CHAPTER 4
PRACTICES AND OPPORTUNITIES BEFORE MUSLIM SALARIED PEOPLE IN ISLAMIC FINANCIAL PLANNING
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CHAPTER 4
PRACTICES AND OPPORTUNITIES BEFORE MUSLIM SALARIED
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4.1. INTRODUCTION:

The recent global financial crisis has shown us the critical importance of having equity participation, risk sharing and fair dealings in all banking and financial services. Internationally, trillions of dollars in wealth was wiped out in the crisis. Customers are increasingly looking at alternative ways of banking. Islamic banking institutions are well placed to cater to the needs of such clients, especially those who want to avoid risks which have been rampant in the international conventional financial sector revolving around sub-prime lending, the American market meltdown, toxic assets, mismanagement of leveraged products, speculation, hedge funds, interest rate options, unethical practices, federal bailouts, short selling, mortgaged debts and derivatives.

The basic Islamic financial model works on the basis of mutual risk and reward sharing while avoiding payment and receipt of interest. Any Islamic banking institution is not permitted to finance or borrow from customers and other banks on interest. Both the customer and the bank share the risk of investments on agreed terms, and divide profits or losses between them. In addition, investments should only support practices that are not forbidden; for example, trades in alcohol, pork, betting, pornography and such. While Islamic financial institutions (IFIs) have not managed to emerge unharmed from the current financial crisis, the extent of impact has been limited as compared to their conventional banking counterparts. This has largely been due to Islam's ban on interest, which prohibits these institutions from investing in collateralized debt instruments (CDOs), complex hedging instruments and derivatives, when their primary objective is to mimic underlying securities and seek only the economic benefits with miniscule risk exposure. Since Islamic banks distanced themselves from derivatives; they kept relatively safe. However, IFIs have faced other risks. The concentration of their exposure remained high in real estate, which was also impacted by the international downturn. This topic deals with objectives of the study number 1, 2, 3 and 4 and also problems of the study number 3.

4.1.1. BUSINESS OPPORTUNITY IN ETHICAL FINANCE

The financial crisis has been a blessing in disguise for banking institutions offering Shariah-compliant solutions, providing numerous business opportunities to them. Islamic banking institutions can now target a fresh High Net Worth (HNW) client base. Reversion to more ethical investments by non-Muslims can offer Islamic institutions significant opportunities for expansion. The institutions which can take advantage of this shift in customer preferences during the current great recession should be in a position to become leaders in the future. Islamic law prohibits investing in businesses that are considered haram in Islamic ethical code. Islamic ethical investment structures avoid businesses that deal in gambling, alcoholic liquor, nightclubs, pornography, pork and such. Islamic investments rely on tangible asset-backed transactions and avoid sub-prime securities and financial leverage from hybrid products, derivatives and associated creative accounting practices.
Investors in Islamic investments have an implicit right of information on the use of their funds and the nature and performance of underlying assets. The comfort level of investors through this transparent guarantee on the proper utilization of their funds is a clear advantage in Islamic banking. Non-Muslim scholars at the Anderson Graduate School of Management, University of California, have pointed out that, "Islamic finance will be less prone to inflation and less vulnerable to gambling-like speculation, both of which are fuelled by the presence of huge quantities of debt instruments and derivatives." Islamic banking, if comprehensively implemented in its original form, can be an ethical solution for preventing future financial crises. Many western social investments and green funds are based on promotion of environmentally friendly businesses. Islamic finance does not allow financing anti-social and unethical businesses dealing in gambling, alcoholic liquor, and nightclubs. In this respect, it is clearly ahead of the recent surge in ethical finance and socially responsible finance.

Islamic financial institutions, because of their knowledge of the nature of their clients’ businesses, are in a better position to detect and prevent the channeling of depositors’ money for financing highly risky anti-social activities. The financing it provides is mostly asset-based, whereby the Islamic bank knows the actual utilization of funds due to the very nature of its transparently structured modes of finance. The global market for Islamic banking services continues to expand and the sector has perhaps the best potential for growth of any sector in international finance today. Products that are compliant with Shariah law are gaining wider understanding and acceptance and are making their way into the international mainstream of financial products. The Islamic finance industry, with the help of leading bankers, product development managers, lawyers, regulators and investors, are contributing to new product innovations and expanding the market in breadth and depth.

**4.1.2. PRESENCE AND GROWTH OF ISLAMIC FINANCE**

Although in the past local banks in the Middle East and Malaysia held a monopoly on Islamic finance, a number of non-Muslim institutions have begun to offer Shariah-compliant services, particularly through the issuance of Sukuk (Islamic bonds). The major Western banks currently engaged in this practice include HSBC, Citigroup, Barclays Capital, Deutsche Bank, BNP Paribas and Standard Charter. Similarly, a number of large law firms have Islamic business departments or units.

Much of the proliferation of Islamic banking practices appears to have taken the form of non-Muslim banks opening Shariah-compliant "windows" or branches in the Middle East. Moody's estimates that over $200 billion individual assets lie in these Muslim "windows," in addition to cash and property assets held by dedicated Muslim banks.'

The growth of Islamic finance can be attributed to numerous factors. First, Shariah-compliant products are increasingly attractive to capital providers. Islamic financial products will enjoy greater use as their effectiveness increases and the cost differential between traditional and Islamic products narrows. Many banks are already proclaiming their products are cost-competitive with traditional loans. Second, an increase in the wealth of Muslim countries, fueled in many areas by cash windfalls due to high oil prices, has caused Muslim investors to look for Shariah-compliant options. Third, an increased regional lending capacity in Muslim-populated areas has created a need for Islamic banking options. Fourth, large-scale development projects in the Gulf region have resulted in lenders entering the market. Fifth, a recent increase in the availability of Shariah-compliant products, including an increase in the
penetration of capitalist markets, makes product adoption easier. Finally, there has been a
growing sense of religious identity among professional Muslims, who are seeking new,
tangible ways to express their values and faith.

Overall, Islamic finance is slowly becoming more regulated and practiced in countries where
Muslims are a majority and even in countries where Muslim minorities dominate the political
and business environments. In fact, the penetration of Islamic finance is becoming more
consistent on a country-to-country basis and ranges in extremes, from countries where only
Islamic finance exists to the more common model of Islamic and traditional finance
coexisting and competing with or complementing one another. Yet, not all Muslim countries
are switching to full-service Islamic financial institutions.²

4.2. PRACTICES AND OPPORTUNITIES IN THE AREA OF ISLAMIC
FINANCIAL PLANNING.

Islamic finance activities have grown quite rapidly over the past decades and are projected to
continue in the same fashion. This specific banking segment has become systemically
important in more than a dozen countries in a variety of regions. The reason for this
expansion is that it has acted as a response to economic growth in countries with large and
generally unbanked Muslim populations, as well as to the high demand for Shariah compliant
investment opportunities. Some argue that Islamic finance is more stable than conventional
finance due to the fact that it prohibits speculation. It is fully collateralized as it is asset-
based, and is founded on strong ethical precepts. Furthermore, Islamic financial institutions
are also considered to be a good platform for small and medium sized enterprises as they, in
turn, supports growth and Islamic economic development.

Finance presents a number of potential benefits for traditional institutional investors as well,
which is why conventional banks also participate to that expansion trend. An example of this
would be the fact that Islamic finance is a priori less prone to crisis because its risk-sharing
feature reduces leverage and encourages better risk management.

However, and regardless of all the acknowledged benefits of Islamic banking, this rapid
expansion calls for more regulation in order to foster harmonization and inclusion within our
global financial system. Such is the foundation of a recent IMF report published on April
6th, on the issues raised by Islamic finance.

4.2.1. REPORT FINDINGS:

Islamic financing grew has been growing exponentially since the 1970s (particularly over the
past decade), rising from $200 billion in 2003 to $1.8 trillion by the end 2013, thus
overtaking the growth of conventional banking. Islamic banking has crossed the threshold of
15% market share in terms of assets in 10 countries in the Middle East and now represents
1.25% of global banking assets.

Islamic banks were fundamentally less exposed to the toxic assets that contaminated part of
the financial system after 2007. However, they did suffer a great deal in the aftermath of the
real-estate slump. Still, asset quality and capitalization are better on average compared to
conventional banks, even though overall profitability remains lower.
Sukuk, the Islamic equivalent of bonds, has registered strong growth led by Southeast Asia and the Middle East. Global insurance of Sukuk has increased dramatically since 2006. It reached $120 billion at the start of 2013 and a staggering $270 billion by the end of that same year, representing ¼ of global bond markets. The issuance is evenly split between sovereigns and corporate Sukuk and mainly dominated in ringgits (Malaysian currency) and U.S dollars. There has been more demand than there has been supply, leading to oversubscriptions on most issuances.

Islamic finance has been benefiting from innovation in trade, corporate, project, and consumer finance, improvements in the regulatory environment, ongoing diversification of Sukuk issuers who are more than eager to gain as much as they can from the Islamic world, and by banks who are seeking to strengthen their capital bases from Sukuk issuances. It has begun to overgrow the confinement of countries, as recently bankers all over the world have been paying more and more attention to Islamic finance. Some bankers, who started their career in the conventional banking sector started creating new types of funds, innovative investment concepts. One such banker is Esam Janahi, one of the youngest to turn to Islamic finance at the time and who went on to be awarded the title of Banker of the Year in 2003 and win other distinctions as well for his contribution to the development of the sector. Esam Janahi and others, such as Alberto Brunoni, the President of the oldest European consultancy specialized in Islamic finance, contributed to create links between the conventional and the Islamic sectors. But all those initiatives that have been flourishing all over the world need supervision, which is why this report was overall well received.

A need for regulation to put it in a nutshell, Islamic finance has the potential to contribute to higher and more inclusive economic growth while at the same time help to promote macroeconomic and financial stability. But at the same time, Islamic banks are also subject to a multitude of risks. These risks challenge their legal and regulatory frameworks. Islamic banks may be exposed to displaced commercial risks, relevant especially where competing with conventional banks. They are also subject to equity investment risks because their assets are made up of physical investments whose returns are uncertain. In addition to this, the heightening of market and operational risks caused by the complexity of products places a reliance on commodities to structure some operations.

The IMF highlights the need for more regulation, in order to face these challenges and enable a safer and sounder growth of Islamic finance activities. Islamic rules and regulations should have global uniformity which will ultimately remove conflicting confusions and doubts from the mind of the general customer. Mohamed Norat, Marco Pinon and ZeineZeidane, all members of the IMF staff who contributed to this report, highlight the fact that indeed, regulation only will enable Islamic finance to realize its full potential.

This essentially means more regulatory clarity and harmonization, in coordination with Islamic standard-setters, but also further clarification of the treatment of Shariah compliant instruments in the calculation of Basel III requirements. They also stress the importance of greater consistency in Shariah-compliance across and within the countries. Most stakeholders within the sector welcomed this IMF report which gives evidence that Islamic finance is not an epiphenomenon, that it has legitimacy and that not only Muslim countries and institutions can benefit from it.3
As the global recovery begins to take hold and confidence returns to financial markets, Islamic Finance has returned to prominence. A number of entities, often from markets and industries that had not previously considered Sharia-compliant funding structures, are exploring the opportunities that Islamic finance may present – most notably the UK government. However, there is a perception that Islamic structures are costly to implement and that without an extensive land-bank or other inventory of assets available to an issuer, Islamic finance is not a viable option. Recent developments in both the Sukuk market and more broadly within Islamic finance may prove these assumptions to be incorrect.

There continues to be a supply/demand mismatch in Sharia-compliant asset classes arising from a lack of both assets and diversification within the classes of asset that are available. This has led to problems such as a "hold-to-maturity" culture and the inevitable valuation inaccuracies that this creates. However, there are also benefits as commercial tension has put pressure on pricing and driven down yields in favor of issuers. Abu Dhabi Commercial Bank (ADCB) benefitted from this particular phenomenon in 2012 when it converted its proposed conventional bond issuance to a Sukuk in order to benefit from more attractive pricing.

Traditionally, Islamic finance has focused on Sukuk and, owing to the need to have real assets underpinning the issuance; issuers have tended to be restricted to those with a land-bank to support such issuance. Much of this was as a result of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) pronouncement in early 2008 which criticized a number of Sukuk outstanding at that time. Criticism focused on the valuation mechanic used to calculate the repurchase price for the assets underpinning the Sukuk and, therefore, the amount available to redeem such Sukuk. AAOIFI was of the view that where Sukuk are based on assets such as equity securities which have a fluctuating market value, it is artificial to fix the repurchase price for those assets five years prior to the date of repurchase (in the case of a five-year tenor). This contrasts with land or moveable property which is always sold at the price agreed between buyer and seller when required. The net effect of this was to restrict issuers of Sukuk to those entities that had land or other tangible assets available to them and to focus almost exclusively on the Ijara (sale and leaseback) structure.

