

Islamic Finance: A review of its scope and prospects

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ABSTRACT: *Islamic finance is the talk of the financial world right now, with almost all the giant economies of the world plunging into it to attract the investors and especially those of Middle East and Islamic nations to invest into Shariah compliant portfolios. The development of Islamic finance has resulted in opening a new dimension to the financial inclusion policies and other aspects of economic development. More than giving people of Islamic community an opportunity to invest according to their beliefs, Islamic finance has got much to offer, starting from a inclusive and ethically responsible economy to removal of poverty and discouragement of certain goods that are harmful to the society. Islamic finance has everything in it that is the need of time, but not in a manner of religious philosophy or commentary but as a strategy and tool to development.*

KEY WORDS: *Shariah, Inclusive, ethical, equality, sustainable growth.*

I. INTRODUCTION

It is said that money is the root of all evils- Indeed it seems to be true in the present scenario, when human activities are measured in terms of money only. Be it any profession, any individual, or organization- the prime objective is to have as much money as possible in their bank accounts. But the wild thirst for money has made us forget our core values and ethics that once guided our activities. Not getting judgemental or preaching about Dharma and values, this paper is an attempt to know more about the ray of hope to counter so many of our vices and drawbacks of present financial system. In course of discussion the term Islamic will be used often but it does not make it a religious commentary nor a promotion of religion, rather a discussion on a strategy and technique to have an ethical progressive and inclusive system of finance.

II. ISLAMIC FINANCE AND ITS ORIGIN

The religion of Islam, founded by Prophet Muhammad in Arabia in the seventh century CE is the third major Semitic faith after Judaism and Christianity. Muslims regard the holy Quran as the true word of god; and the canonical law of Islam as stated in Quran and *Sunnah* (spoken and acted examples of the Prophet), is known as *Shariah*.

The framework of Islamic finance system is based on elements of *Shariah* (The Law of Islam) which governs Islamic societies. *Shariah* provides guidelines for aspects of Muslim life including religion, politics, economics, banking, business and law (Khan, 2013). Islamic finance has its base in the need felt by devout Muslims to conduct their affairs in accordance with the *Shariah* (Foster, 2007). An important element of Islamic finance is the strength and soundness derived from its *Shariah* principles (Aziz, 2008).

Islamic finance is based on the Islamic faith and must stay within the limits of Islamic law or the *Shariah* law in its deeds and actions the four rules-

- [1] Absence of interest based Transaction (*Riba*)
- [2] Avoidance of economic activities involving speculation (*Ghilar*)
- [3] Introduction to Islamic charity Tax (*Zakat*)
- [4] Discouragement of production of goods and sources which contradict the value pattern of Islam (*Haram*) (Suleiman, 2000) (Hesse, Jobst, & Sole, 2008).

The development of a specifically ethical investment product is a phenomenon that emerged during the 1970's in response to the demands of particular types of customers (Wilson, 1997), and Islamic finance started during this period in the Middle East and North African region to primarily provide banking sources to Muslim population (Memon, 2013). The primary motivation of Islamic banking growth came from the oil boom of the early 1970's which afforded tremendous economic power to the oil rich Muslim countries which were not satisfied with the rigid requirements of the western banks which were primarily concerned with earning interest and paid no attention to socio-economic development of the society (Afzal, 1993). In addition to this the surging demand for *Shariah* compliant products from investors of the Middle East and other Muslim nations around the world led to the development of Islamic Finance which could cater to a whole spectrum of activities- retail banking, insurance, capital market (Hesse, Jobst, & Sole, 2008). While oil prices may not for some time return to the same level as they were in 1970's, its beyond question that a significant portion of world's wealth now

lies in the Middle east and it has to be recycled to the rest of the world, (Tomkins & Karim, 1897), which has led to the development of Islamic finance in order to trap the most of the available opportunities by companies around the globe.

III. ISLAMIC FINANCE AS A TOOL OF ETHICAL AND INCLUSIVE DEVELOPMENT

Most of the Islamic nations are poor, except a few oil producing Middle East nations, even India is having a huge number of people following the religion of Islam. There is urgent need of including the people living in these countries into the financial system for achieving an inclusive development and to boost the economy. Moreover in both the developing and developed nations, although a majority of people have access to bank and do invest money in some form or other to earn interest or profit, here there is a need of ethical operations which can ensure that we have a socially inclusive and responsible financial system. A developing nation like India where every other day there is a corporate or government scam, where the gap between the rich and the poor is widening day by day, and where unethical business practices are at boom- Islamic finance can be a viable answer to all this, the only condition is that it should be promoted as a 'new strategy' and not as a religious term, which will ultimately increase its acceptability among a wider audience and regions and not just exclusive to a particular community or nation.

