Islamic Banking In India

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Abstract- *In this paper I propose to discuss the concept of islamic banking in India. Islamic banking is a system which is in consonance with the value system of islam and is governed by the principles laid down by Islamic shariah where interest based transactions are prohibited in islamic banking. Islamic banking differs from conventional banking. The difference lies in the fact that Islamic banks operate on an equity participation system in which a predetermined rate of return is not guaranteed. whereas in conventional banking, operations are based on both equity and debt system that are mainly driven by interest (riba). Islamic banking is a system of banking with shariah laws, which is against the collection or payment of interest, commonly called riba . The potential growth of Islamic finance is tremendous across the world and it is gradually flourishing India as well. Islamic banking is has a huge market potential in India as India is the third largest Muslim populated country in the world. In the case of India, banking regulation act 1949 needs to be suitable modified to introduce Islamic banking. The sachar committee report highlighted that approximately 50% Muslims are financially excluded. The long held issue of financial inclusion can be taken care of by introducing Islamic banking. RBI has initiated correspondence with the centre, seeking the possibility of amending the banking regulation act or bringing new rules to pave way for the establishment of Islamic banking in the country. Significant difference have been found bankers and non-bankers as well as Muslim and non- Muslims regarding the benefits and feasibility Islamic banking in India.*

Keywords- Islamic banking,Shariah, Conventional, Interest, Financial Inclusion.

I. INTRODUCTION

Islamic banking, popularly referred to as interest-free banking, has been gaining increasing popularly among the regulators in the recent past. The entire banking system in many countries has been undergoing the transition from conventional phase has not been smooth for many of them as it called for entire revamping of existing regulations in the banking system. Islamic banking or Islamic finance is a financing activity that complies with sharia (Islamic law) and its practical application through the development of Islamic economics. Some of the modes of Islamic banking/ finance include Mudarabah (Profit and loss sharing), Wadiah (safekeeping), Musharaka (Joint venture), Murabahah (cost plus), and Ijar (leasing).Sharia prohibits Riba, defined as interest paid on all loans of money. Islamic banks offer their services without levying or paying interest to its customers. The absence of Riba is a unique distinguished feature of Islamic Banks. The emergence of interest-free Islamic banking has been viewed as a financial innovation. Islamic banks have been successful in providing effective financial intermediation for the last 4 decades. The influx of “petro-dollars” following the Yom- Kippur war and 1973 oil crisis encouraged the development of Islamic banking and since 1975 it has spread globally. Though Islamic banking has grown faster at the rate of 17.6% between 2009 and 2013, faster than conventional banking the industry is still short of innovative Sharia compliant financial products to compete with their conventional counterparts. Egypt took the credit of being the first country to experiment this new form of banking followed by Iran. The central feature of Islamic banking is that no interest would be charged or paid and the returns would be in the form of profits from trade in which the money lent or borrowed is invested.

OBJECTIVE OF THE STUDY

- To understand Islamic banking
- To discuss mode of financing of Islamic banking
- To discuss the principles of Islamic banking

METHODOLOGY

The study is based on the secondary data collected through various business magazine , journals , internet websites, newspapers and research

II. PRODUCT AND SERVICES

Islamic Banks are providing number of products and services for the common people. Following are the various kinds of products and services offered by Islamic banks:

2.1 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. Under Islamic banking, it is an agreement under which the Islamic bank provides funds which are mixed with the funds of the business enterprise and others. All providers of capital are entitled to participate in management but not necessarily required to do so. 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.

2.2 MUDARABAH (Profit Sharing)

The term ‘Mudaraba’ has been derived from one of the meanings of the Arabic word ‘برضد’ which means ‘Travel’. Mudaraba is a partnership in profit whereby one party provides capital and the other party provides skill and labour. The provider of capital is called "Shahib al-maal", while the provider of skill and labour is called "Mudarib"So, Mudaraba may be defined as a contract of partnership where the Shahib al-maal provides capital to the Mudarib for investing it in a commercial enterprise by applying his labour and endeavor. Both the parties share the profit as per agreed upon ratio and the losses, if any, being borne by the provider of funds i.e. Shahib al-maal except if it is due to breach of trust misconduct, negligence or violation of the conditions agreed upon by the Mudarib. If there is any loss incurred due to the reasons mentioned above, the Mudarib becomes liable for that.

2.3 MURABAHAH (Cost plus sale)

This concept refers to the sale of goods (such as real estate, commodities, or a vehicle) where the purchase and selling price, other costs, and the profit marginare clearly stated at the time of the sale agreement. With the rise of Islamic banking since 1975, murabahah has become “the most prevalent” Islamic finance mechanism. Murabahah works as finance when the borrower/buyer pays the bank/seller for the goods over a period of time, compensating the bank/seller for the time value of its money in the form of “profit” not interest.

2.4 IJARAH (Lease or Hire purchase)

Ijarah refers to transferring the usufruct of an asset but not its ownership. Under Islamic banking, the bank transfers the usufruct to another person for an agreed period at an agreed consideration. The asset under Ijarah should be valuable, non- perishable, non-consumable identified and quantified. All those things which do not maintain their corpus during their use cannot become the subject matter of Ijarah, for instance money, wheet etc.