However, a number of recent Sukuk issuances have employed more creativity in the selection of assets to underpin the Sukuk issuance and have successfully utilised intangible (but nevertheless real) assets. Two noteworthy examples of this are the AxiataSukuk (which used airtime vouchers as the underlying asset) and the FWU AG Sukuk (which used Intellectual Property in and to a software programme as the underlying asset). These issuances are indicative of a move away from some of the more "traditional" Sukuk asset classes and show a greater creativity by all parties involved. The effect of such issuances should be that more companies may consider ways to use the assets and/or cash flows available to them in their current business to support the issuance of Sukuk and thus find the Islamic capital markets open to them.

However, it would be wrong to focus solely on Sukuk as the only instrument available within Islamic finance. The breadth of offering within the Islamic finance sphere is growing allowing the industry to explore new, innovative structures. Sharia-compliant factoring arrangements have been successfully implemented and there is a growing interest in Islamic risk management (using the IIFM/ISDA Master Tahawwut Agreement) and structured investment products. Risk management tools in particular are assisting the Sharia-compliant market to mature and to mitigate the risk profile of issuers – something that was not
previously the case. Developments have also been seen within the traditional fields of Sukuk evidenced by the growth of "Project Sukuk" (notably that issued by Sadara to fund the joint venture between Saudi Aramco and Dow Chemical) and infrastructure Sukuk (notably that issued by the MRT in Malaysia to fund expansion to the Kuala Lumpur metro) which are linked to, and intended to fund, long-term development projects.

It is perhaps worth considering why new structures and asset classes are appearing to support Islamic finance offerings. The reason for this may be quite simple: as industry professionals gain an increased understanding of the requirements of the Sharia, scholars have gained greater freedom to turn their attention to new structures and asset classes. The growing understanding of industry professionals is in turn helping to drive this process forward through the development of more sophisticated products and new asset classes to present to scholars for their consideration. This should bring greater diversity to the investment opportunities within the Islamic sphere and create opportunities for issuers and investors that have not previously considered Islamic finance as a means to raise capital.

It is important to note that Islamic financing techniques are not limited solely to Sharia-compliant companies or investors. In fact, it is estimated that two-thirds of Sukuk issued are purchased by conventional investors and there is nothing to suggest that broker/dealers treat Sukuk any differently to how they treat conventional bonds. Certain types of company – those that are involved in Haram (forbidden) activities – are naturally excluded from Islamic finance; but for most others there is no restriction. It should also be noted that there is nothing in the Sharia that says that the making of profit is forbidden; it merely restricts the means by which such profit may be made. Conventional investors have become ever-more comfortable with the contractual arrangements and economic returns available within Islamic structures. The development of the Islamic financial market and industry professionals operating within it has led to a reduction in the costs associated with structuring and documenting Sharia-compliant products, adding to the benefits of more attractive yields driven by pent-up demand. All of these factors may encourage more companies to look to Shariah-compliant methods of financing.

Perhaps the biggest fillip for the industry has come with the announcement that the UK government intends to issue a Sukuk by 2015. Whilst the UK government won't be the first government in Europe to issue Sukuk (Saxony-Anhalt was in 2005) it will be the largest and most significant to date. The projected issue size may be relatively small (estimated at £200m) for a government issuance, but it nevertheless illustrates the commitment of the UK to develop Islamic finance beyond its traditional jurisdictions and to encourage other UK companies to consider Islamic finance as a viable option in the future. As the Islamic finance industry continues to develop and confidence returns to the world economy more generally, there are many opportunities for issuers to raise capital by Sharia-compliant means. Whether this occurs through Sukuk issuance or by other Sharia-compliant structures any potential issuer will need to be able to identify assets that will underpin the structure selected. Greater creativity and a deeper understanding of Islamic finance by industry professionals should enable potential issuers to identify asset classes that they had not previously considered and therefore allow them to give serious consideration to Sharia-compliant funding opportunities.
4.3. PRACTICES AND OPPORTUNITIES RELATED TO ISLAMIC INVESTMENT OF MUSLIM SALARIED PEOPLE.

Investment opportunities in India are today perhaps at their peak. Strong population growth, a large pool of highly skilled workers, greater integration with the world economy and increasing domestic and foreign investment are expected to drive India’s real GDP by 6% per annum over the next 10 to 15 years. Riding high on its natural strengths, the country is poised to offer investment opportunities in excess of US$500 billion in diverse sectors over the next five years.

India’s economy is predicated on export of highly-skilled workers in software and financial services, and software engineering. Other sectors like real estate, manufacturing, pharmaceuticals, biotechnology, telecommunication, shipbuilding, aviation and tourism are showing strong potentials with higher growth rates.

Putting strong faith in Indian economic increasing number of gulf investors have started turning to India for their investment needs. This is proven from the fact that during the last six months, more than US$10 billion worth of investments had been announced by major Islamic finance players in the Gulf.

With the rise of Islamic investments, domestic Islamic finance players have started playing aggressively. A few examples are worth mentioning here. Mumbai-based Shariah advisory firm TASIS is in the advanced stages of finalizing an agreement with a UAE-based Shariah advisory firm for bringing a suite of Islamic financing solutions to Indian corporates. Mumbai-based brokerage firm IDAFA has started venturing outside its stronghold. Now, the company is spreading its wings to other Indian cities such as Hyderabad, Chennai and Bangalore. Bangalore-based Bearys Group, the proud of India’s first Shariah-complaint realty fund, has established an Islamic finance company focused on foreign investment in real estate.

Ahmedabad (Gujarat) based Parsoli Corporation is reported to be in talks with Delhi-based Taurus Mutual fund for launching an Islamic mutual fund. Similarly, a few institutions have come up with offers on Islamic finance education and training. With such opportunities increasing, more and more, students from reputed institutes like Aligarh Muslim University, Indian institute of planning and Management (IIPM), and institute of Chartered Financial Analyst of India (ICFA) are opting for Islamic finance courses.

1. Stock market opportunity:

To assess the extent of Islamic investment opportunities on the stock market, one only has to look at the availability of stocks that conform to the norms stipulated by the Islamic Shariah. When we talk about Shariah-compatible stocks, criteria to bear in mind are: (i) business of the company, (ii) nature of contract under which the invested capital of the enterprise is
mobilized, and (iii) Shariah-compatibility of the shares of the company for purposes of trading.⁵

2. Islamic Investment Opportunities in India:

Globally, Islamic finance is estimated to be worth about $350 billion, growing at 20% annually. With this growth, the need for Shariah compliant financial products has also increased. The product offerings are similar to normal banking products; however the main difference is that the funds collected are not for the purpose of accumulating/ paying interest or invested in any negative businesses that harm morality of the society. The basic principle of Islamic banking is the prohibition of interest.

India with a 15% Muslim population, the highest in a non-Islamic country and third highest in the world is slowly becoming forefront of Islamic banking initiatives. It has benefited the Indian economy by attracting investments from the cash rich Middle Eastern economies on the lookout for new investment destinations. After 9/11, most of these countries started pulling out their investments from the US and Europe because of the fear of freezing of assets. Another reason could be the slowdown in the economies of western countries. A growing Indian economy has created huge interests among Islamic nations. Five Indian companies, Reliance Industries, Infosys Technologies, Wipro, Tata Motors and Satyam Computer Services figure in the Standard & Poor’s BRIC Shariah Index.

3. Shariah Law:

Shariah is Islamic canonical law, which observant Muslims adhere to in their daily lives. Shariah has certain strictures regarding finance and commercial activities permitted for Muslims. It prescribes a set of criteria which needs to be satisfied before a Muslim investor or institution can invest in the equity of a given company. From the view point of Shariah law, businesses such as those dealing in pork, alcohol, gambling, conventional financial services, media or advertising, tobacco, pornography, music etc are non-permissible for investment. Furthermore, companies have to be screened so that they satisfy certain accounting ratio restrictions.

4. Shariah Compliant Investment Avenues:

Out of 6,000 BSE listed companies, approximately 4,200 are Shariah compliant. The market capitalization of these stocks accounts for approximately 61% of the total market capitalization of companies listed on BSE. This figure is higher even when compared with a number of predominantly Islamic countries such as Malaysia, Pakistan and Bahrain. The growth in the market capitalization of these stocks was more impressive than that of the non-Shariah compliant stocks.

The software, drugs and pharmaceuticals and automobile ancillaries sector were the largest sectors among the Shariah compliant stocks. They constitute about 36% of the total Shariah compliant stocks on NSE. Further on examining the BSE 500 the market capitalization of the 321 Shariah compliant companies hovered between 48% and 50% of the total BSE 500 market capitalization.
5. Stock Market:

Under Islamic banking, the conditions for investing in shares are:

1. The company’s activities should not include liquor, pork, hotel, casino, gambling, cinema, music, interest bearing financial institutions, conventional insurance companies, etc.

2. It is not permissible to acquire the shares of the companies providing financial services on interest, like conventional banks, insurance companies, or the companies involved in some other business not approved by the Shariah, such as companies manufacturing, selling or offering liquors, pork haram (prohibited) meat, or involved in gambling, night club activities, pornography, gold trading, advertising and media (with the exception of newspapers).

3. If the main business of the companies is halal (lawful), like automobiles, textiles etc, but they deposit their surplus amounts in an interest-bearing account or borrow money on interest, the shareholder disapprove such dealings.

4. If income from interest-bearing accounts is included in the income of the company, the proportion of such income in the dividend paid to the shareholder must be given to charity, and must not be retained by investor.

5. The shares of a company are negotiable only if the company owns some illiquid assets. If all the assets of a company are in liquid form, i.e. in the form of money, they cannot be purchased or sold except on par value, because in this case the share represents money only and the money cannot be traded in except at par.

6. For companies whose main activity is not un-Islamic but a part of their income is not purely Islamic or a minor part of it comes from un-Islamic activities are prohibited, for example hotel, sugar, entertainment etc.

Once companies are chosen from the above criteria, further screening is done on the basis of following financial ratios:

1. Exclude companies if Total Debt divided by Trailing 12-Month Average Market Capitalization is greater than or equal to 33%.

2. Exclude companies if the sum of Cash and Interest Bearing Securities divided by Trailing 12-Month Average Market Capitalization is greater than or equal to 33%.

3. Exclude companies if Accounts Receivables divided by Total Assets is greater than or equal to 45%.

4. Exclude companies if they have any interest bearing income more than 10% in any condition.

For profits made through capital gains, the accepted rule is that if requirements of the ‘halal’ shares are observed, then most of the assets of the company are ‘halal’, and a very small proportion of its assets may have been created by the income of interest, so the whole price of the share therefore, may be taken as the price of the ‘halal’ assets only.
Following are the Shariah financial products (halal assets):

1. Mutual Funds

Another opportunity is mutual fund which is based on 100% equity. These funds are invested in different sectors like IT, automobile telecommunication, cement and a few present in interest based financial institutes, almost 10 to 15%. So investor has to purify that amount from the profits. And also there are many sectorial funds which invest only in a particular sector like automobile, Oil & Gas.

Here are some of the most common types of the Shariah compliant funds and their basic investment profile, which an investor must know before leaving his/her hard-earned money at their disposal.

2. Equity Funds

As the name suggests, equity funds invest the money pooled in from the investors into stocks. Equity MFs are further classified into sub-categories depending upon the asset classes such as large-cap, mid-cap and small-cap, sectors or themes. Equity funds carry a bigger risk profile than the bond funds.

3. Sector Funds

Sector funds invest in the stocks of one particular sector and these funds are generally conceptualized after some sector catches fancy of the market or when there is any significant buzz for some major growth in a particular sector. For example, the infrastructure sector is the current favorite in the MF circle, while a few other sectors with exposure to the country’s infrastructure growth are also finding favor. However, sector funds do not offer the much-desired diversification to the MF investors and often these funds enter the market after most of the growth has already materialized in that particular sector. However, there are certain defensive sectors like FMCG and pharmaceuticals, which consistently witness some modest growth with limited volatility.

4. Index Funds

The index funds primarily invest in the constituent stocks of a particular market index, such as Sensex and Nifty, and most often track the movements of those indices. While during a bull run, index funds can give impressive returns, the losses are also sharp during the bearish phases of the market. However, the index funds are known to given good returns in the long term, as their portfolio generally consist of stocks with proven track record. Here however you have to consider purification as quite a few banking stocks are there in the current index.
5. Growth Funds

These funds invest in growth stocks, or the stocks of those companies that are likely to see a sharp rise in their sales and profits. These funds seek to cash in upon the rise in the share prices of these companies, driven by their bulging sales and profit books.

6. Real Estate

The real estate sector is attracting investment from Middle East, as fund raising has got difficult in this sector. India has so far seen investments of over $500 Million for middle-east investors in real estate sector. Investing in real estate is relatively better than stocks or mutual funds where risk and uncertainty are very high.

4.4. PRACTICES AND OPPORTUNITIES RELATED TO THE SHARIAH LAW AND PRINCIPLES.

The Shariah Law in Islam is regarded as the religious law of life and is used in reference to both the Islamic system of law and the Islamic way of life. Islamic Finance is also based on these principles.

The two main sources of Shariah are the Koran, the holy book of Islam, and the Sunna (Islamic guide) which describes the sayings and actions of the Prophet Mohammed during his lifetime. Shariah emphasizes the importance of moral and ethical behaviour as well being considerate of each other’s requirements and circumstances.

