



The Role of Islamic Finance, UAE

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Abstract

Islamic banking is the banking activity that follows the principles of Islamic law (Shariah) and its practical application through the development of Islamic economics. Islamic banking is also known as interest free banking which promotes profit sharing. Shariah (Islamic Law) prohibits the charging and paying of interest which is Haraam (forbidden) in Islam. It is very interesting that sharia banking is working without interest and is still flourishing. They are not only profitable but are also growing at an astonishing rate in sense of capital, assets and consumers. The biggest phase of development of Islamic financial institutions occurred in 1980s. In 1985, the High Council of Organization of Islamic Conference (OIC) declared takaful/Islamic insurance as Shariah compliant. The first Islamic bank was established in 1963, in MitGhamr, in Egypt, but it did not last for long. In Gulf countries Islamic banking is common now. Islamic banking is steadily moving into an increasing number of conventional financial systems. It is expanding not only in nations with majority Muslim populations, but also in other countries where Muslims are a minority. As a concept Islamic banking has gained momentum world over and in India over the past few years. Several foreign banks operating in India, like Citibank, Standard Chartered Bank, HBSC are operating interest-free windows in some of the West Asian countries, Europe, and the USA. The IMF has shown great interest in bringing about macroeconomic and financial stability for its members who have adopted Islamic banking. There is also a growing awareness about the concept among Indian banks and it is generally felt that there is a huge potential market in India for Islamic banking products. Several banks in the country have shown an inclination to undertake this form of interest-free banking. However, unless proper regulations are in place to oversee this form of banking, it will not be possible for scheduled commercial banks to follow the Islamic rules of banking even in a small way. The objective of this study is to assess the acceptability of Islamic Banking in India. Since Islamic Banking is yet to be introduced in India and as suggested by various studies in the past, there is not much awareness about Islamic banking. Therefore, an attempt has been made to study the level of acceptance of the core principles on which Islamic banking is based on the basis of which acceptability or otherwise of Islamic Banking in India can be assessed. The study is mainly based upon the collection of secondary data. The secondary data was collected from various sources of publications such as Magazines, Journals, Research articles, Internet and un-published thesis. The study mainly based on the samples taken from various sources interpreted in various statistical tools to arrive the favourable result for Islamic banking in India. Indian Muslims are having positive perception towards usability, regulatory characters, socio-political characters and accessibility of Islamic finance. The experts and conveners of Islamic Finance in India are optimistic regarding the success of Islamic finance in India. In Findings, we suggest that Islamic finance can be implement in India but required strong political environment and regulation bodies play a vital role in this concept.

Keywords: Islamic law; Islamic banking; Islamic financial institutions; Islamic Banking in India

Introduction and Design of the Study

Concept introduction

Islamic finance also called as Shariah finance or interest free finance, is a system of finance that is consistent with Islamic law

(Shariah) principles and guided by Islamic Economics. Prohibition of Interest, profit and loss sharing, risk sharing, prohibition of speculative behaviour or gambling and prohibition of unethical use of funds are the principles underlying the practices of Islamic finance. For the past three decades, Islamic finance has shown a

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significant growth, globally in 135 countries: including Muslim and Non-Muslim countries. In addition to various Muslim Countries, Islamic finance is also being implanted in Non-Muslim countries across Europe – UK, Switzerland, France, USA, Australia and the far East with about 300 Islamic Institutions. India is the second most populous country after China and is home to one sixth (17.5%) of the entire population of the world⁴. It is also the second largest country in terms of Muslims after Indonesia, contributing to 11% of total Muslim population of the world⁵ and can be perceived to be a potential market for Islamic finance. India is an emerging economy and despite the country's increasing growth rate in the recent years, the poor and especially the Muslims are financially excluded and do not avail benefits from the fast-growing economy. As per the Sachar Committee report⁶, Muslims, who constitute almost 14% of the total population of the country, are the most disadvantaged community in the financial sector. According to the committee over 80% of the community is financially excluded having share of only 7.4 % in the savings account and 4.7% in credit, which leads to the annual loss of approximately Rs. 69000 crore to the community. The committee also reported the percentage of households availing banking facilities is much lower in villages with high Muslim populations. Most of the Muslim populated areas in India have been identified as “negative geographical zones”, where bank credit and other facilities are not easily provided. In order to make Muslims as well as other economically backward sections of the society, to keep pace with the changing economy, Islamic finance may help to reduce the gap. Efforts are being made to formally introduce and implement Islamic finance in India. There are a number of Shari'ah compliant financial service in India, which include Mutual Funds, Shari'ah Indices and Shari'ah compliant Wealth Management schemes, Real Estate Venture Funds and Shari'ah compliant Commodities. There are different institutions and organizations which are defending the feasibility and possibility of Islamic finance in India. Since Islamic finance is in nascent stage in India, a lot of debates are going on regarding its implementation, but there has been lack of empirical studies on the need and requisites of Islamic finance in India. This is an empirical study based on primary data to study the awareness, perception and need for Islamic finance in India. The researcher has also studied the problems and prerequisites for implementation of Islamic finance practices in India.

