of an economy, banking institutions play an important role. In recent years, many of the financial institutions especially banking undergo a massive competition for the growth. Islamic banking is one among them. It is based on sharia. Sharia lexically means path or way. Islamic banking which is also known as interest free banking depends its operations on the sharia law. Goods that are prohibited within the Islamic religion will not trade through these banks. Moreover, they cannot deal in any transaction that is haram in the eyes of Islam (invalid in Islam). Sharia advisory board that comprises scholars are working to provide direction for the smooth operations of these financial institutions. In many countries like Pakisthan, Bangladesh, Malaysia the scope of Islamic banking and positive effect of it in the economy is increasing.

ISLAMIC BANKING

Islamic banking properly implemented in 1960's with the establishment of MIT Ghamar Local Savings in Egypt. Islamic banking is also known as Sharia Complaint Finance or interest free banking. It is based on ethos and values of the Islam religion and the Islamic system which are derived from Quran and Sunnah. This system is known as*Sharia'h.* Shariah include a good code of conduct, individual life, society value and holistic view of Islam. Islamic banking act according to Islamic law. The main five modes in Islamic banking are mudarabah (Profit sharing and loss bearing) wadiah (Safe keeping) musharaka (Joint venture) murabhah (Cost plus) ijara (Leasing). Islamic banking focus on interest free banking. Interest is forbidden in Islam. Thus, the Islam believers can save their investment in Islamic banks rather than in any other bank by respecting Islamic values. Islamic bank is not for Muslims only. Anyone can open an investment account in Islamic banking. Islamic banking is mainly clustered around three parts of the world that include South East Asia, Middle East and South Asia. Also Bangladesh has been carefully and thoroughly following Islamic banking. In Middle East, Qatar is hot spot of Islamic banking. Major Islamic banks in Qatar are Qatar Islamic Bank (Established in 1983) Qatar international Islamic bank (1991) Doha Islamic Bank (2006) and Al Rayan Bank (2006). Malaysia has the highest market share of Islamic banking (16%). In Islamic finance industry, Islamic banking is considered as the largest sector. It contributing USD 1.72 trillion or 71% of the industries asset . Saudi Arabia is the Islamic finance's second-largest market having 16 Islamic banks including windows. India is the country having Muslim population of over 160 million could rethink about the present potential of Islamic baking and can implement many changes in Islamic banking to ensure smooth and standardized operations. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is taken the responsibility for developing and issuing standards for International Islamic Finance Industry.

Islamic banking system is growing in a very fast pace. Main principle of Islamic banking is prohibition of interest on lending and borrowing of money or on any other activity and promotes profit and loss sharing transactions. The basic of purpose of both Islamic

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banking and conventional banking system is same but only operates according to the shariah law. All financial transactions are lawful and permissible unless they do not include an element of interest.

In Islam, charging of interest is prohibited because interest is considered as an unjustified increase of capital with no any effort made to earn it. Islamic banking is not a religious institution only for poor and backward Muslim community. Islamic banking is also referred as ethical banking because certain industries such as adult entertainment, alcohol and gambling are disallowed by sharia and prohibited for investment and also trading in debt is not allowed. Because banks do not deal in traditional bonds rather they have their own version of such instruments called sukuk (Islamic bond). Islamic finance is also encouraging in interest free loan. Today, India is showing much interest in Islamic banking. Kerala government started Al-Barakah financial services ltd, GIC of India runs an Islamic re-assurance scheme, several mutual fund schemes invest by following Islamic rules. TASIS, an index on Bombay Stock Exchange representing only Sharia compliant stocks are evidences for that. Islamic banking will help in mobilizing large capital held by devote Muslims who are very little participants in conventional marketing system because of interest. With the introduction of Islamic banking Indian government will certainly gain advantages to make financial dealings with Muslim dominated nations especially to attract trillion dollars of equity finance from gulf countries. Also inadequate labour capital ratio for informal sector workers associated with agriculture and manufacturing industries could be resolved through equity finance. Thus Islamic banking may financially empower majority of Indian workers. Equity finance allows access to credit without debits of borrowers.

OPPORTUNITIES OF ISLAMIC BANKING

In financial services Islamic banking getting opportunity for growing and attracting a large audience of both Islamic believers and Non-Muslims similarly. In International banking and capital market Islamic banking became fast growing segment.

- India is the country having third largest Muslim populated. So it has a good market potential in India. As per the Pew Research Center , in 2010 India is the country with the third largest Muslim population in the world having one 177 million Muslims . A considerable number of Muslims are investing in non-interest bearing accounts.
- Practically Islamic banking has a good opportunity to attract fund that which conventional banks can't do.