A concept underlying Islamic finance is that money has no intrinsic value and hence there is no charge for it. This implies that riba (interest) is prohibited in Islam since money is considered as a medium of exchange, a store of value and a unit of measure.

4.4.1. THE MAIN PRINCIPLES UNDERLYING ISLAMIC FINANCE ARE:

1. The prohibition of interest whereby it is not permitted to take or receive interest. However, this does not prohibit earning a rate of return on the investments.

2. Speculative behaviour is not allowed. In Islam, this is known as Gharar and implies that gambling and activities that involve extreme risks or uncertainty are prohibited.

3. Shariah principles do not permit the financing of certain activities such as gambling, alcohol, pornography, intoxicating drinks, non-slaughtered animals, entertainment, tobacco-related products, weapons and conventional insurance. Moreover, investments in unlawful activities and capital guarantees are avoided.
Islamic finance is a way to accommodate the values of Islam in finance. It is based on Islamic law, or Shariah, which is designed to promote social and economic justice. Shariah is known for prohibiting interest or usury (Riba), speculation or gambling (Maysir), excessive risk or uncertainty (Gharar) and oppressive practices. Muslims must evaluate business activities to determine whether the business is Halal (“just” or “lawful”), which can be handled, or Haram (“unjust” or “sinful”), which cannot be handled in financing. Haram business activities include the manufacturing or marketing of products such as alcohol, gambling or gambling activities, pork and pork products, certain forms of adult entertainment.

It is important to mention that Shariah specifies no finance is given without actual contracts unless and until all contracts meet the following requirements: (i) there must be a minimum of two parties to an arrangement; (ii) the product must be real and must be owned by one party; (iii) there must be an offer and an acceptance of the offer; (iv) all parties must fully agree to the deal’s purpose and terms; (v) the price must be agreed on mutually, with no party subject to duress; (vi) there must be no undue burden on one party to the advantage of another; (vii) the term must be in accordance with other Shariah principles. For example, a contract involving a prohibited product such as alcohol or pork would not be acceptable.

The desire for financing modes and investment vehicles that are in accordance with Shariah principles has impacted the growth of Islamic finance today. “Shariah governance” is typically described as “a set of institutional and organizational arrangements through which Islamic Financial Institutions (IFIs) ensure that there is an effective independent oversight of Shariah compliance over the issuance of relevant Shariah pronouncements, dissemination of information and an internal Shariah compliance review. “Shariah compliance” is “to describe financial activities and investments that comply with Islamic law which prohibits the charging of interest and involvement in any enterprise associated with activities and products forbidden by Islamic law. Since Shariah is the backbone and foundation for the existence of the Islamic banking and finance industry, Islamic finance experts assert Shariah governance should be considered as the single most important distinction between a conventional and an Islamic financial institution.

Islamic, or Shariah-compliant, finance is concerned with the conduct of commercial and financial activities in accordance with Shariah, or Islamic law. Islamic finance emphasizes productive economic activity over pure speculation, and encourages transaction counterparties to share profits and losses in order to promote collaborative efforts. The main Shariah principle relating to Islamic finance is the prohibition of Riba, which essentially represents unearned excess or profit charged in connection with a transaction, and derived by the mere passage of time. This is generally thought to include a prohibition against charging interest in connection with the use of money. Other relevant Shariah principles are the prohibition of: (i) Gharar (undue uncertainty in a contract); (ii) Maysir (impermissible speculation); (iii) Qimar (transactions tantamount to gambling); (iv) Investing in, or being
involved with, haram products and activities (such as alcohol and gambling establishments); and (v) becoming unjustly enriched.

4.4.2. ISLAMIC FINANCE STRUCTURES:

Profit and loss sharing forms the bedrock of Islamic finance since Islam perceives that the ideal relationship between contract parties should be that of equals where profit and losses are shared. Shariah by no means prohibits the making of profit, but it does scrutinize the basis upon which profit is made as, for example, charging interest could exploit the client in a time of hardship whilst the financier’s wealth is increased by no effort of its own. Islam instead empowers the financier to derive a profit by investing its money or other consideration directly (or indirectly through a joint venture arrangement, for example) in real assets using one or more of the Islamic finance structures discussed below. The financier will then generate a profit and recoup the principal sum invested in the asset by exercising its rights as an owner; using, leasing, or selling the asset. Here, unlike conventional finance, the money itself has not yielded the profit; instead the assumption of the risks and responsibilities as owner of the asset, or as a partner in the venture, has yielded the profit made by the financier. This highlights the preference of Islamic finance for equity over debt and seeking to deal in tangible assets. This also explains why Islamic finance can be used as a form of both asset backed financing and asset based financing.

The principal Islamic finance structures applied in a commercial context (either singularly or in combination) are:

1. Ijarah (lease):

A form of lease financing pursuant to which the usage (usufruct) of an asset or the services of a person are leased by the lessor to the lessee for rental consideration.

2. Istisnah (procurement):

A contract for the manufacture or development of an asset. Under this structure, one party engages a counterparty to construct an asset in accordance with agreed specifications, and agrees to purchase or lease the asset upon completion.

3. Murabahah (cost-plus financing):

An asset purchase transaction, in which a party purchases an asset from a third party upon the request of its counterparty, and then resells the asset to that counterparty. The sale price payable by the counterparty equals the original acquisition price paid by the first party plus an agreed return (i.e., cost-plus), and is payable on a deferred basis.
4. Mudarabah (investment fund arrangement):

An investment fund arrangement, under which one party (the rab al maal) provides capital to an enterprise while a second party (the mudarib) contributes work. The mudarib manages the enterprise's capital for a fee, and the mudarabah parties also share profits of the enterprise according to agreed percentages. However, only the rab al maal bears the risk of losing money on the enterprise.

5. Musharakah (partnership arrangement):

A partnership arrangement in which transaction parties contribute cash or property, or both, to a collective enterprise. The parties share profits according to agreed percentages (as with the mudarabah), but also share losses in proportion to their capital investments.

6. Sukuk (Islamic trust certificates):

Often referred to as 'Islamic bonds', sukuk are more akin to Islamic trust certificates representing an undivided beneficial ownership interest in an underlying asset where the return is based on the performance of that underlying asset. A sukuk issuer pays an agreed amount of the revenue produced by the sukuk assets to the sukuk holders.

4.5. PRACTICES AND OPPORTUNITIES RELATED TO THE ISLAMIC FINANCE AND SHARIAH AWARENESS.

Islamic banking is fast emerging as an alternative to the interest based conventional banking. It has registered exponential growth in last two decades. The recent global financial crisis and its impact on the conventional banking, has further given impetus to the concept of Islamic banking. India, with a Muslim population of over 180 million is the second largest Muslim population in the world. It remains an unexplored and a big market for Islamic Banking system.

“Islamic finance has become a competitive form of financial intermediation that has been able to meet the differentiated requirements of our economies. In an environment of rapid change, a key factor that will influence the future prospects of the Islamic financial services industry will be the investments to build the foundations on which further progress can be achieved. Investing in the future, in research and development and in the development of talent and expertise will be the differentiating factor that will contribute to the effectiveness, resilience and competitiveness of the industry. This undertaking needs to be the joint responsibility of both the private and public sectors to mutually elevate the performance of the industry and thus increase its potential to contribute to wealth creation and prosperity of our nations.”

Innovation is a key to sustaining growth and securing the competitive advantage. Innovation is about developing new Islamic financial products and services and increasing the range of products and services to meet the more sophisticated and complex requirements of today’s
consumers and businesses. It is also about improving the overall efficiency by which the products and services are being provided. Innovation will also involve the introduction of new structures that may contribute towards enhancing convenience for consumers and businesses. Finally, it may also contribute towards creating new markets or expand the existing markets for Islamic products and services. Industry practitioners thus have an important role to promote innovation. Financial institutions need to equip their business strategies with research and development to design new innovative products and services. Such innovative financial products and services which are credible, competitive and Shariah compliant would indeed find a ready market. The introduction of the global sovereign Sukuk more than two years ago was an important innovation that has since gained significant ground.

Innovation can also take the form of the application of technology to improve convenience for customers and reduce the cost of financial transactions. In embracing new leading-edge technology, the potential for the Islamic financial industry to provide new products and services will be enhanced. It also represents the potential to increase access to financial products through a wider range of new delivery channels. Greater application of IT in the industry can also enhance efficiency by driving down costs for consumers and businesses. Other areas include leveraging on IT in making strategic decisions in the alignment of business, in elevating institutional capacity and operational efficiency and strengthening risk management capabilities. Moving forward, the enhancement of technological capabilities becomes vital for the financial industry as it competes in an increasingly technology-driven environment.

The environment and the incentive structure are also important in providing an enabling environment that promotes innovation. In particular, the regulatory framework and the tax structure are important to the innovation process. The regulatory framework should not be so onerous as to impose a high cost and a regulatory burden on businesses. Intrusive regulatory approaches on new products can become a disincentive to innovation. Tax structures can also be designed to support the innovation process. Within financial institutions, organizational structures can also create an environment for innovation by aligning the organization’s processes and implementing appropriate performance incentives.

The pace of innovation that has taken place in the Islamic financial services industry has contributed to the development of a broad and diversified range of Islamic financial products and services that has been able to effectively mobilize financial resources to meet the investment requirements of the economy. Notwithstanding this significant progress, the process of innovation in Islamic finance has generally been structured mainly along the adaptation approach. Although there are Islamic financial instruments that are distinct from the conventional financial instruments, the numbers are still few. In most instances, the Islamic financial products are repackaged along the features of the conventional financial products, while eliminating the elements that are not in compliance with the Shariah.

The Islamic financial services industry is now at the threshold of a new level of development. As we advance forward, the Islamic financial services industry can expect to have a different set of regulatory and supervisory standards which is conducive to its unique financial
operations. There is also an increased awareness and understanding amongst the international financial community on the distinct nature of Islamic banking and financial operations. In addition, a higher degree of Shariah dynamism is evident in the evolution of sophisticated Islamic financial products that are being structured based on multiple Shariah concepts. Against these developments, it is timely to move away from “plain vanilla” innovation and to embrace a new wave of innovation that will evolve Islamic financial instruments into distinct products that will maximize the potential and wisdom of the Shariah and that meets the greater sophistication of consumers and the more complex requirements of today’s businesses. This paradigm of innovation in Islamic finance, which by itself shall accord Islamic financial institutions with the competitive advantage to forge ahead, entails substantial and continuous investments in research and development (R&D). R&D is indeed an essential aspect of modern industries and enterprises and is no less the case in the financial world. There are three important pre-requisites in strengthening research and development capabilities, namely, adequate allocation of resources for infrastructure development, forging strategic alliances through smart partnerships and developing the required pool of qualified and skilled talent.

4.5.1. SWOT ANALYSIS OF ISLAMIC FINANCE:

A. STRENGTH

1. Proved better banking system in recent global financial crisis.
2. Based on profit and loss sharing agreements.
3. Based on the principles of Sharia
4. People have positive attitude that Islamic banks are and based on equity, justice and ethics.
5. More controlled form of banking due to dual monitoring.

B. WEAKNESS

1. Majority of people believe that this system is for Muslims only
2. Market share is negligible as compare to conventional banking
3. Major regulatory and legal framework need to be changed
4. There are some conflicts in Shariah laws among different school of thoughts.
5. Lack of awareness about Islamic Banking system
C. OPPORTUNITIES

1. Biggest Muslim population in the world
2. An alternate to the conventional banking
3. Chances of innovation and reengineering in financial products are more
4. Positive attitude of Indian Muslims and non-Muslims towards Islamic banking.

D. THREATS

1. Opposition by some political groups.
2. Stiff competition from conventional banks.
3. There is a perception that religion and financial matters are two separate things.

There is a general lack of awareness about Islamic banking in India. It is completely a new alternative banking system. People are less aware about Islamic Banking and its terminology. Both Muslims and non-Muslims show a positive attitude towards Islamic Banking. However, a good number of respondents said that they will prefer to put their savings in Islamic Banks if these banks provide better profit than existing commercial banks. Most of the Muslim respondents say that they will either keep the deposit in same or the different Islamic Banks, because placing a deposit with a non-Islamic Bank contravenes Islamic principles. Further, they wished to remain a depositor at the Islamic Bank if it has no profit to distribute on investment and saving deposits for any one year because of their hope that it could distribute high profits in the subsequent years.

The fast pace of innovation in global financial services in general and for the Islamic financial services sector in particular, will demand a rapid and continuous infusion and upgrading of skills. Developing a substantial pool of talent and expertise is indispensable for strengthening research capabilities. In this regard, there has to be a strong focus on human capital development through training and education. In today’s competitive environment, intellectual capital is the major factor in determining the level of innovation and competitiveness of an institution or corporation. A key challenge for Islamic financial institutions is to attract a knowledge-based workforce with the skills required to enhance the potential for innovation, productivity and performance. The Islamic financial services industry needs to continually promote human capital development and expertise to create a larger pool of experts and high caliber professionals. This involves attracting and retaining the existing talent, and building a robust pipeline of skilled individuals for the future. In addition, specialists in Islamic finance would need to combine knowledge and understanding of the Shariah with the necessary skills in finance. The provision of training and career development will have a key role in the sector. Learning systems therefore need to be strengthened to meet the skills and talent requirements of the next decade.
Training is a joint responsibility between the industry, academia and Government. In Malaysia, the Government plans to establish an international financial training institute on Islamic finance. The groundwork to establish this institute has already commenced. While this may meet some of the requirements, Islamic banking institutions are also encouraged to explore the feasibility of entering into collaborative arrangements with universities and other institutions locally and abroad, to identify and provide specialized training for the financial services industry. These would include training workshops and courses in new and emerging product lines which require specialized skills and expertise.