Problem of study

India is the second most populous country after China and is home to one sixth (17.5%) of the entire population of the world. It is also the second largest country in terms of Muslims after Indonesia, contributing to 11% of total Muslim population of the world and is being perceived to be a potential market for Islamic finance. Over 80% of the Muslim community in India is financially excluded

having share of only 7.4 % in the saving account and 4.7% in bank credits. Due the reasons of faith, Muslims in India are not able to access the conventional finance products and services. Efforts are being made to introduce Islamic finance in India. So for only few Shari'ah compliant financial solutions and indices are launched, which include; TESIS, Taurus Ethical Fund, offshore Shari'ah Funds launched by Tata and Reliance, Reliance Wealth Management, TM Shari'ah Strategy, and Bajaj Allianz Shari'ah Compliant Pension Plan, Secura India Real Estate Fund and NSEL's E-Gold, E-Silver & E-Copper. Lack of awareness of silent features of Islamic finance among the Indian population is among the key reasons why India is continuing to be an unexplored market for the Islamic financial products and services (Fernandes, 2013). Regulatory hurdles within the existing financial system of India are the main obstacles for the successful implementation of Islamic finance India. There have been no empirical studies to assess the need for Islamic finance in India and the problems faced by Indian Muslims in the conventional finance sector. This study aims to assess the awareness and perception of the Indian Muslims towards Islamic Finance, to assess the need for Islamic finance in India and identify the prerequisites for the implementation of the same.

Scope and significance

Islamic finance has made its global presence in almost 130 countries which include Muslim as well as non-Muslim countries. Since Islamic finance is a vast, emerging and multi-dimensional area of research, the researcher has to restrict and limit the focus of the study. The scope of the present study is restricted to the need and relevance of the Islamic finance in India. India has a sizable segment of Muslim population to successfully implement Islamic finance. It is seen as the potential market for the Islamic finance. The study “Islamic Finance in India” is a significant and relevant study as it is the only such kind of study as it assesses the need for implementation of Islamic finance in India. This study assesses the preferences for savings, investments, lending and borrowings among the Muslims. This study would also help to evaluate awareness, perception of Islamic finance among the Muslims. As efforts are being made to introduce and implement Islamic finance in India, this study would help the conveners and policy makers of Islamic finance, to develop a suitable frame work for successful implementation of Islamic finance in the country. As a part of this study is based on the opinion of experts of Islamic finance, this study would evaluate the difficulties in implementation of Islamic finance in India. As Islamic finance is being practiced in various non-Muslim countries and has spread over Europe, the United States of America and the Far East, this study highlights reasons as to why India is still not exploring the market for Islamic finance. As this study highlights the lack of awareness among the Muslims about Islamic finance, the successful promotion and implementation of Islamic finance would require the policy makers

and practitioners of Islamic Financial system to pursue a plan which would include creating awareness among the targeted population. The researcher hopes that the present study will add the dimensions to the existing body of research in the area of Islamic finance and will provide a base for further research.

Objectives of the study

The Main objective of the study are listed below

- To assess the awareness among the Indian Muslims regarding the Islamic finance products and practices.
- To assess the perception of Indian Muslims regarding the Islamic finance practices.
- To study the need for Islamic finance in India
- To assess the prerequisites for the implementation of Islamic finance services in India

Research design

Research design is the most important stop after designing the research problem is preparing the design of the research project. A research design help to decide upon issues like what, when, where, how to much by what means etc. with the regard to an enquiry. A Research design is the arrangement of condition for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure the regulation specify conditions for registration certificate limitation on compensation of research design limitations on compensation of research design various disclosures to be made during public appearance and during making recommends through public media, codes of product record to be maintained manner of conducting inspection etc. The Researcher raised the research questions, formulate the problem statements, formulate objectives and framed the title of the study.