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- If Islamic banking would be implemented completely as an alternative financial sector, interest free banking system can grow rapidly because majority of the Muslims are looking for interest free banking system.
- Islamic banking helping to improve the labour capital and informal sector workers associated with agriculture and improves the standard of living of majority of Indian workers.
- But comparing with international countries especially Muslim populated gulf countries Islamic banking is functioning better in those countries because they identified the benefit of Islamic banking in the growth of an economy. The reality is that Islamic banking is strengthening also in the countries where Islamic believers (Muslims) are minority and not only in nations having great number of Muslim population.

Today, Islamic banking in India exist in a form of different private financial institutions and the business is small. It is focusing on niche segment which means focusing on only a certain region which limit access. According to the Planning Commission, until 2017 India is facing funding gap to meet its infrastructure funding requirement and India could use Islamic financial product such as sukuk [long term bond] to fund infrastructure and also other sectors following the example of countries such as Germany, France, UK, Indonesia and Malaysia and make them role model.

There should be proper awareness given about the benefits regarding Islamic banking and widely spread its importance and remove the misconception that Islamic banking could be beneficial only for Muslim people. This misconception is a hindrance in the development of interest free banking. Instead of calling Islamic banking it is recommended to call interest free banking. Because, some people might not like the term "Islamic" and refer it as "anti-Indian". They also point out religious issues and use as political weapon to exploit in the name for Islamic religion . It will lead to becoming a bottle neck for the implementation of Islamic banking. In February 2017 RBI had sent a copy of IDG report to finance ministry and recommended "Islamic window" in conventional banks for gradual introduction of shariah complaint banking. This can be considered as a piece of hope for interest free banking in our country in near future. RBI and ministry about finance really have to rethink about replacing the old shadow economy. In India, for implementing Islamic banking the existing legal frame work needs to be adjusted. Islamic banking particularly could be used for the wailing economy as a healing mechanism at the least as an alternative system. The political leaders

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and their voters also need to understand that Islamic banking is not just being implemented for Muslims and not a narrow religious prism instead really helps in the inclusive growth of Indian economy.

Islamic banking continues growing by increasing share of Islamic finance markets. It is gaining acceptance especially in high growth emerging markets. There is huge potential for Islamic banking in India. Enhance the outreach of Islamic banking and launch awareness campaign through media to inform the people of their products and financial benefits. Amend the banking laws in India to allow a framework for Islamic banking. It should be advertised as an alternative system for banking which runs on profit and loss sharing that can lead to financial inclusion and not as only suitable for Muslims. It should not be reviewed form religious view point or used as a political weapon. World have a perception that Islamic banking in west has a dislike for interest and only meant for Muslims but most importantly they have realized the economy has to enhance financial growth and also economic welfare. In 2008, a committee on Financial Sector Reforms, leaded by Raghuram Rajan who is the former RBI Governor had recommended on the need for implementation of Islamic banking which is interest free banking in India, but there had no positive approach from central bank.

CHALLENGES OF ISLAMIC BANKING

Islamic banking is not free from challenges. Still now Islamic banking is a distant dream for Indian citizens while many of them not at all aware about that .

- It faces the problems such as Islamic banks can't borrow from other banks or RBI to meet their short term funding requirements, because it includes interest.
- There is lack of awareness about Islamic banking, bank have to educate customers regarding the benefits of Islamic banking.
- Tax on profit on Islamic banking is treated differently.
- There is misconception regarding the belief that Islamic banking is only for Muslims.
- It involves restrictions on equity investment and trading.
- Opponents says that Islamic banking could be exploited politically as well as used to gather funding from gulf coast countries for terrorist activities, although it is wrong.
- There is a misunderstanding about Islamic banking through the worm's view of religious prism.

CONCLUSION

In the past few years world achieved popularity about Islamic banking concept. But, India still has to go along way for properly implementing Islamic banking. Many leading co-operations are attracted in Islamic banking and finding its best way to get into this market. Studies yet to be have to focus on the relevance and efficiency of Islamic banking. For Islamic banking an Independent Sharia Supervisory Board is very important. For Islamic banking there are no commercial laws or company existing. This leads to lacking legal support for Islamic banking. Therefore, central bank and regulators need to review and reform necessary laws that are related to investments, legal procedures to meet the requirements of Islamic banking.

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ISLAMIC BANKING – AN OVERLOOK INTO PRESENT SCENARIO GLOBALLY AND IN INDIA.