Education of graduates and other personnel entering the Islamic financial market is also important. Undergraduate opportunities to study Islamic finance or Shariah, either as a specialty or a major component of a business degree, should be readily available at local and foreign universities. The challenge is to provide programmes which keep pace with changes in financial innovation and technology. Meeting this need requires rigorous, extended programmes such as the post-graduate programmes in Islamic Finance and Financial Engineering with emphasis on Islamic banking principles. At the same time, relevant organizations can support such programmes by creating funds to sponsor promising students to pursue formal education, ranging from modular courses in Islamic finance to full post-graduate programmes. There is also a need to increase programmes and initiatives that provide education and training in Shariah. Islamic research organizations and financial institutions need to work towards developing a sufficient number of competent Shariah scholars who are equipped with sound knowledge and expertise in both Islamic jurisprudence and Islamic commercial laws to deal with innovative and cutting-edge products.

There is also the need for extensive education of the consumer and business community. This would increase the outreach resulting in increased demand for new and innovative products and approaches. Malaysia has implemented 10-year structured consumer education programmes to increase the level of consumer awareness on the unique characteristics of Islamic financial products and the product choices offered by Islamic financial service providers. Increased awareness will drive the demand for a broader range of Islamic products and services customized to their requirements at more competitive prices and through more convenient channels. The outreach has also been targeted at small and medium sized businesses. This process will also prompt the financial industry to increase innovation to strengthen their competitive position. This can be reinforced by market research to enhance the understanding of customers’ distinct financial needs and their risk tolerance and therefore enable the design of Islamic financial instruments that offer tangible benefits and value to customers. In addition, with increased disclosure and transparency on the manner in which Islamic financial transactions are being conducted and on how Islamic financial contracts are being executed as well as on the risk and return profiles of financial products, this will further strengthen the role of competition. In conclusion, the investment in the future needs to be undertaken by all the relevant entities in the Islamic financial sector - the industry, the regulators, the market participants, the academia and the international community. As a coordinated and concerted effort it will be mutually reinforcing in elevating the performance of Islamic finance. While the increasingly more competitive prevailing environment raises the pressures to produce immediate-term results, it is the investment in human capital and in
research and development that will secure the long-term sustainability of the industry. It is these investments that will be the defining element of the future development of Islamic finance and its long-term success.  

4.6. PRACTICES AND OPPORTUNITIES RELATED TO THE SHARIAH BASED FINANCIAL PRODUCT.

The basic Islamic financial model works on the basis of mutual risk and reward sharing while avoiding payment and receipt of interest. Any Islamic banking institution is not permitted to finance or borrow from customers and other banks on interest. Both the customer and the bank share the risk of investments on agreed terms, and divide profits or losses between them. In addition, investments should only support practices that are not forbidden; for example, trades in alcohol, pork, betting, and pornography.

While Islamic financial institutions (IFIs) have not managed to emerge unharmed from the current financial crisis, the extent of impact has been limited as compared to their conventional banking counterparts. This has largely been due to Islam's ban on interest, which prohibits these institutions from investing in collateralized debt instruments (CDIs), complex hedging instruments and derivatives, when their primary objective is to mimic underlying securities and seek only the economic benefits with miniscule risk exposure. Since Islamic banks distanced themselves from derivatives; they kept relatively safe. However, IFIs have faced other risks. The concentration of their exposure remained high in real estate, which was also impacted by the international downturn.

Islamic banking products are increasing day by day and previous studies found that Islamic banking products are on a par with conventional banking products. There is a lot of Islamic banking products in Malaysia, however there are some common Islamic products that will be discussed briefly in this section:

i. Bai' al 'inah (sale and buy-back agreement):

Bai' al 'inah is a contract which involves sell and buy back transactions of an asset by a seller to the customer. The seller will sell the asset on spot basis but the customer will buy back the asset on deferred payment at a price higher than the cash price. In other words, subsequently the asset is sold to the customer on a deferred-payment basis and the price is payable in installments.

ii. Bai' bithamanajil / BBA (deferred payment sale):

BBA refers to the sale of goods on a deferred payment basis at a price, which includes a profit margin agreed to by both parties. It means that the Islamic bank will purchase certain assets on a deferred payment basis and then sell the goods back to the customer at an agreed
price including some margin or profit requested by the customer. The customer will paid in installments over an agreed period.

iii. Murabahah (mark-up):

Murabahah is a cost-plus financing contract where a sale is made at a specified profit margin. It establishes a form of mutual contract between two parties where they agree to the mark-up. The bank acts as an intermediary and purchases the goods requested by the customer. The bank will later sell the goods to the customer in a sale and purchase agreement, whereby the lender re-sales to the borrower at a higher price agreed on by both parties. Murabahah is derived from the root word which means profit, gain or a legal addition.

iv. Mudarabah (trust financing):

Mudarabah is a form of partnership where one party (rab-al-mal) provides the funds and the other party (Mudarib) assumes the role of the entrepreneur through effective management. While rab-al-mal is the sleeping partner in the South East Asia partnership contract, the mudarib is directly involved in the day-to-day running of the business. The parties share the profit of the business venture based on agreed percentage and bear any loss incurred. In the event of losses the entrepreneur loses his or her labor and the financier loses the capital.

v. Musharakah (partnership contract):

Musharakah is a word of Arabic origin meaning ‘sharing’. It is a form of shirkat al-amwal where all partners invest capital into the joint-venture. Musharakah emphasizes practical participation of parties in the partnership business and it is a form of partnership between two or more parties based on mutual trust. Musharakah means partnership whereby the Islamic financial institution provides the capital by the customer with the understanding that they both share the profit and loss according to a formula agreed before the business transaction is transacted.

vi. Ijarah (leasing):

Ijarah is a financing mechanism involving rental of an asset or hire purchase where a form of rental fee is paid for a stipulated period of time agreed by the parties. This is more in accordance with the Shariah concept of leasing where the bank acquires ownership based on the promise and leases back to the client for a given period. The customer pays the rental but the ownership still remains with the bank. As the ownership remains with the lessor (bank), who is responsible for its maintenance, it continues to give the service for which it was rented.

vii. Istisna (Manufacturing contract):

Istitna is a manufacturing contract of a made-to-order asset based on a deferred delivery basis. It is a transaction on a commodity before the commodity is produced. The manufacturer is morally obliged to produce items which are at the agreed time and in accordance with specifications (price, quality, description). The price, specification,
description and quality of the commodity to be manufactured should be fixed with the consent of the parties to the contract. Normally, Istisna is used to finance construction and manufacturing projects.

viii. Takaful (Islamic insurance):

Takaful is a conventional Islamic insurance and also is an alternative form of cover that Muslims can avail themselves against the risk of loss due to accident. It is depend on the concept of what is uncertain with respect to an individual may cease to be uncertain with respect to a very large number of similar individuals. Insurance by combining the risks of many customers enables each individual to enjoy the advantage provided by the law of large numbers.

4.7. PRACTICES AND OPPORTUNITIES RELATED TO THE ISLAMIC FINANCIAL MARKET.

The world’s economic centre of gravity is gradually shifting from the established, wealthy economies of Europe, Japan and North America to the emerging economies like China, India and South East Asia, with China and India projected to be the largest economies of the world in the next 50 years. Improving macroeconomic fundamentals, higher disposable incomes, emerging middle class, low cost and highly competitive workforce, investment friendly policies and progressive reform processes are all likely to combine to make a strong case for India to have a larger share in the overall investment pie. With this sound economic base and with hundreds of companies complying to the Shariah laws, India offers a large economic opportunity for Islamic investors, who follow Shariah investment and therefore can’t invest in interest-based ventures or in Islamic unethic ventures like tobacco, alcohol, fashion, gambling, vulgar entertainment and conventional finances like banks and non-banking financial institutions.

Realizing the growing need of Islamic investments in India, the Indian government has recently taken a number of steps in this direction. First, a high-level committee appointed by the government to prepare India’s future financial structure recommended interest-free banking for inclusion of Muslims in the financial sector. The Report draws its significance from the fact that this is first time an Indian finance committee has said something on the issue, which hitherto was considered quite sensitive in political circles. This is a good sign for Islamic finance in India. Recently the financial crisis in the West and the drought of liquidity in this region has made Indian policy makers look for other alternatives of financing. The recent visit of the Indian Prime Minister, although at the far end of the tenure of the present government, to a couple of GCC countries assumes more significance in this regard. The Indian Prime Minister visited the region along with his Chief Economic Advisor Professor RaghuramRajan who had earlier recommended Islamic banking in his report to the government.
For more than a quarter century, Islamic banking and finance has been developing from an idea and an expression of Muslims' distinct identity to a mature and fast-growing industry. With the latest global financial crisis, Islamic banking and finance became one of the most debated issues around the world. Because all that is different in their shape and reaction is attractive, Islamic banks have been analyzed since the onset of the crisis in order to identify their characteristics, sources of resilience, weaknesses, potentials and opportunities for growth.

The Islamic banking system is an important component of Islamic finance. Islamic finance has unique features because its foundation is laid on the principles and rules of Islamic law (Shariah), which states that everything is owned by Allah and man has only been permitted to use it. Accordingly, the use of funds is governed by several regulations.

In a general first assessment of Islamic banking, the risk and equity sharing characteristic stands out. The most essential feature of Islamic banking is the prohibition of interest (Riba). Islamic banks neither charge nor pay interest in a conventional way where the payment of interest is set in advance and viewed as the predetermined price of credit or the reward for money deposited. Islamic law accepts the capital reward for loan providers only on a profit-and loss-sharing basis, working on the principle of variable return connected to the actual productivity and performances of the financed project. Another important aspect of Islamic banking is its entrepreneurial feature. The system is focused not "only on financial expansion but also on physical expansion of economic production and services." In practice, Islamic banks have concentrated on investment activities such as equity financing, trade financing and real estate investments.

Islamic banks are profit-driven institutions just like conventional banks, but they manage all their activities in accordance with sharia. Notably, the first modern Islamic banking phenomenon emerged as a result of the reaction of Muslim intellectuals to the use of conventional commercial banks in trade activities between local business communities and imperial powers. Colonial rule in Islamic countries heightened Muslims' need to maintain and protect Islamic law and principles, even in the financial sphere. Early experiments in this sector were undertaken in 1963 in Egypt and Malaysia. Without any references to Islamic principles (for fear of political repercussions), Ahmad El Najjar established the first Egyptian savings bank based on no-interest and profit-sharing principles. Muslim Pilgrims Savings Corporation was the first Islamic financial institution in Malaysia. It was set up to help people save for performing hajj. Today, Malaysia is the biggest issuer of Sukuk (Islamic bonds) worldwide and one of the main promoters of regimentations and innovation in the Islamic banking system.

The first genuine Islamic banks were not launched at the national level. Instead, during the 1970s, a number of these banks were established on a more local level in the Middle East and North Africa. The very first Islamic bank was Nasser Social Bank, which started to operate in Cairo in 1972. It was followed by Dubai Islamic Bank in 1975, and Faisal Islamic Banks was established in 1977 in Sudan and Egypt. The second step in the evolution of the Islamic banking system was to take the system to an international level by creating the first Islamic international financial institution, the Islamic Development Bank, in 1973. The third step
came with the transformation of entire national banking systems into sharia-compliant systems. This is currently the case in Iran, Pakistan and Sudan.

Islamic banks operate mainly in Muslim countries, but currently they are also operating outside these countries. For instance, the United Kingdom has become the most important location for Islamic financial activity outside the Muslim world. Today, approximately 53 countries have Islamic banking institutions, and at least 70 countries have some sort of Islamic financial services. Almost without exception, the major multinational banks presently offer a broad range of sharia-compliant financial products and services. The largest Islamic banks are located in Gulf Cooperation Council countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates).

For the last four decades, the Islamic banking system has experienced a tremendous evolution from a small niche visible only in Islamic countries to a profitable, dynamic and resilient competitor at an international level. The size of Islamic banks around the world was estimated to be close to $850 billion at the end of 2008 and is expected to grow by around 15 percent annually. While Islamic banking remains the main component of the Islamic financial system, the other elements, such as Takaful (Islamic insurance companies), mutual funds and Sukuk (Islamic bonds and financial certificates), have witnessed strong global growth, too. According to a reliable estimate, the Islamic financial industry now amounts to over $1 trillion. Moreover, the opportunity for growth in this sector is considerable. It is estimated that the system could double in size within a decade if the past performances are continued in the future.