IV. AS A TOOL OF FINANCIAL INCLUSION

To protect the poor debtors from the rich creditor Islam introduced a financial system based on the moral principles which promotes Justice, fair trade, equality and ethics in order to create a healthy and supportive society. The very first characteristic of Islamic finance is its principles that are based on the *Shariah* and draws its core concepts from the Holy Quran and thus it ensures perfectness in its message which motivates the people who need to invest money according to their beliefs and ideologies. The principal is prohibition of '*Riba*', which is the spirit of Islamic Economics. '*Riba*' refers to excess, forbids trading of money as commodity because it itself is not a commodity- monetary advantage without putting effort or labouring and strictly forbids such earnings; according to *Shariah* this earning do not contribute to economic development and hence leads to inflation (Khan M. , 2011) The concept of *Riba*, with no interest operations will ensure the poor farmers and other marginally excluded people of society involved in various small scale productive activities to have a better and reliable source of finance that can be invested for their growth. Countries like India where poor farmers are committing suicide- Islamic finance seem to be a perfect answer to the burning problem. Its scope in India is very wide, where it has potential to boost entrepreneurship, along with complimenting the conventional banking system and can bring FDI into India (Khan, 2013). Viable alternative to capitalist financial system prone to extreme risks, the interest free solutions of Islamic finance (banking) could restore equilibrium in Indian society by providing succour to debt ridden farmers, labourers and other marginalized groups (Akhtar & Talreja, 2012).

V. AS A TOOL FOR EQUALITY

Islam worldwide maintains a fixed set of rules and guidelines for *Shariah* and *Zakat* (Obligatory Charity) which is one of the five principles of Islam to alleviate poverty (Anas & Mounira, 2009). The concept of *Zakat* is another great principle of Islamic finance that can help reduce the widening gap between the rich and the poor. Paying *Zakat* is mandatory on the part of Muslims to purify their wealth regardless of mental health or youth (Farook, 2007). Islam requires all Muslim who posses' minimum net worth above their basic needs *Nisab* to pay *Zakat* (2.5% of the assets that have been owned over a year), which is a major economic instrument predetermined to spread socio-economic justice among Muslims (Kayed & Hassan, 2011). Islamic finance appreciates distribution of wealth in order to reduce gap between the haves and have not's (Khan M. , 2011). Islam has always maintained that a certain sum of money should be given to the poor which relates to the present system of Corporate Social Responsibility in India where the corporate are required to spend 2% of their earnings for the development of the society with focus into the areas of eradicating hunger, poverty, malnutrition and promoting preventive healthcare, promoting sanitation and availability of safe drinking water, promoting education, promoting gender equality, ensuring environmental sustainability, protection of national heritage. Now, if a major chunk of our population starts following this principle of *Zakat* than it might prove to be a game changer and compliment the steps taken by the government to solve all these problems. The intense commitment of Islam to justice and brotherhood demands that business organization should take care of some of the needs of community (Hassan A. , 2009). Islamic finance embraces the philosophy of promotion of social and economic welfare which extends beyond profit maximisation; the development of such socially responsible investing and proliferation of *Shariah* compliant finance brings much need ethical scrutiny into financial investments (Sorenson, 2011).

VI. AS A TOOL TO ENSURE ETHICAL AND SUSTAINABLE DEVELOPMENT

Mankind is the representative of Allah on earth as such Allah entrusted mankind with stewardship of his possessions and the destruction of the environment is considered harmful to the interests of the individual or society at large which is strictly prohibited by Islam (Farook, 2007). The most salient features of Islamic finance are fairness, socio-economic justice and its uncompromising commitment towards the well being of future generations through the caring of the environment and preserving earth's valuable resources (Kayed & Hassan, 2011). Islam also maintains that money cannot be invested or one cannot be associated with activities that are *Haram* (Not permitted by the Islamic law *Shariah*). Muslims cannot invest their money in enterprises that engage in impermissible activities for stance pig farm, alcohol producing factory, tobacco industry etc., and also cannot invest in activities that are financed by debt on investment (Farook, 2007). Let us broaden this concept of *Haram* in our present scenario and also widen its scope a little bit. Why only gambling, pork or alcohol or pornography, let us take this to a new level where companies involved in child labour, environmental degradation, child abuse, exploitation of labourers, degrading our social and cultural values (Showing objectionable advertisements and women as sex objects or involving in such activities) etc. need to be black listed or ranked in a position at the bottom when it comes to make decision about investing money. In a way this will discourage unethical business practices and promote socially acceptable sustainable decisions. Investments made not only on financial criteria but also ethical and social perspective leads to a feel good factor for the investors (Anas & Mounira, 2009), (Wilson, 1997).