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ABSTRACT

Banking is the term used for the business activity which accepts and deposits others finance and then lending out this money for economic activities such as profit-making or simply for operating activities. Islamic banking is a concept based on the Islamic law Sharia. This law prohibits interest. Interest-free banking is the theme of Islamic banking. The objectives of Islamic banking may accept deposits from individuals and institution will be invested in projects like small scale hotel for generating revenue and providing job opportunities. At a glance, globally looking in many countries Islamic banking functions successfully. But it had failed to take wings in India. The first successful Islamic bank perhaps a financial institution called Tabang Haji. And the growth is not only confined within the Muslim countries. China, Germany, the UK, and the US are some of the non-Muslim countries with Islamic banking in place. Research shows that the Islamic finance sector continues to grow and evolve in size and complexity, with Islamic banking offered in more than 60 countries worldwide.

This study aims at analyzing the growth of Islamic banking in different countries through exploratory study. It also makes a journey through the steps taken to implement Islamic banking in India and also Kerala. RBI interventions other challenges in India are also taken into account.

Keywords: Islamic Banking, Interest-Free, Economic Activity.

INTRODUCTION

Islamic banking or sharia compliance banking is based on the Islamic principle shariah. Islamic banking is a system of finance based on the sharing of risk and profit, rather than on the payment of interest or the payment of predetermined rates. Islam provides a banking system based on profit and risk-sharing rather than the fixed payment of interest after a fixed interval. The Islamic financial institutions borrow and lend money based on profit sharing. But in mortgage lending, Islamic banks also should have the edge over conventional banking on account of the principle of non-interest. Islamic finance, the financial activity based on religious principle, that's all. Here the principles followed are

1. Profit-sharing
2. Riba free i.e. interest-free

These principles are majorly used in Muslim majority companies; however, owing to the economic advantage posed by Islamic banking countries like Japan and the UK have also adopted them. Islamic banking is ethical banking and is advantageous to people irrespective of their religion. An old survey report released by the international monetary fund (IMF) shows that 10-15% per year growth is shown by the Islamic banking industry. An industry that is currently spread over 51 nations and 300 financial institutions.

Seeing this rapid growth of interest it can be safely assumed that the trend of Islamic banking may prosper in the years to come and replace conventional banking systems. Indian and foreign banks should exploit Islamic banking's untapped potential to ensure the financial inclusion of "unbanked" populations excluded by the existing financial system.

KEY PRINCIPLES OF ISLAMIC FINANCE

- Interest-free banking and profit-sharing.
- Inclusion of Ijarah
- Prohibition of Riba.
- Sanctity of contract
- Risk mitigation in Islamic banking

OBJECTIVES OF THE STUDY

- To know the trends of Islamic banking in 2021
- To know the challenges of Islamic banking in India
- An overlook of Islamic banking globally.

RESEARCH METHODOLOGY

As the topic is wide in nature exploratory and descriptive study was conducted. Various journals and web pages were used for the study.

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LEGAL VALIDITY OF ISLAMIC BANKING IN INDIA

Under article 14 and article 15 of the Indian constitution, the right to equality is guaranteed to every person in India prohibiting discrimination based on religion amongst four other grounds. However Islamic banking does not violate the principles embedded in the constitution of India. it is an ethical banking system that benefits Muslims and people belonging to other religions equally. When considering the application of Islamic banking in India the question of fundamental rights violation does not come up.

Under sec 17 (1) of the reserve bank of India act empowers RBI to accept monetary transactions without any interest from the govt. (central or state),banks, local authorities, or other persons. Therefore, if we apply the principles we can see that only RBI is legally authorized to undertake Islamic banking.

Under sec 5(b) of the banking regulation act, banking is defined as accepting investing and lending money that is repayable on demand and can be withdrawn via cheques or drafts, or other instruments. Section 5(c) defines "banking policy". Nowhere in this section is "interest" mentioned as a prerequisite for banking, this opens up the possibility of Islamic banking in India.

Therefore, Islamic banking can be constitutionally upheld, it is not communal, and the benefits of it can be reaped by the whole community.

CURRENT SITUATION IN INDIA

Kerala has become the first state in the country to establish its very own Sharia-compliant bank. This happened with the support of India (Marxist) the bank is in Kannur district and has helped in bringing forward investments by Muslims who shunned the conventional banking system. It also introduced halal chitty through KSFE n, as a derivative to N RI chitty, which is interest-free. Kudumbasree units were granted interest-free loans for new startups. The Halal Faiydah will not charge any interest. Only invest in activities considered 'halal' or legitimate under Islamic law.

ISLAMIC BANKING AND RBI

Currently, RBI does not support Islamic banking is different from regular banking. However, there is a scope for Islamic banking in India that will not only benefit the Muslims but people from other religious backgrounds as well. Given the proper support from the public, Islamic banking can be easily sustained in India. It can function as an NBFC (Non-

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Banking Financial Corporation) and the official language for the operation can be changed to English in non-Islamic Nations such as India...