In the decade prior to the financial crisis, the sharia-compliant financial system had quite exceptional returns. Assets doubled almost every two years, and net income doubled every year. There were some institutions with a posted return on equity of more than 30 percent and in some cases even more than 40 percent. They were also able to earn an average return on assets reaching 10 percent. Even if these figures are not exceptional compared to those posted by conventional financial institutions between the years 2000 and 2007; they are quite remarkable if we consider the timeframe and the dynamics of the Islamic financial system's evolution.

The global financial crisis that started in 2007 was the first real challenge for this fast-growing financial sector. The climate generated after the crisis hit the real economy, creating both challenges for its foundation and opportunities for rapid expansion. The crisis's aftermath could be divided into two important phases: its impact on the financial sector, and the effects generated by the financial crisis on the real economy. Due to the lack of comprehensive and detailed research, the analysis of the performance of the Islamic banking system during the crisis is mainly based on empirical evidence, testimonials and analysts' reasoning.

The first stage of the crisis, during 2007 and 2008, favored the Islamic banking system compared with the conventional system. According to a recent IMF study, Islamic banks performed better than conventional ones in 2008 in terms of profitability, credit and asset growth. The Islamic banks' profitability crunch was less than 10 percent, whereas the
conventional banks' profitability slumped more than 35 percent in 2008 compared with 2007. The IMF study reported that Islamic banks have maintained stronger credit growth compared to conventional banks in almost all countries and in all years, suggesting that the system has great potential for further market-share expansion and a possible contribution to market stability through the available credit. The same trend was maintained on the assets side, which was less affected by deleveraging and grew on average more than twice that of conventional banks during the period of 2007 to 2009. Because the global crisis is an ongoing phenomenon, these results are provisional; however, they are supported by the Islamic banking system's characteristics.

The Islamic banking business model's features helped the system by protecting it from the first financial impact of global crisis. While conventional finance is largely debt-based and allows for risk transfer, Islamic financial intermediation is asset-based and focuses on risk sharing. Prohibition on excessive leverage and on risk transfer according to Shariah principles made the system more resilient, less exposed and thus protected from the impact of toxic assets and derivatives' effects that triggered the global financial crisis.

The Islamic banking system's features make its activities more closely related to the real economy. This reduces its contribution to excesses and bubbles, but it also makes it more exposed and vulnerable to the second wave of financial crisis: the real economic downturn. Islamic banks lent a large part of their funds to the consumer sector and invested in assets that proved in time to be illiquid, sharing the losses of their activity with the stakeholders. According to the IMF study, Islamic banks' larger decline in profitability in 2009 was due to weaknesses in risk-management practices, mainly associated with high degree of concentration on, or greater exposure to, one sector and/or borrower.

This second-round effect has brought to the surface some shortcomings that may possibly jeopardize the Islamic banking system's capacity to grow and develop. Those challenges that have to be addressed in order for Islamic banks to maximize their potential include the need to improve management of certain market risks such as liquidity and reputation risk.

Liquidity management is difficult under Islamic finance rules due to the lack or limitation of practical instruments and the small number of participants on the money market. Because most of the conventional liquidity tools are banned according to sharia principles, Islamic banks sustain higher liquidity ratios compared to conventional banks. Nonetheless, the lack of contract standardization, the absence of instruments to hedge against the volatility in currency and commodity markets, the incomplete legal framework, and the insufficient expertise at the supervisory and industry level seems to weaken the potential of Islamic finance and affect its reputation.

Just like conventional banks, Islamic banks increasingly funded long-term assets with short-term funding, even if this was done in a sharia-compliant manner. Islamic financial institutions did not invest in the structured financial products that activated the crisis, but the assets in which they invested were just as illiquid. The degree of leverage increased because the expansion of the banks' activity was not supported by the proportionate increase in
capital, which remained static due to the distribution of returns earned during the rapid growth period.

The Islamic banking system is not homogenous. Some banks have more sophisticated risk-management tools, varied financing sources and a diversified customer base. Others have less-complex activities and different levels of leverage and liquidity. Nonetheless, all Islamic banks are vulnerable to negative spillover effects from the real economy and have to overcome their current shortcomings, among which the most pressing are liquidity management, improvement and harmonization of regulatory and supervisory regime, and keeping the legal infrastructure updated in line with the pace of the rapidly changing financial landscape.

The Islamic banking system proved its resilience during the financial crisis, but it should not be regarded as a panacea for the conventional banking system affected by the crisis. There is no such thing as the perfect banking system; there are only systems best adapted to the market conditions in which they are operating. Islamic banks were less affected by the financial crisis but were unable to avoid the negative impact of the effects of the economic downturn on the credit worthiness of their clients and to prevent the repercussions of the high degree of concentration.

Before the crisis, the Islamic banking system could be regarded as a micro-system that performed great on that dimension. Lack of standardization and domestic-focused activity were Islamic banks' particularities. New market conditions have now taken the Islamic banking system to another level where different rules are in place and there are various risks to be mitigated.

Islamic banks can grow and consolidate their position by operating commonly on a cross-border basis. For that it would be necessary to offer diversified and standardized products and services, implement sharia compliancy recognition authorities and/or processes, and improve the management of counterparty/credit risk and liquidity risk. Some authors argue that the business model of many Islamic financial institutions will need to be rethought by building diversified sources of revenue, such as incomes from advisory services, asset management or financial services provided to retail clients. Even though Islamic banks have to achieve the scale economies that make them viable competitors, the solution is to adapt to targeted market conditions and requirements and not to imitate conventional instruments or risk management strategies. The focus, thus, should be on choosing and structuring the most adequate products, services and risk management tools, which are truly compliant with Shariah and adapted to the needs of almost 1.3 billion Muslim customers.

The most important thing for all products, tools and activities of the Islamic banking system is that they are Shariah compliant. Of course, profit is important, too. Nonetheless, when conventional banks subordinated all else to revenue maximization, the banks' activities no longer heeded reality, and the consequences were drastic. This loss of touch with reality was criticized by analysts long before the crisis started. Some even compared derivatives to "financial weapons of mass destruction," but the illusion of enormous gains blurred all participants' vision on the value-added mission of the bank as one of the important players in
the chain of financial intermediation. The only hope is that the people responsible for shaping the future of Islamic banking have in mind the lessons of the current crisis and take the best out of the conventional banking system to be adapted to their own, and vice-versa.

There are existing markets and new markets in the global Islamic financial. The existing countries are Malaysia, UAE, Bahrain, Qatar, Brunei, Indonesia, Pakistan and Sudan. Potential new markets are United Kingdom, Hong Kong, Singapore, Thailand, Japan and USA. Currently, there are over 300 Islamic financial institutions in more than 75 countries though they are mainly concentrated in the Middle East and Southeast Asia, but are also gaining popularity in Europe and the United States. It is estimated that the industry will grow at a rate of 15 to 20 percent annually, from current assets of US$300 billion.

Prospects for the development of Islamic finance should contain a balanced development of the Shariah and integrated market by the prospect of a unique Islamic finance. In addition, the products and services must also not limit to Muslim’s market only. But, also emphasizes acceptance and applications globally. The creations of many innovations and initiatives have also contributed to the advancement of Islamic financial system. However, the challenges can be overcome by increased effort in every cooperation, increase understanding of the Shariah concern, mutual respect and collaboration practices. Islamic finance has a role in shaping the future of the global financial system and reinforcing ethical and moral values that are inherent in Islamic finance principles and fundamental towards promoting the stability of the global financial system. Ongoing efforts to further strengthen the resilience of Islamic financial industry would enhance the prospects for global growth and the potential of Islamic finance to contribute toward global financial stability.

4.8. PRACTICES AND OPPORTUNITIES RELATED TO THE ISLAMIC FINANCIAL PLANNING ACCORDING TO THE SHARIAH RULES.

The Islamic Financial planning is an emerging financial sector in the market that needs encouragement and support by the regulators, practitioners and other stakeholders. Malaysia can capitalize on its global Islamic financial status to push further the boundaries of this new sector. These financial sectors can potentially growth along with the growth of the Islamic finance because it is one of its components. Financial planning is essentially a process, i.e. it is not a product. According to MFPC (Financial Planning Association) constitution defines it as a process or methodology of assisting clients in determining their financial goals, objectives and priorities and the resources to meet them in an optimal and practical manner. The outcome of the process is to help the client achieve his financial goals and objectives. The product approach offers the financial products first and then trying to package them into a financial plan. The financial planning approach, does not assume a need as in the product approach. Goals and objectives are set based on the current circumstances of the individual who assume the position of a client. Since goals and objectives may vary over time, the financial planning process should be a never-ending process. The process described is comparable to identifying the characteristics of all the holes (problems) before selecting the
plugs (solutions) to fit those holes which are more logical than the reverse way performed by financial solutions seller. It can be understood that financial planning is a process of meeting the goals of the client through a proper management of his finances and existing wealth. The advisor does not possess the finance or the wealth but only provide the advice base on his knowledge and skills, the determination of the financial goals and objectives are based on the available data gathered by the financial planner, in addition to that the financial planning is structured based on the current circumstances of the client whereby the financial planning is designed according to the existing wealth of the client. It is very important to observe the proper matching between the condition and circumstances of the client. The goals of the client may include buying or selling, saving or spending, education, starting a new business, restructuring an existing business, opening new windows for investment or planning for retirement, etc.

The major parties involved in formulating the financial planning scope and framework are:

1. The personal financial planner
2. The client of the personal financial planner
3. The financial goals
4. The existing wealth and resources of the client
5. The financial plan provided by the personal financial planner

The concept of Islamic financial planning is based on the incorporation of the Shariah rules and elements into the process of the financial planning, whereby Shariah rules and principles will be positioned as the core of the application of financial planning, and accordingly Shariah will be observed, respected, and enforce throughout the process. According to this concept the services provided to the customer must be Shariah compliant in its concept, criteria, structure which satisfy the client needs and Shariah rules and requirement. Shariah is very concern about the financial planning due to its financial implication on the family and society at large. Therefore Muslims are encouraged and urged to plan their life economically and financially as well in order to achieve the objectives of Shariah in society, business and finance which bring prosperity and happiness to every individual in the ummah. The financial planning never been against the concept of tawakul and destiny, Shariah always urge Muslim to spend effort to achieve the goal of Shariah especially which are related to the five universal fundamental objectives of Shariah. One of them is the preservation of the wealth whereby the financial planning plays this role to materials this objective. It is important to note that one of the objectives of financial planning is to achieve the balance between the material and soul, to be a person who lives to fulfill the needs of both of them equally. This established concept is not against
wealth creation, but it monitors and regulates acquiring wealth and spending according to Shariah principles.¹⁰

Islamic financial planning is defined as the process of meeting life goals through the management of finances in accordance with the Shariah such as how to increase, create, protect, purify and distribute wealth based on Shariah guidelines. Shariah rules and principles are incorporated into the process of financial planning and form the core position in the application of Islamic financial planning. Hence, Shariah decree has to be observed and adhered throughout the process. Islamic financial planning as a process of determining their financial goals and priorities and the resources to meet them optimally within the parameters of the Shariah. The crux of Islamic financial planning is the planning itself in pursuit to meet the goals of the individuals through execution of the financial plan and monitoring of it. Islamic teachings always urge Muslims to plan and take necessary actions to ensure success in life. Thus, every individual would set their financial objectives and strive to meet their objectives. However, the intention to conduct financial planning based on Shariah and its underlying principles of permissible (halal) transactions distinguish the implementation measures in both practices. To protect wealth, Muslims are to use Takaful scheme and to finance business operations halal business operators are to use financing products offered by Islamic financial institutions or get micro financing from Islamic pawn broking. In addition, wealth should be kept and invested in Islamic financial institution products and services.

**4.8.1. FINANCIAL PLANNING PROCESS**

Financial Planning is a scientific methodology to manage wealth with a holistic viewpoint. It involves developing coordinating and implementing a comprehensive range of strategies to address the wealth management challenges. **Financial Planning is a process that encompasses the following six steps:**

1. **Establish financial goal**

   Goal setting is critical to create a successful wealth management plan. The whole financial planning process starts with establishing and prioritizing realistic financial goals and objectives. Appropriate time frame and risk tolerance level must be clearly spelt out as well. It is important that the goals must be quantifiable so that their attainment can be measured.

2. **Gather relevant data**

   After identifying your financial objectives, you need to gather as much as possible the relevant information. This information must be accurate, up-to-date and relevant to the financial objectives. The more complex your situation and the more varied the number of your goals the more challenging the information gathering risk. This step requires significant amount of time and patience.
3. Analyze the data

Analyzing and evaluating the data can be started when we have enough information. The objective of this step is to establish where you are now in comparison to the financial goals that were established in step one. This is the step that you determine the strengths and weaknesses of the present financial position.

4. Develop a plan for achieving goal

Normally there will more than one way for a financial objective can be achieved and multiple alternatives should be explored and considered. The plan should be specific in nature, detailing who is to do what, when and what resources. In order to increase the commitment to the plan the report describing the plan should be in writing.

5. Implement the plan

A financial plan is useful only if it is put into action. The success of a financial plan very much depends on someone’s commitment to implementing the plan. For example implementation of plan is by writing or updating a will restructure current asset allocation; reduce debts and mortgages and etc.