VII. AS A TOOL TO ABSORB FINANCIAL DOWNTURNS

Financial bubbles are generally linked to easy credit, excessive debt, speculation, greed, fraud and corruption (Kayed & Hassan, 2011), which by large is not in the Islamic finance tenants. The shock awakening the global economic crisis proved guilty beyond the current financial practices which have generated social problems such as poverty, decline in moral values, environmental destruction, and unemployment- in addition to reckless financial attitude (Nur, 2012). Recent global and economic crisis has demonstrated most compellingly, the imperative for the global economy, a new development paradigm which is sustainable and inclusive. Islamic finance supports this shared vision through a number of important dimensions. The first dimension relates to the *Shariah* tenants, the second dimension is its evolution as an inclusive financial system and other dimension where it is having the prime objective of the welfare of the society (Aziz, 18th April 2013). Islamic finance on average showed stronger resilience during global financial crisis and people take it as an alternative and safe during global crisis situation (Grewal, 2013). Islamic banks may be more shielded to economic crisis which may be due to the reason they do not take much risks (Memon, 2013). The characteristics of Islamic finance and the above opinions may ensure that to some extent Islamic financial products are resilient to the economic downturns. A major factor that helps the companies to sustain any restraints is the public affection which a company earns due to its ethics and values that it follows in its operation. A majority of corporate houses that sustained the recession are the ones that were ethically managed, having goodwill and a reputation in the society where it operates. The feel good factor in the mind of the consumers can do wonders when it comes to make investment, but here one has to give away with profit in the short run but in the long run such companies will have the association and affection of the people which can help profit in long run and sustenance from economic downturns.

VIII. AREAS THAT NEED CLARIFICATION

Islamic finance is having a very rigid tenant which guides all its activities and any derailment from the path will exclude it from the domain of Islamic finance. Questions may be raised as to what extent an economy will develop, given the number of restriction on it. Also people of other communities might raise question on its acceptability, because we although propagate that we are secular but somewhere we are not able to accept what others have to give us. Therefore should Islamic finance be promoted as just for people of Islamic community or for the general masses, then wouldn't it be better to substitute the word Islamic with something that relates to all. After all we are not made for religion but religion is made for us to have a structure and guideline to act responsibly. There are a majority of companies that do not involve directly in the activities prohibited by Islam like the Hotel industry which deals with alcohol and even pork, the Airlines where we have all this things in some form or the other, and such other sectors, where a clarification may be sought as what would be the criteria (Wilson, 1997). There may be division of sectors as ethically desirable but ethically neutral (Socially not harmful) which are also necessary for proper functioning of economy (Nienhaus, 2011). Moreover the creation of *Shariah* compliant products and portfolio is a time consuming process because of its unique feature and rigorous approval process and it remains difficult to get *Shariah* compliant products (Sorenson, 2011), unless the *Shariah* rules are implemented from the top. Also there is dearth of Islamic banking professionals and lack of awareness, as most people believe that it is for Muslims only (Akhtar & Talreja, 2012). Moreover any step that is taken by the corporates are more of an promotional stunt rather than a real commitment to the

development of the society. It should not just be an attempt by the developed economies to trap the huge reserves from the wealth of oil rich nations but also an attempt to develop the poor nations and the deprived people of the society. In that case we need to identify that there is a pure intention in the actions that are been adopted by those who are claiming to have followed the *Shariah* guidelines.

IX. CONCLUSIVE STATEMENTS

Islamic finance is in its growth phase where economies around the world are adopting and incorporating it in their economic system. Not just Islamic nation, but even the developed western nations like USA, UK are also having an optimistic view about the success of Islamic finance in near future. India is also having an index of *Shariah* compatible financial products which are showing tremendous growth potential. A number of big corporate houses have been identified which are *Shariah* compatible includes the giants like Tata Consultancy Services, Wipro, Nestle, HUL, Airtel, GAIL, Asian Paints, Maruti etc., which are performing better than other and are giving good returns compared to other financial products. Indeed TATA Mutual Fund is having a TATA Ethical Fund which is having portfolio of *Shariah* compliant products. Islamic finance has some logic which has its basis in a comprehensive Islamic economic system that deals with allocation of resources, production and exchange of goods and services and the distribution of wealth which are to a greater extent familiar to the conventional economic textbooks; moreover it is based on rich and elaborate set of tenants and principles, obligation of which is its core and the growth which is almost 15 to 20 % (Akhtar S. , 2008). Islamic finance has been developed as an alternative to and a radical departure for conventional finance, enabling its practitioners and customers to follow the commandments of god (Visser, 2012).

Islamic finance is to be promoted not in a religious background but prohibition against certain anti-social activities and there should be replacement of 'Islamic Finance' by '*Shariah*' Compliant (Nienhaus, 2011). Islamic Finance has a long way to go and great impact to make in the coming future. There is needed to be steps taken to incorporate the guidelines of *Shariah* into the conventional financial system to provide a sustainable and ethical growth in all the sectors. There are tougher days to come and the recent recessions and downturns have showed us that the present system is not enough to overcome all that we talk about in our lectures and books, rather it is needed to have a strong base for all the activities. It is not that the conventional system be substituted by the Islamic finance but both should complement each other in achieving greater objectives. It has got the potential to achieve both social and economic objectives simultaneously, having a socially ethical and economically viable system; and also to meet the need of those who believe in an ethical society, and not just for a particular community or nation, but for the mankind as a whole.

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