ISLAMIC BANKING CURRENT SCENARIO

2020 was mostly spent in managing COVID-19. Almost all countries had schemes announced by their central banks, which entailed a payment holiday or relaxation of some sort. This often required a change of systems and processes with Islamic banks closely working with their respective Shariah boards. We also witnessed that some policies announced by central banks were beneficial for Islamic banking clients. Business direction moved from growth to portfolio protection and stabilization. The credit underwriting criteria were tightened due to the slowdown, with a greater focus on hard-hit sectors like hospitality, airlines, etc. this was the time for banks particularly Islamic banks to demonstrate their true values by engaging with clients to ease the burden in settling their monthly EMIs for the card, personal finance. In India, Islamic banks announced free of cost moratorium of EMIs for the lockdown period.

EMERGING THEMES OF ISLAMIC BANKING IN 2021

- **Shariah governance**

The growth in Islamic banking also brings greater demand from the central bank to strengthen the governance culture and move towards greater standardization and transparency. In UAE, we have seen the increased rollout of new regulations covering the operating model of Islamic banks, product structures, and governance requirements. It is also expected that shariah boards being more accommodative towards product structures and processes to accommodate the evolving consumer needs fuelled by the pandemic.

- **Islamic Fintech**

Fintechs will continue to challenge traditional banks who will have to choose between the 'compete' vs. 'collaborate' approach. Many banks will oscillate toward a value-adding partnership with fintech, to reduce operational cost and which will lead to competitive product offerings reaching a wider target market. UAE was the fourth largest market in terms of the number of Islamic fintech start-ups globally. Thus Islamic fintech has a great opportunity to play a leading role.

- **Socially responsible finance**

There is a natural link between social responsibility and Islamic finance as Shariah emphasizes to maintain a balance between wealth creation and wealth circulation. The focus on equitable distribution of wealth and promoting the doctrine of 'prevent harm and do good is deeply rooted as part of Maqasid Shariah (objectives).

With this backdrop, Islamic banks should take the lead and develop products around the concept of endowment, donation, and almsgiving. This will result in introducing new Islamic products that will provide a competitive edge. This is an opportunity for Islamic banks to drive financial inclusion and contribute to creating a more sustainable and equitable financial system.

INDIAN BANKS MUST EXPLOIT THE UNTAPPED BENEFITS OF ISLAMIC BANKING

- A large number of Muslims in India need Islamic banking. Introduction of the same by the govt. and the RBI will make banking more inclusive in India. Indian Muslims will invest in Islamic banking and they amount to 14.9% of the population of India making them the largest minority in India.
- Islamic banking will solve the problem of inflation and liquidity to an extent. It will boost India's economy.
- Through its financial services, entrepreneurial development can be boosted in India.
- The Islamic banking system has a lot of advantages in contrast to traditional banking which demands high rates of interest, foreclosure due to payment default. It is ethical and works on the principle of equity.
- The flow of funds from the gulf council will be an added advantage.
- Creation of job opportunities and new fields of study.

CONCLUSION

Islamic banking is the way to move forward. It will uplift the financial activities of Muslims in India without harming any other religious faction. The benefits of Islamic banking are far too good to be ignored. Interest-free and equity-based principles make it all the way more attractive. They have greater resilience to crises and shocks. It will not only be more inclusive but all will support small and medium-sized enterprises.

Also, with the advent of Islamic banking, the labour-capital ratio will improve. This will boost Indian agriculture and the informal sector. Another problem with conventional banking is that it increases disparities between classes, the rich become richer, and the poor become poorer. But with the help of Islamic banking, the profits will percolate to lower levels of society and reduce the disparity due to the class aspect.

The conventional banking system is exploitive. However one cannot ignore the few risks associated with Islamic banking. As per IMF, the risk involved with Islamic banking is terrorism financing and non-compliance with FATF (Financial Action Task Force) on money laundering. Destruction of money transfer transaction records is very common with Islamic banks and might lead to a lack of audit trail. This will make our economy a "grey and black economy".

Is undertaking all these risks worth all the untapped advantages?

Only time can tell. Islamic banking has already made its way in western countries and has proven to be successful compared to Muslims. Some studies have shown that more non-Islamic population is investing in these banks as compared to Muslims.