Analyses Relating to Objective

Methodology

For the purpose of this study, a questionnaire was framed which contained five statements/questions designed to measure the acceptance or otherwise of Islamic Banking principles and the respondents were asked to give their responses on a five-point scale from “Strongly Agree (1)”, “Agree (2)”, “Neutral (3)”, “Disagree (4)” and “Strongly Disagree (5)”. The questionnaire in Hindi and English was sent online to about 1000 respondents through Google Forms. Responses were received from 857 respondents and after removing duplicate entries, 812 responses were found valid which form the basis of this study. The basic principles on which Islamic Banking is based include prohibition of interest and borrowing and lending on profit and loss sharing basis rather than on fixed rate of interest. Through the questionnaire, the respondents were asked a hypothetical question whether they would like to invest in a Bank

which offers share of profit/loss rather than fixed rate of interest on their deposits. At the same time, they were also asked whether they would like to borrow from a bank which offers interest-free loans on Profit/Loss sharing basis. It is felt that responses on these questions would indicate the acceptability or otherwise of the principles of Islamic Banking in India.

Swot analysis

It is a mechanism for evaluating the favourable and unfavourable internal and external factors in a venture. Internal consists of strengths and weaknesses. The former are the advantages of the venture over other industries and the latter are the disadvantages relative to others. External comprises of opportunities created by the venture and threats which the business has to cope. The SWOT analysis of Islamic Banking in India is represented as follows: Thus, prima facie the strengths and opportunities exceed weakness and threats. Besides, weaknesses cab be remove very easily. Creating awareness and grooming experts is just matter of time (Tables 1-5).

Table 1: Swot Analysis.

EXTERNAL FACTORS	INTERNAL FACTORS
STRENGTHS	OPPORTUNITIES
Considerable no. of Muslim Population in India (Around 14%)	Benefit to Indian Economy by Gulf Investment
Demand for niche product is increasing in India	Addresses the issue of financial inclusion
	Upliftment of farmer, SMEs & scope for Inclusive growth.
	Potential to bridge the rising income disparity created by improper mobilization of money
WEAKNESSES	THREAT
Non awareness	Expected to become political weapon, maybe under the shield of secularism
Lack of experts	
Amendments in Laws needed	

Summary of Finding and Conclusion

Findings of study

Q1: If a bank offers interest-free loans, on Profit/Loss sharing basis, I would borrow from such a bank

The responses these questions are summarized in the table below:

Figure – bank offer interest free loan on profit/ loss sharing



If a bank offers interest-free loans, on Profit/Loss sharing basis, we would borrow from such a bank. Results reveal that 80.7% of respondents expressed their willingness to the proposition (Strongly Agree-39.8% & Agree-40.9%) while 7.7% disagreed

with the proposition (Strongly Disagree-2.3% & Disagree-5.4%). 11.6% of the respondents were neutral. Thus, more than 80% of the respondents are willing to borrow from Banks on Islamic Banking principles.

Table 2: Finding 1.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1.00	19	2.3	2.3	2.3
	2.00	44	5.4	5.4	7.8
	3.00	94	11.6	11.6	19.3
	4.00	332	40.9	40.9	60.2
	5.00	323	39.8	39.8	100.0
	Total	812	100.0	100.0	
Source: Primary Data					

Table 3: Finding 1.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1.00	19	2.3	2.3	2.3
	2.00	76	9.4	9.4	11.7
	3.00	124	15.3	15.3	27.0
	4.00	282	34.7	34.7	61.7
	5.00	311	38.3	38.3	100.0
	Total	812	100.0	100.0	

Figure 4: q1 * q2 Cross Tabulation Count.

		q2					Total
		1.00	2.00	3.00	4.00	5.00	
q1	1.00	4	3	1	4	7	19
	2.00	4	20	6	9	5	44
	3.00	0	17	41	27	9	94
	4.00	5	24	57	183	63	332

Total	5.00	6 19	12 76	19 124	59 282	227 311	323 812
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Figure 5: Chi-Square Tests.