6. Monitor the plan

The financial planning process is dynamic and requires constant monitoring and reviewing. The plan should be reviewed at least once a year or more frequently if changing circumstances warrant it. The review process should involve tracking the progress and performance of plan implementation.

A wise financial planning is one that can balance between spending and debt management and investment, in line with Shariah and the income that obtains blessings from Allah. It is necessary to be reminded that this planning and management is in accordance with the Sunnah/practice of prophets. In depth, financial planning refers "financial planner" to "a person who analyses other individuals' financial position and proposes a financial plan so that the individuals achieve their financial targets and objectives. In short, Islamic financial planning is "a process where an individual's overall financial goal is used to develop and implement a holistic plan to achieve goals that follows the Shariah and gains blessings of Allah. Financial planning that is based on Islam has the goal of making financial aspects such as Wasilah (mean) to achieve Hasanah (good deeds) in this world and hereafter.

Hence, in ensuring that these goals are achievable, the planning should consider one's spending and wellbeing such as physical and spiritual needs, spending for the wellbeing of others such as livelihood, donation as well as spending for the wellbeing of the public such as building a mosque or a hospital. In a more systematic manner, financial planning from the perspective of Islam should consider the following components credit management and cash flow, risk management and takaful planning, Islamic investment planning, tithe and tax planning, retirement planning and customary estate and Wakaf planning. There are two aspects that are stressed by Islam in relation to affairs on wealth management the first is how the wealth is acquired; it must come from a legal source like trade, Islamic way of investments, gift and so on.
The second aspect is how the wealth is spent, whether for goodness or in the way forbidden by Allah. This can see from Prophet Muhammad's saying that means: "A servant of God will remain standing on the day of judgment until he is questioned on his (time on earth) and how he used it: about his knowledge and how he utilized it; about his wealth and from where he acquired it and in what (activities) he spent it; about his body and how he used it". Therefore, the main aspect that should be considered in Islamic financial planning is gaining the blessings of Allah. Excessive wealth is meaningless if it does not bring goodness and blessings. Even the wealth can bring Fitnah (slander) — it can make someone feel so lacking in something that he is ready to do anything to get it, such as committing bribery and breach of trust. On the other hand, wealth that is blessed by Allah, regardless how little it is, will bring the effect of peace and goodness throughout our lives. Blessings mean getting consent, acceptance or mercy from Allah. In order to obtain the blessings and mercy, we should abide by all Allah's orders.

Islamic Financial Planning represents an important aspect in everyone’s life as a prudent financial management would help lighten financial burden and ease human life in this world so that we can live our life according to our wishes and utilize our wealth for the enjoyment of this life. The purpose of life for Muslims is for higher intention that Muslims are required not only to seek material pleasure but to seek the pleasure of his Creator in order to attain success in this world and Hereafter. Muslims are compelled to adopt Islamic financial planning as it is part of the Shariah requirements. As individuals, Muslims are required to enter Islam in totality. Hence, understanding the concept of Islamic financial planning becomes more important as the Muslims have to embrace Islam in its totality and abide to the Shariah principles in their financial decision making. The financial planners with qualified Islamic financial planning training and education must observe and practice the principles of Islamic ethical values in giving advice to the clients. Future study should explore on the perception of Malaysian public towards the integrity and ethical behavioral practices among the financial planner in Malaysia with the perception on financial planners in the West whose conducts are thought to be of scam and scandals. The credibility and integrity of financial planner will enhance the public confidence and trust on Muslim financial planners in the future.

Islamic finance and financial planning aim to preserve one of the five essentials needs namely the preservation of wealth, which is interrelated to preservation of religion. The preservation of wealth is to be achieved in at least five main dimensions:

1. Preservation of wealth through protection and ownership.
2. Preservation of wealth through its acquisition and development.
3. Preservation of wealth from damage.
4. Protection of wealth through its circulation.
5. Preservation of wealth through protection of its value.
4.9. PRACTICES AND OPPORTUNITIES RELATED TO THE AGE, EDUCATION, SEX, LOCATION, STANDARD OF LIVING, INCOMES, SAVINGS, EXPENDITURES AND AWARENESS OF MUSLIM SALARIED PEOPLE.

The family income has significant influence in size of saving, number of physical asset owned, number of insurance policies and choice criteria. The impact of family income was more in contractual saving rather than discretionary saving. It is concluded that the income difference has significant impact on saving and investment activities. Family income is the very important demographic variable for any investment behaviour studies. First, most of the customers of Islamic banks fall in the age category of 25-35 years. Islamic bank customers are highly educated and have durable relationships with the banks. Second, high customer awareness and usage exist for various deposit mobilization instruments but there is not high awareness and usage of any individual financing facilities of Islamic banks. Third, income category and education have a significant role in customers’ usage of various Islamic bank products and services. Fourth, customers seem to be satisfied with a number of products and services of Islamic banks. Fifth, among the service delivery elements, “employees” deserve an immediate attention for improving customer satisfaction. Finally, “religious principles” is the key bank selection criterion of the Islamic bank customers.

The study found that women headed household had higher saving rate, precautionary saving motives and consumption was smooth. Majority of households had saving pattern with the exceptions of a negative link between saving and the educational attainment of the head of the household. The study found that household owning only a few standard durable asset exhibit higher saving rate, ceteris paribus, consistent with the view that these household do not have access to retail credit market and hence forced to accumulate saving and use in durable asset purchase. It is concluded that there is a negative wealth elasticity of household saving. The low income families with children, have many motives to save however the cost of raising children, low wage employment, mean tested programme and need for child care to make it difficult for them to save. The study found that working people save more than non-workers. The respondents with age above thirty years saved more than that of teen age people, owners occupier saved more than tenant, higher income people saved more than lower income people. The unexpected expenditure affected saving habit of the people and debt management. Respondents felt that debt was inevitable. It was concluded that most of the respondents felt that saving had led to them to save more money. About half of the respondents participated in the saving gateway had no lasting effect on their saving behaviour, the most half of the respondents thought that they might start to save again in foreseeable future.
The saving performance is significantly different between men and women, married and unmarried. It found that both men and women were saving successfully. However, women were saving better than their male counterparts across the level of education, marital status and type of work. The matched asset building account provide a model that can encourage saving among the poor. The loans given by the bank have enabled the member to improve their standard of living. It has also included financial discipline and the level of awareness about the investment. It is concluded that the income, expenses, saving and investment pattern of urban vary according to their socio-economic status. Majority of the respondents kept their saving as cash at home so as to meet emergency needs. The respondents used their bank account only to receive money from government schemes and withdraw the same and they did not availed of any other bank facilities. The access to a bank account has not always led to usage of account, the transaction that have taken place are largely due to the fact of the respondents received payment under various government schemes. Moreover, the household did not have enough money to save. This can be considered as one of the important reason for the low usage of account. This study concluded that bank needs to play a more proactive role in informing people about financial inclusion.

4.10. PRACTICES AND OPPORTUNITIES RELATED TO THE ISLAMIC MARKET ECONOMY, INFLATION, MARKET FORCES, LIBERALIZATION, PRIVATIZATION AND GLOBALIZATION AND DEMONETIZATION.

Globalization is a process that enhances the flow of goods, services, capital, people, technology, and ideas across national borders. It is a phenomenon whereby numerous countries combine and increasingly appear as one country; complete globalization is akin to the unification of states that today make up the United States of America. The process of globalization proceeds more rapidly when barriers between countries that affect the movement of goods, services, capital, technology, and labor are reduced, and are enhanced by reduced information and transportation costs. It is a multifaceted and multidimensional process of growing interconnectedness among the nations and peoples of the world. Its main dimensions are: (i) economic and financial, (ii) cultural, and (iii) socio-political. Its economic and financial dimensions include growing trade flows across countries, flows of capital and investment, flows of technology, and labor flows (both skilled and unskilled), accompanied by standardization of processes, regulations, and institutions, all facilitated by the free flow of information and ideas. Its cultural implications are the amalgamation of cultures, adverse impact on languages (diminution of their use) that are used by a few and are not important to business and commerce, and diminution of distinct cultural identity. Its socio-political tendencies are convergence of ideas, political and economic institutions, and norms. It is a process that affects every dimension of life and existence. The reverse of globalization may be termed de-globalization. Globalization and de-globalization are ongoing processes, and at any point in time one dominates the other; as such, the process is
continuous, whether the world is becoming more, or less, global. While the impact of globalization on conventional finance has been studied and recognized, its impact on Islamic finance, a relative newcomer, has not been addressed. Islamic finance is a system of finance that prohibits debt-based financing; thus, it prohibits interest, and the financing of activities that are not permitted in Islam, such as gambling and the manufacturing and distribution of spirits and wines. Islamic finance is based on risk sharing, trust, transparency, and the upholding of Islamic values. It has developed and grown side by side with conventional finance over the last 40 or so years.

Islamic finance has become a worldwide industry, with assets under management in accordance with the Shariah law valued at over $200 billion. There are so many claims and numbers but we need to spend the effort to define exactly what the number is, where these funds are invested, in what instrument, and who manages these funds and what investment tools, models and goals are used? Within individual countries, especially in the Muslim world, Islamic finance plays a significant role, with the financial systems of countries such as Iran and the Sudan operating under the Shariah law. We usually say that the investment and banking is under the “Shariah Law”, but what is that? Is it a mere replacement of the word interest with the words: “Profit”, “Service Charge” or “rent taken as the index of LIBOR or Prime Rate”. Are these efforts focused on sincere & real disengagement from the Riba /Interest (money renting). Other countries such as Pakistan are preparing to implement laws on Riba free banking, while in the Gulf States Islamic banking is playing an increasingly significant role, accounting for over 20 percent of deposits in Kuwait and Qatar. Bahrain has become a major regional centre for Islamic finance. At the same time many major multinational banks including Citibank, HSBC, ABN-AMRO and Deutsche Bank are offering Islamic financial products, while in Malaysia a sophisticated market in Islamic securities has developed and Bahrain is providing money management instruments that comply with the Shariah law. We need to ask ourselves about the motivation of these major banks in offering the Islamic Products & the modes operandi used. It is in my opinion to meet market demand but without deviating away from the principles of the Riba System. So, nothing new and unique is offered to capture the imagination of the people & offer those products & services that they need.

In global terms Islamic finance is a limited niche activity. There are others in the Islamic Banking Arena who wants to look at it as a movement not only for Muslims but also non-Muslims. However, while international financial markets are dominated by Riba based activity. There are significant pressures from international organizations such as the IMF and the WTO for Muslim countries to open up their financial markets to multinational banks. International rating agencies such as Moodys and Standard and Poor classify Muslim government debt and rate commercial banks, and even some Islamic banks, which affects the terms on which they can conduct their business. The Basle based Bank for International Settlements has capital adequacy guidelines that pose significant challenges for Islamic banks and Islamic finance more generally.
The liberalization of financial system has had a huge impact on banking sector and economic structure of countries all over the world. Malaysian banking system which began in the conventional and since 1983 many Islamic banks has established. The rapid growth of the Islamic banking and finance in Malaysia are made possible with the full backing support by the Malaysian government. The government has provided a strong foundation for the industry to grow such as establishing the financial and legal platform for rapidly growth industry. The banking liberalization intended to enhance the efficiency of the banks, improve the allocation of credits, stimulate savings and, thus, attain a higher economic growth. Opening up a country’s financial sector to global competition is the essence of financial liberalization. According to the doctrine, with financial liberalization, the banking institutions would be more efficient, allocating credit to the most productive sectors. The Islamic banks as financial institutions along with their products in facing liberalization and openness took some of the interest in the recent years. Islamic finance in Malaysia continues to demonstrate dynamic growth with a comprehensive Islamic financial system that is supported by robust regulatory, legal and Shariah governance frameworks, more than 100 Islamic banking products and services available in the industry. Innovative products and financial instruments that are aligned with the global Shariah principles have been issued in the global market.

Islamic banking liberalization is an integrated part of banking & financial liberalization and also part of the overall economic liberalization as a whole. The banking liberalization intended to enhance the efficiency of the banks, improve the allocation of credits, stimulate savings and thus attain a higher economic growth. Opening up a country’s financial sector to global competition is the essence of financial liberalization. According to the doctrine, with financial liberalization, the banking institutions would be more efficient, allocating credit to the most productive sectors. However, there are fears that such competition might also lead to instability of the domestic banks. It also fears that foreign bank participation might increase instability by linking the domestic country with cyclical fluctuations of the foreign country. However, many cross-country evidences show that foreign bank participation, on the whole, provides net benefits in terms of stability. Some of the studies also show that the foreign bank entry lowers the probability of the banking crisis and reduces both overhead costs and profit of the domestic banks. This promotes efficiency of the banking sector.

The banking liberalization intended to enhance the efficiency of the banks, improve the allocation of credits, stimulate savings and thus attain a higher economic growth. The ongoing liberalization of the financial sector in Indonesia & Malaysia will create opportunities for partnerships between domestic and foreign banks, which may become a key driver for East-to-East linkages promoting trade and increasing the size of the global Islamic finance industry Islamic banks. Islamic Banking in India needs to be revamped through several initiatives: Liberalization, financial inclusion, human capital development, business & product innovation.
The term "inflation" originally referred to increases in the amount of money in circulation. However, most economists today use the term "inflation" to refer to a rise in the price level. Inflation simply refers to "an increase in the price you pay for goods." In other words, a decline in the purchasing power of your money.