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THE INFLUENCES OF ISLAMICFINANCE / BANKING SYSTEM IN THE WORLD ECONOMY

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ABSTRACT

The objective of this article is to reveal how the Islamic Banking/financial system influences the world economy. The aim of this article is to know the level of quality of Islamic financial system over the world economy. The main finding is that Islamic financial system influences the world economy for growth and development. Many international conventional banks have started to open branches which operate in accordance with the Islamic shariah principles in some countries including developed countries, western countries, far Asia countries and Middle East countries etc. These countries are now taking keen interest in Islamic banking because it is not based on interest rate systems. Rather it is asset-based banking as compared to the conventional banking which is money based. Although Islam has allowed the profits, but the pre-determined fix amount of returns is not allowed. Risk of loss and variability of profits must be faced to get the returns. The Islamic banking was started with the simple profit and loss sharing accounts, Islamic savings and investment products but it is now flourishing as the Islamic bonds (Sukuk) and hedge funds are introduced in the market, the main products of Islamic banks are now based on profit and loss sharing principle (Mudarabah), partnerships or joint ventures (Musharakah), Sales contract (Salam), leasing contract (Ijarah) and interest-free loans (Qard-e-Hasna), trade with mark-up (Murabaha).

Keywords: Islamic banking, Interest free, Microfinance, Conventional Financial system.

INTRODUCTION

"O you who believe, you shall not take Riba, compounded over and over. Observe God that you may be successful". (The Quran 3:130)

Islamic financial system is a system which is in accordance with shariah. This means the interest-free banking / financial system. Riba (interest) is prohibited in Islam.

The financial activities that comply with shariah and its practical application are through the development of Islamic economics.

The Islamic financial system is not much different from the products and services in the traditional financial system, but its operations are essentially based on a certain set of moral and ethical principles that determine what is viewed as morally 'right'. Implying actions and transactions that promote public good and wrong, implying actions and transactions likely to be against the public good.

Islamic finance is founded mainly on the prohibition of riba. Thus, the main aim of Islamic banking and finance is to provide an Islamic alternative to the conventional system that is based on riba. As an alternative to riba, the profit and loss sharing arrangements are held as an ideal mode of financing in Islamic finance. It is expected that this profit and loss sharing will significantly remove the inequitable distribution of income and wealth and may lead to a more efficient and optimal allocation of resources as compared to the interest-based system. Thus, it will ensure justice between the parties involved as the return to the bank on finance is dependent on the operational results of the entrepreneur Islamic finance is founded mainly on the prohibition of riba.

Thus, the main aim of Islamic banking and finance is to provide an Islamic alternative to the conventional system that is based on riba. As an alternative to riba, the profit and loss sharing arrangements are held as an ideal mode of financing in Islamic finance. It is expected that this profit and loss sharing will significantly remove the inequitable distribution of income and wealth and may lead to a more efficient and optimal allocation of resources as compared to the interest-based system. Thus, it will ensure justice between the parties involved as the return to the bank on finance is dependent on the operational results of the entrepreneur

The philosophical functions of an Islamic financial system go beyond the interactions of factors of production and economic behaviour. The Islamic financial system can be fully appreciated only in the Islam's teachings on the business ethics, wealth distributions, social and economic justice, which are at the centre of moral economy.

Whereas the conventional financial system focused primarily on the economic and financial aspects of transactions with their material outcomes. The Islamic financial system places equal emphasis on the ethical, moral, public and social interest dimensions, to enhance fairness as well as the role of the state.