	Value	Df	Asymp. Sig. (2-sided)
Pearson Chi-Square Likelihood Ratio	409.805a		
Linear-by-Linear Association N of Valid Cases	354.010 167.167 812	16 16 1	.000 .000 .000

Q2: I would like to invest in a Bank which offers share of profit/loss rather than fixed rate of interest on my deposits.

The responses this question are summarized in the table below: I would like to invest in a Bank which offers share of profit/loss rather than fixed rate of interest on my deposits (Figures 1,2).

Figure – investment in bank with share of profit/ loss sharing

Results reveal that 73.0% of the respondents agreed with the proposition (Strongly Agree-38.16%; Agree-34.89%), 11.7% disagrees (Strongly Disagree-2.3%; Disagree-9.4%) and 15.3% were neutral. Thus, majority of the respondents are willing to make deposits in a bank which offers share of profit/loss rather than fixed rate of interest. Based on the assumptions, Chi-square test was applied and the results for the same are as depicted in the table below: A. 6 cells (24.0%) have expected count less than 5. The minimum expected count is .44.

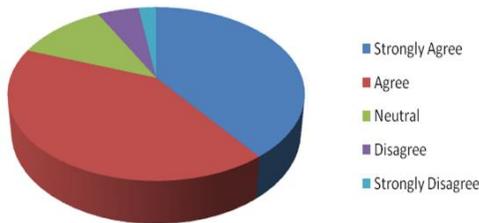


Figure 1: If a Bank offers interest free loans on profit/loss sharing basis, i would borrow from such a Bank.

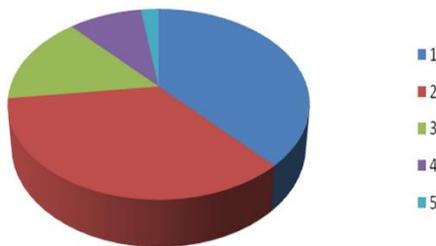


Figure 2: I would like to invest in a bank which offers share of profit/loss rather than fixed rate of interest on my deposits.

Interpretation

P value is less than 0.05 and so the two questions are dependent. The two questions with regard to willingness to borrow from a bank on Profit and Loss sharing basis and willingness to make deposits in banks on Profit and Loss sharing basis rather than fixed rate of interest are dependent. Banking involves accepting deposits from customers and lending the accumulated funds to applicants. Both aspects are important for successful banking operations. Loans can be advanced by banks only out of deposits received from customers and interest on deposits can be paid only if the bank lends the available funds on a higher rate of interest. As discussed above, results of the study reveal that an overwhelming majority of the respondents are willing to borrow as well and make deposits in Banks on Profit and Loss sharing basis. Thus, the findings suggest that the basic principles of Islamic Banking have wide acceptability in India [1-17].

Conclusion

India is the second largest country in terms of Muslims after Indonesia, constituting 14% of total Muslim population of the world but India is nowhere found in the world scenario of Islamic finance. Despite the fact that Islamic finance institutions as economic entities were established in early 1930s and almost 400 setups of Islamic finance were working in 1990s, India could not come up with single institution which is on par with any of the conventional finance institutions of India. Despite the significant growth of Islamic finance globally in 100 countries, Indian could not make the implementation of Islamic finance a fact. Despite the fact that Islamic Banking is yet to be formally introduced in India, findings of this study suggest that there is wide acceptance of the core principles on which it is based and it can fairly be concluded that if and when Islamic Banking is introduced in India, its prospects are bright. With emphasis on interest-free, ethical and non-exploitative banking, Islamic Banking may be the right alternative to conventional banking for a country like India It may be ideal for financing development projects, financing micro, small and medium enterprises (MSMEs), agricultural finance, etc., No doubt, there exist several barriers, but with some flexibility and regulatory changes, these can be addressed and overcome. Indian



Muslims are having positive perception towards usability, regulatory characters, socio-political characters and accessibility of Islamic finance. The experts and conveners of Islamic Finance in India are optimistic regarding the success of Islamic finance in India, but according to them there is lack of political will and empathetic view from the regulators for implementation of Islamic finance in India. It requires the policy makers and practitioners of Islamic Finance to pursue a plan for creating awareness among the targeted population for the successful promotion of Islamic finance in India.

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