4.10.1. CAUSES OF INFLATION:

1. Over-expansion of money supply i.e. excess liquidity in the economy leads to inflation because “too many money would be chasing too few goods”.

2. Expansion of Bank Credit Rapid expansion of bank credit is also responsible for the inflationary trend in a country.

3. Deficit Financing: The high doses of deficit financing which may cause reckless spending, may also contribute to the growth of the inflationary spiral in a country.

4. A high population growth leads to increase in demand and money income and cause a high price rise.

5. Excessive increase in the price of fuel or food products due to political, economic or natural reasons will lead to inflation for short- as well as long-term.

4.10.2. EFFECTS OF INFLATION ON ECONOMY

Inflation is the increase in the price of general goods and service. Thus, food, commodities and other services become expensive for consumption. Inflation can cause both short-term and long-term damages to the economy; most importantly it causes slowdown in the economy.

1. People start consuming or buying less of these goods and services as their income is limited.

2. Banks will increase interest rates as inflation increases otherwise real interest rate will be negative.

3. Rising inflation can prompt trade unions to demand higher wages, to keep up with consumer prices.

4. Rising wages in turn can help fuel inflation. Inflation affects the productivity of companies. They add inefficiencies in the market, and make it difficult for companies to budget or plan long-term.

5. Inflation can act as a drag on productivity as companies are forced to shift resources away from products and services in order to focus on profit and losses from currency inflation.
6. Higher interest rates lead to shut down in the economy.

4.10.3. MEASURES TO CONTROL OR REDUCE INFLATION:

1. **Hard currency is tied to gold or silver standard:**

   The Islamic system requires currency / medium of exchange to be based on the gold and silver standard which have an intrinsic value. Paper currency can be used to represent the precious metals instead of carrying gold and silver around, but they must be backed up by them. Due to the intrinsic value in the precious metals stability is achieved and devaluation and inflation controlled. In Islam, currency is treated as a medium of exchange/store of value and should not be treated similar to commodity (i.e., that can be traded at anyone’s urges).

2. **No artificial money:**

   The Islamic system does not only forbid riba, but also does not allow us to loan what we do not own or have. Banks cannot produce money at any time, as and when they like.

3. **No hoarding to manipulate supply and demand:**

   The Islamic system abhors hoarding and the artificial manipulation of supply and demand.

4. **Ownership of natural resources:**

   Islam’s solution is based on its view of ownership and permissibility of generating profits from natural resources. Islam is the only system that defines 3 types of ownership; individual, public and state property. The Prophet SAW in his Hadith has included natural resources that combust (oil field, gas field, coal mine, etc) as public property as well as other natural resources. Public property cannot be transferred to the state or private sector, but remains the property of the public (Muslim Ummah) and is run by the Islamic state for their benefit on a no profit, no tax basis. Any profit generated by selling surplus oil to friendly non-Muslim countries must be spent on the Ummah.

   Hence the Islamic view on natural resources would be a pivotal factor in reducing prices and controlling inflation

5. **Revival of deadland:**

   The Prophet SAW informed us that a Muslim who revives a dead Khiraji land (drought land), which was never cultivated since Muslims opened it, would own the neck as well as its produce. The Prophet SAW also informed us any Muslim or Zimmi (non-Muslim citizen of
the Islamic state) who revives a dead Khiraji land (drought land) on which Khiraj (land tax) was applied in the past would own the produce, whilst the neck would remain with the State.

The concept being whoever revives a dead land can benefit from it. This presents a great incentive for poor farm workers and others to take advantage of this Islamic rule and revive dead land and the whole state would benefit. Poverty would be reduced, employment would increase and so would production. Increased production leads to increased supply and therefore cheaper prices and lower inflation.

4.11. PRACTICES AND OPPORTUNITIES RELATED TO THE ISLAMIC FINANCE FAITH.

The rules governing Islamic Finance are derived from the Shariah. The Shariah is a framework of Islamic Jurisprudence derived from the primary sources: The Qur'an and the teachings of the Prophet Muhammad (pbuh) known as the Sunnah. In addition to which there is a dynamic secondary source of common law rulings and scholarly interpretations referred to as Fatwa's. These fatwas are the results of human interpretation of the Shari’ah, of its texts, or its principles, or a combination of the two; they are not the word of God. Islamic law, it must be remembered, is more a process than a code, and the results of legal deliberations may differ when different methods are employed. Several fatwas are indicative of an acceptance on the part of Shariah Supervisory Boards of new realities in the marketplace and of their willingness to understand and work with these to the extent that Islamic religious and legal principles will allow. Such an attitude has ever characterized the best in Islamic legal thought.

The originators of modern banking based their system on ‘interest-oriented investments and earnings which are clearly prohibited in the Shariah of Islam. Therefore, modern banking institutions, which gradually became essential to the commercial activity of the entire world, were totally antithetical to the guidance revealed to humankind through the Qur'an and the Sunnah of the Prophet Muhammad (pbuh).

Many Muslims, believing in the prohibition of interest, remained aloof from this modern system of banking, and those who did enter the field restricted themselves to the routine work necessary for their employment. This was done because they had reservations about interest-based transactions and also because, owing to their political decline, they were unable to control the wheel of international commercial transactions.

4.11.1. RULES OF ISLAMIC FINANCE

The rules of Islamic finance adhere to the broad principles of avoiding Maysir and Qimar which are gambling and speculation along with Gharar which is uncertainty coupled with exploitation and unfairness. This closes the door to the concept of interest and precludes the use of conventional debt-based instruments. The Islamic financial system encourages risk-
sharing, promotes entrepreneurship, discourages speculative behavior, and emphasizes the sanctity of contracts.

The central tenet of the Islamic financial system is the prohibition of Riba, a term literally meaning "an excess" and interpreted as "any unjustifiable increase of capital whether in loans or sales". More precisely, any guaranteed increase in return tied to the maturity and the amount of principal, regardless of the performance of the investment, would be considered riba and is strictly prohibited.

Islamic finance offers different instruments to satisfy providers and users of funds in a variety of ways. Basic instruments include cost-plus markup financing (murabaha), profit-sharing (mudarabah), leasing (ijarah), partnership (musharakah), and forward sale (bai’ salam). These instruments serve as the basic building blocks for developing a wide array of more complex financial instruments, suggesting that there is great potential for financial innovation and expansion in Islamic financial markets.

The Islamic scholars and Shariah Supervisory Boards of different Islamic financial institutions have passed a large number of resolutions through collective Ijtihad interpreting the basic principles underlying Islamic transactions and the requirements of the Shariah with regard to different modes of financing, as well as some details of their practical implementation. This understanding is necessary to facilitate not only their compliance with the Shari’ ah, but also helps Islamic financial institutions to use the new products in the light of Islamic principles.

If an Islamic financial institution is not in compliance with Shariah precepts, there is nothing but its name to distinguish it from a conventional institution. One of the goals in publishing this work is to enhance the appreciation of practitioners for the importance of Shariah compliance and its significance for consumers.

The bedrock of Islamic banking is the Shariah law enshrined in the Qur'an and the Sunnah of the Prophet Muhammad (pbuh). Unfortunately there is an impression in certain quarters, especially in the West, that there is no agreement among the Shariah scholars on what actually constitutes Islamic banking. Late Sir Edward George, Governor of the Bank of England highlighted this impression, in address to a recent conference on Islamic Banking.

There are a number of issues that we need to address. One is that there is no single definition of what constitutes Islamic banking. Different institutions interpret the acceptability of Islamic banking products in their own way. Individual boards of Shariah advisers apparently have equal authority, so that in some jurisdictions there is no definitive answer as to the status of a particular Islamic banking product. This leads to uncertainty about what is, and what is not, the ‘acceptable’ way to do a particular business, which in turn can complicate assessment of risk both for the bank and its customers.
Rather, it will be seen by the involvement of Shariah scholars that they are quite definitive, and in agreement, on what constitutes Islamic banking. The minor differences of opinion, if and when they exist, relate to matters of procedure or detail, but not to substance. Such differences are common among judges in courts of law throughout the world.

4.11.2. SHARI'AH GUIDING PRINCIPLES

The Shariah has evolved within the guidelines set by three broad principles agreed upon by Islamic scholars and jurists over the centuries. These are:

Interest of the community takes precedence over the interests of the individual.

Relieving hardship takes precedence over promoting benefit.

A bigger loss cannot be prescribed to alleviate a smaller loss and a bigger benefit takes precedence over a smaller one. Conversely a smaller harm can be prescribed to avoid a bigger harm and a smaller benefit can be dispensed with in preference to a bigger one.

Modern banking developed in an era that witnessed the political decline of the Muslim Ummah throughout the world. The originators of modern banking based their system on ‘interest-oriented investments and earnings which are clearly prohibited in the Shariah of Islam. Therefore, modern banking institutions, which gradually became essential to the commercial activity of the entire world, were totally antithetical to the guidance revealed to humankind through the Qur'an and the Sunnah of the Prophet, upon him is peace and blessings.

Many Muslims, believing in the prohibition of interest, remained aloof from this modern system of banking, and those who did enter the field restricted themselves to the routine work necessary for their employment. This was done because they had reservations about interest-based transactions and also because, owing to their political decline, they were unable to control the wheel of international commercial transactions.

Since the acquisition of political freedom by many Muslim countries during the past thirty years, it has been the cherished dream of the Muslim Ummah to develop a new banking system based on Islamic principles. Unfortunately, the political authorities of the Muslim countries paid precious little if any attention to bringing their socio-economic activities into harmony with the principles of the Shariah. Hence, certain groups of Muslims individuals were forced to establish Islamic banking institutions on their own, and without any meaningful support from their governments. Several Islamic banks were established in the decade of the Seventies and through them the cherished dream of Islamic banking was translated into reality, at least at the private level.

From the very beginning, Islamic banking institutions have been constantly guided by Religious scholars on their respective Shariah Supervisory Boards who are responsible for designing their transactions in accordance with the principles of the Shariah and subsequently
keeping a watchful eye over their operations. These boards have devised new modes of financing to replace interest-based transactions. The management of an Islamic banking institution brings its day to day problems before its Board which, after examining the relevant details, will decide whether or not the proposed transactions are in line with Shariah principles. Such decisions by the Boards are called fatwas.

The function of a Shariah Supervisory Board is of a very delicate nature. On the one hand, they are meant to abide strictly by Islamic principles, and on the other they have to fulfill the requirements of the constantly emerging needs of the contemporary marketplace. The task entrusted to the Shariah boards is indeed a difficult one; because when we claim that Islam provides solutions to the problems of every time and place, it does not mean that Islam has given a specific rule for each and every minute detail of every transaction.

In fact, the sacred sources of the Shariah, the Qur'an and the Sunnah, have provided Muslims with a set of eternal principles, but their application to the practical situations of each age requires the exercise of Ijtihad (effort). This means consultations in which the individual deliberations of many scholars play a vital role in reaching many firm conclusions. This exercise sometimes brings different answers from different Shariah Supervisory Boards with regard to the same question. The Shariah Supervisory Boards, being comprised of a number of Islamic scholars, decide the matter placed before them after mutual deliberations, which is tantamount to collective Ijtihad (effort).

4.11.3. RESOLUTION OF THE ISLAMIC FIQH ACADEMY

The Islamic Fiqh Academy, constituted under the auspices of the Organization of the Islamic Conference (OIC) represented by all its member countries, in its Second Session held at Jeddah adopted a resolution which, inter alia, provided:

1. Any excess or profit on a loan for a deferred payment when the borrower is unable to repay it after the fixed period and similarly any excess or profit on a loan at the time of contract are both forbidden as riba in the Shari’ah.

2. Alternative banks should be established according to the injunctions of Islam to provide economic facilities.

3. The Academy resolves to request all Islamic countries to establish banks on Shariah principles to fulfill all the requirements of a Muslim according to his beliefs so that he may not face any repugnance.
4.12. PRACTICES AND OPPORTUNITIES RELATED TO THE AVAILABILITY OF ISLAMIC EXPERT OPINION.

Over the past years Islamic finance has experienced tremendous development, and this is due to the effort of many parties, including the Shariah scholars, market practitioners and regulators. It is hoped that such efforts will continue in the future, as the Islamic finance industry still has a long way to go before it matures and fully develops. The tradition and experiences of conventional finance have also been valuable to the establishment of Islamic finance, in that the Islamic finance stakeholders have been able to learn from and employ all of its positive and permissible ideas, tools and traditions. Having said that, Shariah is the backbone of the industry and the role of Shariah scholars is very pertinent to ensure that the credibility and integrity of the industry are maintained. This includes all the classic scholars who have provided a wealth of guidance and references for the current scholars to work on and further develop. Over the past 30 years the Islamic finance industry has proven to be relevant, resilient and rich with potential for further progress, and it is now recognized worldwide as an alternative to conventional finance.