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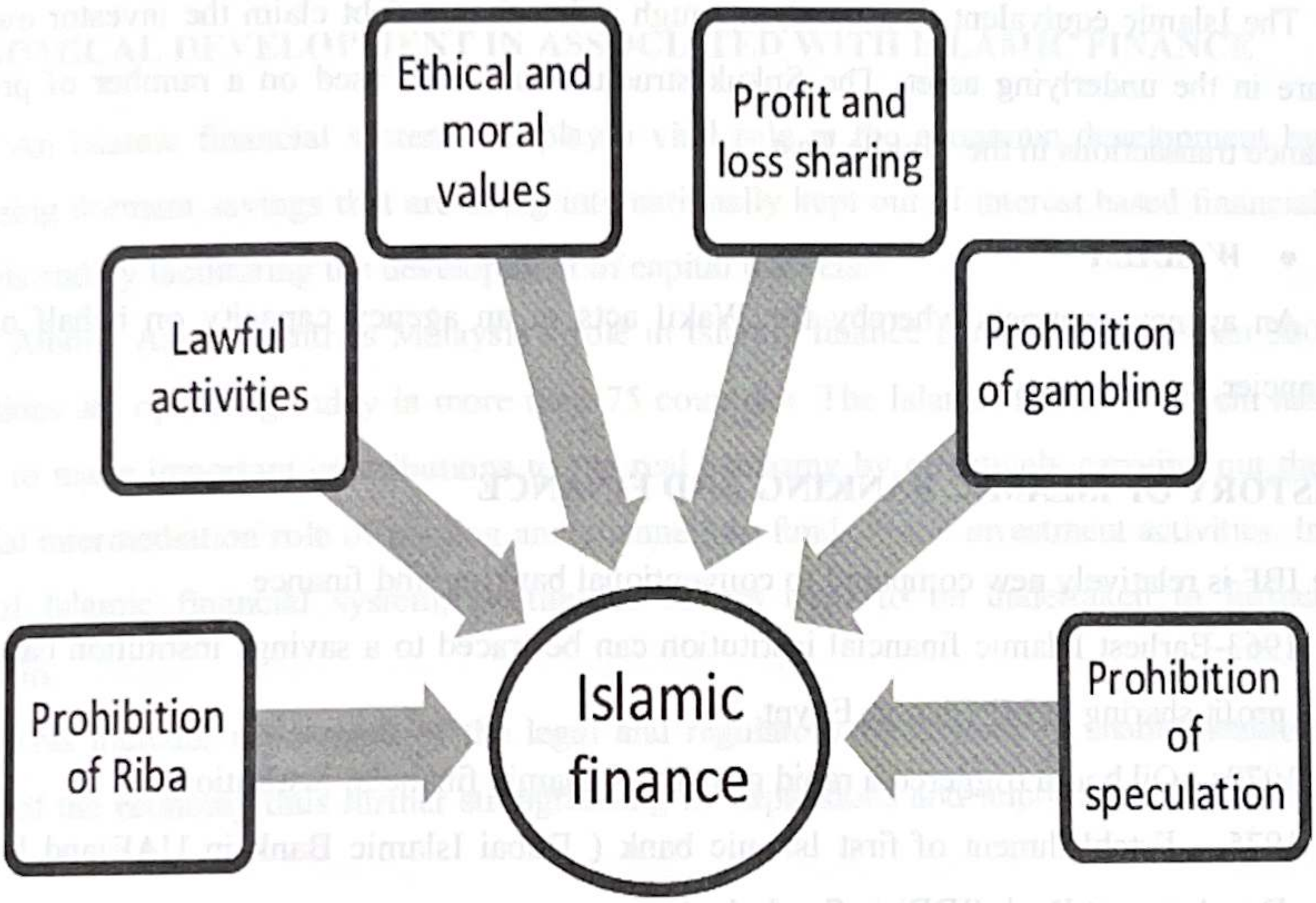
ISLAMIC FINANCE AND BANKING

Islamic financial system is simply an "interest free" financial system. This may be viewed as a form of ethical investing, or ethical lending except that no loans are possible unless they are interest free.

In contrast, the term "Islamic finance" in the modern sense appeared only in the mid – 1980s. Islamic financial system is founded on the absolute prohibition of the payment or receipt of any predetermined, guaranteed rate of return.

The system encourages risk – sharing, promotes entrepreneurship, discourages speculative behaviour and emphasises the sanctity of contracts.



BASIC ISLAMIC FINANCIAL ARRANGEMENTS

- ***MUDARABA (Profit loss sharing contract)***

The mudaraba financing model is a profit and loss sharing structure in which profits are shared between the stakeholders of a project.

- ***MURABAHA (Instalment sale)***

In the Murabaha model, a non- profit and loss sharing form of financing, an asset is purchased at a given price and then resold at predetermined mark-up.

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- ***IJARAH (Leasing)***

The Ijarah model is a non-profit loss sharing model similar to Murabaha financing, except that instead of a bank reselling an asset to its customer, it leases it to the customer over the period of the contract in exchange for periodic payment.

- ***SALAM AND ISTISNA (Islamic forward)***

Both are sales of a special nature; **Salam** is used to finance agriculture like goods and **Istisna** is used to finance manufactured goods.

- ***SUKUK***

The Islamic equivalent of a bond, although rather than a debt claim the investor owns a share in the underlying asset. The Sukuk structure has been used on a number of project finance transactions in the Middle East.

- ***WAKALA***

An agency contracts whereby the Wakil acts in an agency capacity on behalf of the financier.

HISTORY OF ISLAMIC BANKING AND FINANCE

❖ IBF is relatively new compared to conventional banking and finance

- 1963-Earliest Islamic financial institution can be traced to a savings institution based on profit sharing in MitGhamr, Egypt
- 1970s - Oil boom triggered a rapid growth of Islamic financial institutions
- 1975 – Establishment of first Islamic bank (Dubai Islamic Bank in UAE)and Islamic Development Bank (IDB) in Saudi Arabia
- 1978 – First attempt in the West to establish Islamic banking was in Luxembourg

INFLUENCE OF ISLAMIC BANKING AND FINANCE

Islamic finance is one of the most rapidly growing sectors of the global financial system. This paper empirically outlines the pure effect of Islamic finance including Islamic banking and Islamic bonds on economic growth and development.

Financial arrangements constitute an integral part of the process of economic development. A growing economy requires a progressively rising volume of savings and adequate institutional arrangements for the mobilisation and allocation of savings. These

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arrangements must not only extend and expand but also adapt to the growing and varying financial needs of the economy.