2.5 BAI SALAM (Advance Payment)

Salam means a contract in which advance payment is made for goods to be delivered at a future date. The seller undertakes to supply some specific goods to the buyer at a future date in exchange of an advance price fully paid at the time of contract. It is necessary that the quality of the commodity intended to be purchased is fully specified leaving no ambiguity leading to dispute. Bai Salam covers almost everything which is capable of being definitely described as to quantity, quality and workmanship.

2.6 ISTINSA (Manufacturing Finance)

Istisna means asking someone to construct, build or manufacture an asset. In Islamic finance, istisna' is generally a long-term contract whereby a party undertakes to manufacture, build or construct assets, with an obligation from the manufacturer or producer to deliver them to the customer upon completion. In practice, the key advantage of an istisna’ contract is that it can provide flexibility to the customer, where payments can be made in installments linked to project completion, at delivery or after project completion.

2.7 MUSAWAMAH (Bargaining)

This is similar to murabaha financing. Musawamah transaction, the customer requests the bank to purchase certain assets or commodities from a third party. The price is unknown to the customer, and upon acquiring the commodity, the bank adds its profit amount and offers to sell it to the customer, who has the right to accept, refuse, or negotiate the price. If accepted, the customer repays the total amount in agreed installments. Musawamah is usually provided to finance local purchases including vehicles, real estate, home appliances, machinery and equipment.

2.8 HIBAH (gift)

This is a token given voluntarily by a debtor in return for a loan. HIBAB usually arises when Islamic banks pay their customers a ‘gift’ on savings account balances, representing a portion of the profit made lending funds from savings account balances. Unlike interest and like dividends on shares of stock, HIBAH cannot be guaranteed.

2.9 WADIAH(Safe keeping)

In WADIAH a bank is deemed as a keeper and trustee of funds. A person deposits funds in the bank and guarantees refund of the entire amount of the deposit, or any part of the outstanding amount, when the depositor demands it.

2.10QARD AL HASSANA(Loan Contract)

It is a loan extended on a goodwill basis, under a 'good loan', the borrower is only required to repay the amount borrowed. However, the borrower may, at his or her discretion, pay an extra amount beyond the principal amount of the loan (without promising it) as a token of appreciation to the Islamic bank. In the case that the debtor does not pay an extra amount to the creditor, this transaction is a true interest-free loan.

III. PRINCIPLES OF ISLAMIC BANKING

In Islamic finance there are seven major principles that should follow every Islamic bank for their operations.

3.1 PROFIT AND LOSS SHARING

It is the one of the best principles is Islamic finance where the partners will share their profits and losses according to the part they played in the business. there will be no guarantee on the rate returns that the Muslims will play the past of a partners and not a creditors.

3.2 SHARED RISK

In the economic transactions, the risk is promoted by the Islamic banking, where 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 fact of the state

3.3 PROHIBITION OF INTEREST

The wealth will get The return without any risk or effort Regardless of the outcome of economic activity the person who gets the loan has to be return the money and riba to the lender in principles of Islamic 2, taking Advantage of the issues that others are facing is unjust.

3.4 GHARAR

According to this principles suggest that, Muslims are not allowed to participate in the ambiguous and uncertainty 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.

3.5 GAMBLING

In islam the acquisition of wealth through evil it means participation in gambling is prohibited. It will protect the Muslims from the conventional insurance products because that is a type of gambling on the other hand, Islamic banking works in takeful that involves mutual responsibility and shared risk.

3.6 NO INVESTMENT IN PROHIBITED INDUSTRIES

The Industries that are harmful to society or have a threat to the social responsibility are prohibited in islam. They are pornography, prostitution, alcohol, pork, drugs. According to the Islamic finance principles says that investments to these industries are prohibited. You cannot even participate in the mutual funds that will help the industry to flourish.

3.7 ZAKAT

There is a property tax included in the rules of islam that it know as Zakat, which allows the balanced distribution of wealth. According to the Islamic banking principles the fair amount of Zakatis 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.

IV. CONCLUSION

Islamic banking is a larger growth in the last few decades and also the acceptance of Islamic banking increased all over the world. The Islamic banking not only serves the needs and wants of one community .the benefits can use the entire community of the country. In Malaysia and UK 40% of the customers are non muslims. Most of the developed countries are UK,USA, FRANCE, Malaysia ..etc have embraced in Islamic banking. Aligarh Muslim university started a postgraduate program in Islamic banking and finance under the guidance of Professor Nejat Ullah Siddiqui. In India is not applicable because of these acts such as Banking Regulations act 1949, Reserve Bank of India act 1934 and Co-operative Society act 1961 these all acts are against the basic laws of Islamic banking. The government of India and RBI has to taken challenging steps to introduce Islamic banking in India and also amend the banking laws in India to allow a framework for Islamic banking.

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