A Study on Islamic Finance And Banking

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ABSTRACT *Although not a near equivalent to conventional banking in terms of size, the global Islamic banking industry has grown at a very rapid pace in the last three decades. This paper provides a description of how Islamic finance and banking work. We have also tried to understand how differently it works when compared to the conventional banking. Much research has been carried out in this area but there is no systematic documentation of research findings on Islamic banking. The paper also compares and evaluates the practice of Islamic banking in Middle East countries with that of India. At the end, paper identifies the areas where further research is needed.*

INTRODUCTION

(Marc L. Ross, 2018) Sharia compliant Finance, popularly known as Islamic Finance or Islamic Banking is that type of banking activity which acts in accordance with the Islamic law known as Sharia. Its practical application mainly focuses on the development of Islamic economics. There are 5 main modes in Islamic finance and banking, which are Mudarabah which relates to profit sharing and loss bearing ; Wadiah which is safekeeping ; Musharaka which is joint venture; Murabahah which is cost plus and ijara which is leasing.

(Shahid M. Ebrahim, 2015) In recent years, Islamic banks provided products that are compliant with Sharia law which fulfilled the economic needs of the people. They believe that no person should be profited from another person's loss. Hence the concept of Riba (interest) was prohibited. Islamic banks take the risks of profit sharing and bears the entire burden of financial risks. Islamic banks acquire the direct credit risk normally borne by equity investors rather than holders of debt. Consequently, Islamic banks have an increased incentive to be incredibly selective in their loan processes and started to monitor their projects strictly.

(The Institute of Islamic Banking and Insurance, 1990) the origin of Islamic banking was when the birth of Islam took place, when the prophet himself acted as a trading agent. It is believed that Islamic partnerships dominated the business world for centuries.

(Mark Andrews, 2006) A very unique concept in Islamic finance and banking is interest free banking. A report found out that, in the 1960's, Muslim thinkers began to explore ways and means of organising commercial banking on an interest-free basis. In Egypt, the first Islamic interest-free bank came into being. People did not place their savings in any bank as they knew that interest was forbidden in Islam. Because of these circumstances, the task was not only to respect Islamic values concerning interest, but also to educate the people about the use of banking. Based on the Quran, Islamic Finance offers the people, Sharia's compliant banking. According to an article (written by Mark Andrews, Head of Islamic finance and banking, Risk Reward ltd.) the real meaning and the true benefits are often lost on outside observers.

(The Economic Times, 2014) There are many myths about Islamic Finance principally that it is banking for Muslims only. This is not true at all. Anyone can open an investment account and apply for the full range of services on offer. Non-Muslims are welcomed. Only Iran and Sudan are few of those countries which have solely Islamic banks. In places such as Saudi Arabia around 35% of banking sector assets are Sharia compliant, figures are lower for UAE (22%), Qatar (20%) and Malaysia (20%).These Sharia banking services adds-up to a global industry amounting to around $2 trillion in assets, out of which 80% is accounted for and by Islamic banks, 15% Suck (Islamic bonds), 4% Islamic mutual funds and 1% Takaful (Islamic insurance).

(Tam sir Cham, in 2017) Islamic banking is positively associated with growth after controlling other determinants of growth. There is growing interest in Islamic banking recently in the midst of a surge in asset size of the industry, its resilience to the recent global financial crisis and the increasing need for non-conventional financing in meeting sustainable development goals. They concluded that Islamic countries that suffer from low growth should develop their banking sector through modernizing the legislative, regulatory and infrastructural environment.

LITERATURE REVIEW

There has been number of articles written about how Islamic finance is growing at a very fast pace, with an estimate of 15% - 20% growth rate. Taking into consideration the statistics, Islamic Banking assets account for less than 1% of global banking assets today. After growing to a $1 trillion asset class in Muslim countries, Islamic finance is poised for an era of globalization. Like other financial services Islamic finance is facing the challenges of economic uncertainties, rapidly changing markets and fierce competition. Assets are concentrated in Muslim countries of the Middle East and Southeast Asia, but the sector appears poised to enter Western markets and

complement conventional financing. In addition, the customers of this generation are empowered enough to choose between the banks. According to a research, (Fayaz Ahmad, 2017) many banks are directing their strategies towards increasing customers satisfaction.