A well-developed and efficient capital market is an indispensable prerequisite for the effective allocation of savings in an economy. A financial system consisting of financial institutions, instruments and markets provides an effective payment and credit supply network thereby assisting in channelling of funds from savers to the investors in the economy. The task of the financial institutions or intermediaries is to mobilise the savings and ensure efficient allocation of these savings to high yielding investment projects so that they are in a position to offer attractive returns to the savers.

ECONOMICAL DEVELOPMENT IN ASSOCIATED WITH ISLAMIC FINANCE

An Islamic financial system can play a vital role in the economic development by mobilizing dormant savings that are being internationally kept out of interest based financial channels and by facilitating the development of capital markets.

Among Asian countries Malaysia's role in Islamic finance is unique. More than 300 institutions are operating today in more than 75 countries. The Islamic financial system has started to make important contributions to the real economy by effectively carrying out the financial intermediation role of pooling and channelling funds to the investment activities. In view of Islamic financial system, continuous efforts need to be undertaken to further expansion.

This includes refinement of the legal and regulatory framework to enable healthier growth of the economy thus further strengthening its expansions and importance on a global level.

Estimated assets held by Islamic financial institutions worldwide. Double-digit growth to around USD 3 trillion is expected over the next few years. Islamic finance has grown from a small base to exert considerable influence in banking particularly in the middle and Far East.

Its shariah principles encourage a spirit of partnership between supplier and customer that particularly benefits smaller companies in developing countries. Western financial and other firms can benefit from delivering products and services based on a firm grasp of Islamic financial principles.

Islamic banking system and present economic scenario: An analysis of the economic growth of a civil society largely depends on the displacement of fiscal deposits from depositors to investors so as to sustain developmental projects boosting the socio-economic development. In any economy banks play a very important role.

A bank is a reliable financial institution, which has a core business of mobilising the savings of people for investment. It receives the money from one group and lends to other groups of people. We can say that these financial institutions operate like an intermediary between depositors and investors. Bank as a monetary institution is as old as human society because the moment man realises the importance of money as a medium of exchange, the necessity for an agency to regulate, control and facilitate was naturally felt.

In recent years, financial institutions have experienced a dynamic, fast-paced and competitive environment at a cross-border scale. One of the most growing parts is the paradigm of Islamic banking which has remarkably captured the interest of both Islamic and contemporary economists. The main difference of Islamic banks with contemporary banks is that while the latter is based on the conventional interest-based principle, the former follows a principle of interest-free and profit and loss sharing system in performing their business as intermediaries.

While few countries have imposed the Islamic finance model, many encourage its growth as a preferred mode of banking. The Islamic financial model relies on several principles derived from shariah; it shared risk/ reward, prohibition interest usury, prohibitions of uncertainty and speculation and the necessity of physical presence for money transfer.

Islamic banking is based on two main financial principles. Firstly, investment is to be made in the private sector through interest-free financing. Secondly, the development of financial instruments is to be done on the basis of profit and loss sharing as well as sharing risks. Although the phenomenon of Islamic banking and finance have developed significantly in recent years, only very few studies have inquired into its efficiency and relevance in the wake of the recent crisis in the financial sector. Islamic banking in the west has often been regarded as a system having dislike for interest; however, it is something more than that as it also signifies amalgamation of ethics and economics so as to facilitate financial growth and economic welfare.

The Islamic financial model deals with most financial activities, from banking to insurance through micro-credit and bonds. It is mainly used to finance huge infrastructure projects, but could expand its activities to offer a new level of financing for SMEs through new business partnership. Western banks looking to develop Islamic finance activities should establish a new intimacy by creating new marketing, branding and sales strategies.

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To deal with the new stakes and meet the new requirement of Islamic finance, banks must adapt their processes, organisational structures and tools. A country needs to maintain a positive direct relationship with the financial organization for financial growth. However, some inadequate financial policies and decisions based on conventional interest systems were incapable of functioning both effectively and ethically within the society, consequently resulting in a weak financial system with meagre outcomes.

The financial performance of Islamic finance contributes and promotes economic growth only through profitability. This result confirmed the concept of endogenous growth theory when the Islamic banks' profitability increases and stimulates investments and the capital stock which leads to economic growth.

A decisive challenge for Islamic finance is to conform to both globally and nationally applicable regulation while applying shariah law principles. Observing the low rate of bank and insurance usage in emerging markets (particularly among smaller firms), developing Islamic finance activities could be a perfect way to catch this isolated segment.

FINDINGS OF THE STUDY

- The findings demonstrated that the only significant factor of the financial performance of Islamic finance, which affects the endogenous economic growth, is profitability through return on equity (ROE).
- For western financial institutions, developing Islamic finance activity could be an efficient way to expand in Middle Eastern countries and some far eastern countries, such as Malaysia and Indonesia.
- The experimental findings also indicated the necessity of stimulating other financial performance factors of Islamic finance to achieve a significant contribution to economic growth.

CONCLUSION

Islamic financial system is able to generate more revenue and profit efficiently than those of conventional banks. Although they have less experience than conventional banks Islamic financial activities play a significant role in promoting investment and savings, it creates wealth and increases income within the economy, hence serve as a critical agent of economic growth. Thus, only capital accumulation served as the channel of transmitting growth in the short-run.

Islamic finance industry has a very positive impact on economic growth, because it attracts the majority of the banking consumers internationally.

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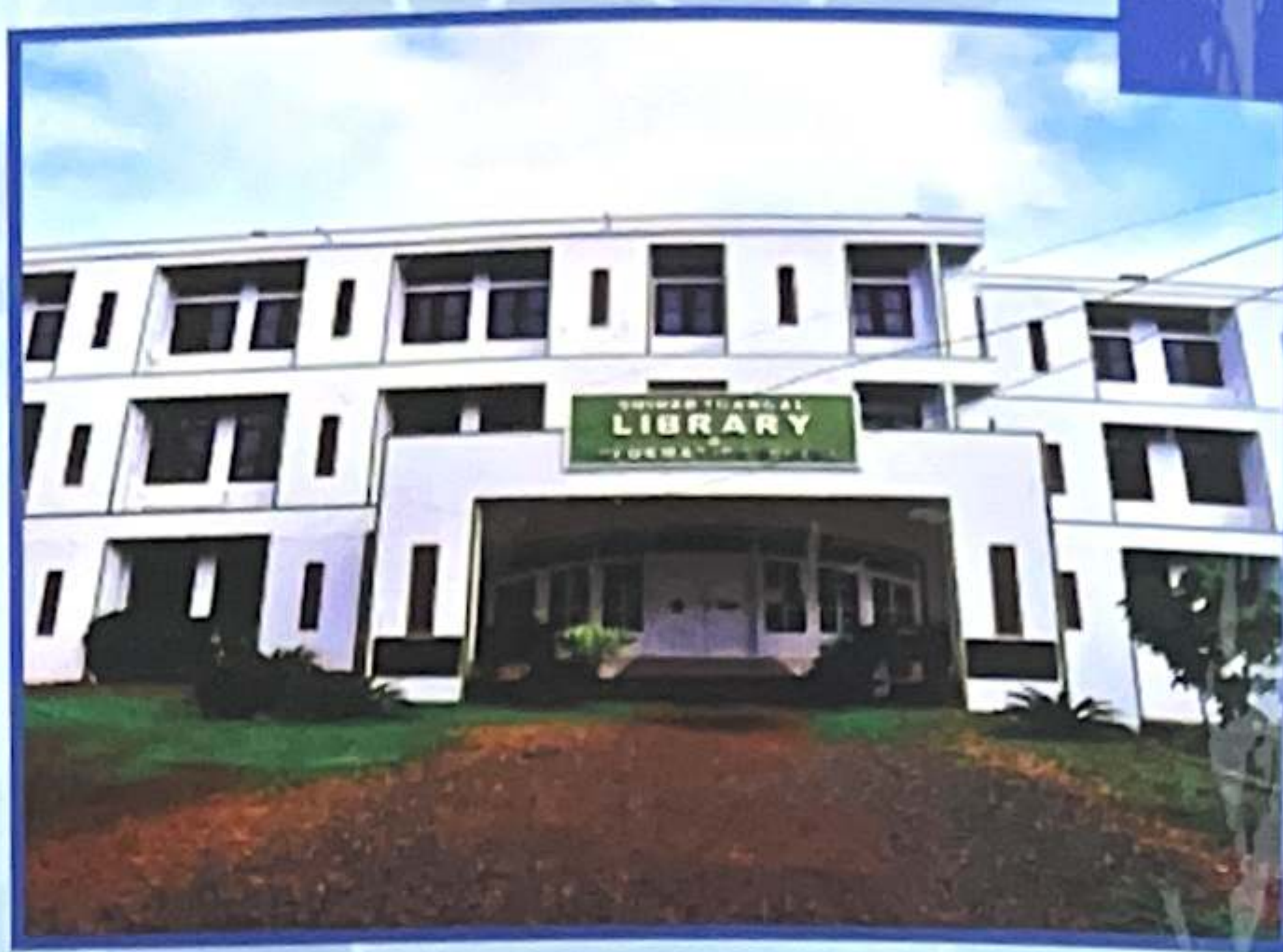

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