Islamic banking and finance activities are mainly clustered around three parts of the world that include the Middle East, South Asia and Southeast Asia. The Middle East is literally the motherland of Islamic finance and banking, as it is overwhelmingly populated by Muslims. In South Asia, Islamic Banking has been recently revived in Pakistan under the dual banking system. Bangladesh has been following Islamic banking policies more thoroughly and carefully. According to sources, Islamic Banking and Finance has been promoted in the Western Countries by their own financial institutions such as Citibank, ABN, AMRO, Goldman Sachs, Kleinwort Benson and others. The growth of Islamic Banking and Finance practice appears to be very promising in the Western financial world.

Qatar is another hotspot of Islamic banking and finance affairs in the Middle East. There are 4 major Islamic banks in Qatar, namely

- Qatar Islamic bank (established in 1983)
- Qatar International Islamic bank (established in 1991)
- Doha Islamic Bank (established in 2006)
- Al Rayan Bank (established in 2006)

In India, the Islamic Investment and Finance Board (IIBF) comprised of eminent scholars has approved the following financial criteria for investment in stocks. It is not allowed for inverters to invest in excessive debt companies (no investment in companies that have debt-to-market cap exceeding 33%), companies with high outstanding receivables net receivables in excess of 45 percent of market cap) and companies that do not have at least 25% of its capital in fixed assets (Money Mantra, 2011).

India is one of the most Shari'ah compliant countries in the world in terms of the number of shari'ah stocks available for investment and also the variety of these stocks. To capitalize on this opportunity a reinsurance company has planned to start an international retakaful operation on a shari'ah basis. In the past few years, Indian regulators have approved schemes with exclusive claims of shari'ah compliance. Many prominent studies and reports have shown that Muslim participation in the financial system of the country is minimal. A report dated November 2006 by a committee by JusticeRajinder Sachar to look into the affairs of Muslim minority in India (Sacar 2006) has reported almost 50% of the community's population is excluded from the formal financial sector. In some other studies it has been found that Muslim participation in the financial sector is even less than their participation in India's prestigious government service i.e., Indian administration service.

NEED FOR STUDY

One of the reason for choosing Islamic Banking for the study was to know how it works and how different it is from conventional banking. The prohibition of interest based banking makes the topic much more interesting. By this study we can know why it did not gain much popularity and why it is used only in a few countries. By comparing Islamic banking and conventional banking, we can get to know which is better for people, for the country and its economy.

OBJECTIVES OF STUDY

The main objective of this study is to find out the difference in customer satisfaction towards Islamic and conventional banking.

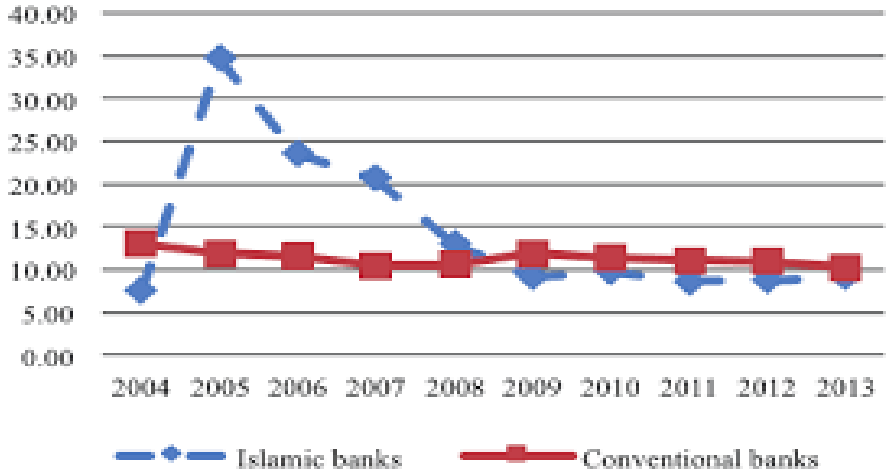
STATEMENT OF PROBLEM

The relationship between Islamic banks and monetary authorities is a delicate one. As far as the customer satisfaction is concerned, people not being aware or being unfamiliar with the Islamic banking system is a big problem. Islamic Banks always prefer to run on guaranteed profit basis having Sharia coverage. For this reason sometimes the conventional Economists and General people failed to understand the real difference between Islamic Banking and conventional Banking.

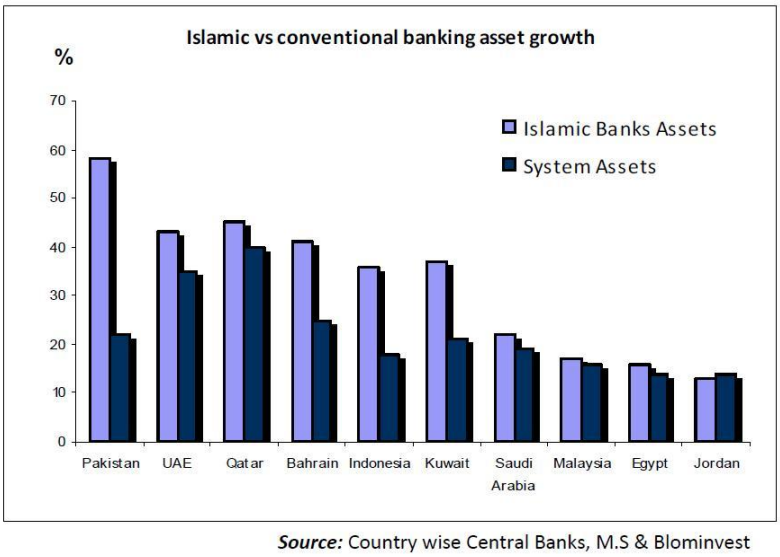
RESEARCH METHODOLOGY

This study is entirely based on secondary data as primary data was not available to meet the requirement of the study. Lot of research papers and articles were studied and conclusions were made. The data was collected from books on Islamic finance and banking, different research journals, annual report of Moradabad Association of Pakistan, annual and quarterly financial statements of different Islamic commercial Banks and conventional commercial banks.

ANALYSIS AND INTERPRETATION



(Source: article.sapub.org) The above image is an approximate comparison of the performance of conventional and Islamic banking during the year 2004-2013



(Source: Country wise Central Banks, M.S & Blomnivest) This is a Bar graph showing the asset growth of Islamic banking and conventional banking in Pakistan, UAE, Qatar, Bahrain, Indonesia, Kuwait, Saudi Arabia, Malaysia, Egypt and Jordan.

(Source: Shariah-Fortune.com) Above, is a pie chart showing the market share of Islamic banking in the different countries.

Malaysia has the highest market share of Islamic banking with 16% and Iran, Pakistan and Saudi Arabia has 4% which is the least. Bahrain has the second highest market share of Islamic banking with 14%. UK has a market share of 9% of Islamic banking. 7% of theIslamic market share is of Kuwait and UAE. USA has a market share of 6% of Islamic banking. Other countries in the world share the market share with 29% of the market share.

CONCLUSION

The discussion makes it clear that Islamic banking is not a negligible or merely temporary phenomenon. Islamic banks are here to stay and there are signs that they will continue to grow and expand. Even if one does not subscribe to the Islamic injunction against the institution of interest, one may find in Islamic banking some innovative ideas which could add more variety to the existing financial network. Now it depends upon the Islamic banks how to tape this vast market potential. It is suggested that Islamic banks must enhance their outreach and launch awareness campaign through media to inform the people of their products and financial benefits. They must establish their branches in small towns and big villages where the people have strong commitment with interest-free financial products and competition is less as compared to urban areas.

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