4.12.1. Shariah Governance

Shariah governance is a very critical area in Islamic finance and is no less important than is corporate governance to any institution. However, Shariah governance is particular to Islamic finance, as it is the mechanism which determines the “Islamicity” of any particular Islamic business or financial institution as well as the system as a whole. The significance of Shariah governance transpires via its role of ensuring the confidence of Islamic finance industry in the eyes of the public. More importantly, Shariah governance ensures that the industry is at all times in accord with the wishes and laws of the Almighty by ensuring the legitimacy of the products offered. Shariah governance affirms that Shariah is backbone of this industry as well as its main driver. In addition, history has shown that improvement in the aspect of Shariah governance can assist the speedy and better growth of the industry. Thus, this aspect of Islamic finance can never be taken lightly, and discussion of how it can be enhanced is very much welcomed at all times and by all means.

Effective Shariah governance requires the setting up of a clear and comprehensive framework to regulate the Islamic finance industry and guide its development. Fundamental to this process is definition of its main actors, namely the Shariah advisors, and their responsibilities as well as the roles that they need to undertake for the wellbeing of the whole Islamic finance sector. Other aspects of Shariah governance are supporting initiatives that can assist in enhancing a Shariah advisor’s performance, such as legitimate mandate, Shariah secretariat and others. However, first and foremost, it must be emphasized that the Islamic finance industry is accountable to Allah for all its practices; thus, adherence to Shariah in all activities undertaken is the responsibility of all Islamic finance stakeholders.

From the regulatory perspective, discussion of Shariah governance usually focuses on four elements that need to be ingrained for a comprehensive Shariah governance system to be established. They are the elements of competence, independence, confidentiality and consistency. The installation of these elements has been elaborated in the recent IFSB Exposure Draft on Guiding Principles for the Shariah Governance System. These elements are very significant to ensure the best practices and conduct of Shariah boards, but the
process and procedures for installing them may differ in different markets and jurisdictions. At present, different models of Shariah boards are operating in various jurisdictions, and the processes and procedures adopted for Shariah governance vary as well from one jurisdiction to another. Variation is also found in the regulation of Shariah advisory services, for which different practices have been adopted. Certain jurisdictions have instituted central regulation, while some take a voluntary tack and others have adopted a hybrid approach. Nevertheless, guidelines for the best practices are greatly needed so that Shariah advisory services can be further enhanced and respected.

4.12.2. Shariah Advisory Board

Shariah advisory boards comprised of Shariah experts are the main actors in Shariah governance. Their existence and decisions are very crucial as they serve to ensure public confidence of the legitimacy of Islamic finance operations and products as well as ensuring that Islamic finance is operating and developing based on Shariah guidelines. They are further considered as the stakeholders’ advocate regarding Shariah compliance and optimum service. Thus, they shoulder a very heavy responsibility towards many parties, but, most importantly, they are responsible to the Almighty for all their actions and statements. Therefore, it is important to affirm that qualified and competent Shariah advisors are appointed and that they are given various forms of assistance, exposure, resources and training to further develop them.

The development of Islamic finance has been accompanied by transformations in the duties and responsibilities of Shariah advisors. Their roles were previously limited to advice and product endorsement. However, at present they are also involved in product development and innovation, in addition to supervision of Islamic finance operations as well as, on certain occasions, development of policies and regulations for Islamic finance. This development increases the challenges facing the Shariah advisors, for they need to interact more with various people and stakeholders in the industry to understand and perform their roles better. As a matter of fact, in certain instances, experts from other relevant fields, such as finance, risk management, economics or law, are invited to Shariah board meetings to provide better understanding to the Shariah boards on matters related to their fields related to the issue under discussion. Thus, some scholars have encouraged that dual expertise scholars be appointed as members of Shariah boards, as such persons have expertise and mastery in Shariah and another field relevant to Islamic finance, as mentioned above. Such competence and caliber will certainly enhance and speed up the process of Shariah advisory.

4.12.3. Shariah Advisory Board: Criteria

It is crucial that criteria of the members of Shariah boards be discussed here, even if not in detail. This is due to the fact that only qualified and competent members will be able to perform their role well. Shariah advisors are defined in the Governance Standards of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), as follows:

Shariah advisors are specialized jurists, particularly in fiqh mu’amalat (Islamic jurisprudence) and Islamic finance, entrusted with the duty of directing, reviewing and supervising the activities related to Islamic finance in order to ensure that they are in compliance with Shariah rules and principles. The views of the Shariah advisors shall be binding in the specific area of supervision.
Different models of Shariah advisory are adopted worldwide, but a consistent preference has been shown for in-house Shariah advisory boards, which are perceived to be better able to advise and monitor the operation of an Islamic finance institution than an external Shariah advisory firm. However, it must be remembered that in-house Shariah advisors still act as external consultants and not as permanent employees, although they are expected to contribute significantly to the Islamic financial institutions. In addition, the best practice in Shariah governance require that the boards be comprised of more than three experts, thus allowing for the practice of collective Ijtihad (effort) and the adoption of consensus. This practice, if adopted, shall improve Shariah advisory services, and the decisions arrived at shall be more reliable and credible.

Various regulators and Islamic finance institutions have placed minimum guidelines for eligibility to serve on a Shariah board; for instance, a Shariah advisor should possess necessary knowledge, expertise or experience in fiqh mu'amalat or usul al-fiqh (Islamic jurisprudence), have considerable knowledge of current practices in finance and Islamic finance, and be a person of reputable character. Certain authorities do not require ‘paper qualifications’ or formal education in Shariah studies, but some other authorities specifically state the necessary working experience in the Islamic finance industry and the minimum length of time for such experience. In order to ensure the standard of advisory services provided, a Shariah advisor should possess the following criteria:

1. Considerable knowledge or mastery in fiqh mu’amalat and usul al-fiqh (Islamic jurisprudence)

2. Sufficient knowledge of the current Islamic and conventional finance practices.

3. Deep understanding of maqasid al-Shariah (Shariah objectives).

4. The capability to derive legal rulings.

5. Sufficient understanding of the issue and problem posed.


7. A person with good reputation and of good Islamic character.

In addition to the above criteria, the members shall be practicing Muslims who preach what they believe, in order to maintain the credibility of the decisions made. This is important, as Islamic finance is not only related to the ‘legal’ aspects of Islam, but it is also part of Islam’s belief system.

**4.12.4. Shariah Boards’ Duties and Responsibility**

As some jurisdictions have provided a clear framework on Shariah governance or Shariah advisory, a clear outline of Shariah board’s duties and responsibility can be easily found. It also assists the Shariah board members to understand all their responsibilities and execute them accordingly. Some jurisdictions, such as Malaysia, have also listed the duties and responsibilities of Islamic finance institutions to support the Shariah board’s function. A clear framework for proper Shariah governance and advisory is obviously needed for clarity and consistency in the performance and services of Shariah boards. However, apart from those
guidelines, Shariah advisors may assist Islamic finance institutions and the industry in other matters consistent with their competence and capability that are relevant to the growth of the industry.

The range of roles and duties of Shariah advisors includes giving advice to Islamic finance institutions on matters pertaining to Shariah issues, involvement in designing the framework for the establishment of an Islamic finance institution, monitoring the activity and proceeds of the institution, developing products and underlying contracts, acting as a reference on Shariah matters to Islamic finance institutions specifically and the Islamic finance industry in general, providing training and awareness programs for Islamic finance institutions’ staff, supervising the Islamic finance industry, trying to harmonize it with global practices, representing Islamic finance institutions in forums to allow for the exchange of ideas and sharing of experiences and, lastly, conducting Shariah audit exercises for the Islamic financial institutions.

The abovementioned shows the wide scope of roles that Shariah advisors may play, and the tasks that lie ahead of them are not at all light or trivial, so they will need all the support that can be provided. This can be done via establishment of a Shariah department or secretariat to assist Shariah boards by providing resources, collecting fatawa and Islamic finance institution reports, conducting research, assisting in the product development process and in conducting internal reviews, audits or any other assistance that may be necessary to Shariah board.

In discharging their duties there are several considerations that particularly need to be observed:

1. Firstly, ensure that product development uses the acceptable principles of the Shariah and follows acceptable Shariah standards, whether those standards are developed locally or internationally. The rapid growth and advancement of Islamic finance has resulted in the development of Shariah standards and frameworks for product development by international bodies such as AAOIFI and the Islamic Financial Services Board (IFSB) or national bodies like the Shariah Advisory Council of central banks and other financial institutions. Thus, the task of Shariah scholars is to ensure that these standards are upheld and followed, whenever applicable to a local situation, in order to preserve the high level of integrity of their decisions.

2. Secondly, ensure that the decisions of the Shariah boards are understood by the practitioners so that they will be properly implemented, as they are the ones responsible for applying the decisions of the Shariah boards. Negligence and lack of understanding on the part of the practitioners may jeopardize the whole Islamic offering. Apart from that, Shariah boards have a duty to educate the practitioners on Shariah principles so that both sides can mutually work for better Shariah-compliant products, operations and conduct by the Islamic finance institutions. It is also highly desirable that Shariah scholars conduct training and engage in close interaction with officers in the institution to increase their understanding of Shariah and fiqh mu'amalat (Islamic jurisprudence).

3. Thirdly, Shariah scholars need to be competent to scrutinize the documents related to products and transactions, as negligence will result in non-compliance and negative legal consequences. Therefore, Shariah scholars must have sufficient knowledge about the Shariah, legal and operational aspects of the products and transactions. It is highly desirable that Shariah scholars be involved in product development from the early stages up until the contract is concluded. This will definitely require them to have a good command of
languages, as they need to read and examine all the terms, conditions, clauses and secondary contracts that are set out in the contract, as well as all the supporting documents. They shall need to ensure clarity in Shariah principles in the documents and that the contract is fair and just for both parties.

4. Shariah advisors must have full knowledge of the purpose of the products and its technicalities. They have to ensure that the products have positive objectives and are not used as means to forbidden ends. It is also a major cause for concern if Islamic finance proceeds are not well managed or are channeled to non-compliant activities. If this is not checked, then efforts to build a Shariah-compliant system will be fruitless, as a permissible matter that leads to a prohibited matter is also prohibited. Shariah scholars must be firm and strict so as not to allow any forbidden or doubtful activity or one that involves legal trickery (hiyal).

5. Shariah scholars must also assess the economic implications of the product to the Ummah. This will require them to take a maqasid approach. It must be remembered that Islamic finance products are supposed to provide facility to the people and not to burden them, as in Islam wealth is one of the essentials of human life. Therefore, Islamic finance has to be reviewed on a macro-scale, namely, ensuring that it is serving the Ummah effectively. For instance, retail products must not be neglected, although wholesale products may yield more profits. The Islamic financial system, which is commonly characterized as a moral and ethical system, must contribute effectively to overall wealth creation, growth and development, and greater shared prosperity.

Another aspect that needs to be considered by Shariah scholars is their role in strengthening the governance of Islamic financial institutions as well as instilling Islamic values in the financial institutions’ business operations and governance. This will include facilitating Shariah audits, ensuring Islamic and ethical management practices, protecting consumers’ rights and ensuring the accountability of the financial institutions. Islamic ethics and discipline should be incorporated in the policies and governance of the Islamic finance institution, and Shariah advisors should be role-models in ethics and work performance. This shall add to the Islamicity of the institution, and an Islamic standard of Corporate Social Responsibility (CSR) should be incorporated.

4.12.5. Duties and Responsibilities of Shariah Boards from Legal and Regulatory Perspectives:

Shariah advisors have many roles to play, and their advice and expertise are sought after in many areas. Apart from their duties to the Islamic financial institutions that engage them, Shariah advisors should also play significant roles in the growth and betterment of the industry on the national level, at least, if not the global. Islamic finance as it exists today is the fruit of a collective effort of all its stakeholders and a combination of various disciplines and knowledge. These disciplines include banking and finance, accounting, law, economics, information technology and others. However, it is acknowledged that law and regulation comprise two of the most important elements that will be determining factors in the growth of Islamic finance. As they are essential to Islamic finance’s growth, Shariah advisors need to play a role in ensuring that these disciplines are not in contradiction with Shariah requirements.
4.12.6. Importance of the Shariah Registered Financial Planner Programme:

1. To increase and enhance the pool of Islamic Capital Market expertise through training and education.

2. To provide an understanding of the influence of Shariah in the business context and prepare graduates to hold key positions in the Islamic Finance and Takaful Industries.

3. To provide an international benchmark qualification that will equip candidates with a practical understanding of Islamic Financial Planning.

4. To introduce more competitive and innovative Islamic financial products and services.

5. To increase the awareness of Malaysia’s Islamic Financial Planning on the domestic and international levels.

6. To establish strategic alliances between India and other Islamic countries.

4.12.7. Responsibilities of Islamic Financial Planner:

1. Identification of Halal Critical Control Points (HCCP).

2. Traceability of the ingredients up to their source and manufacturing process.

3. To give Shariah verdict on each and every raw material/ingredient used in the product.

4. Monitor the use of processing aids.

5. To evaluate the Halal food management system of the company its documents, manuals and procedures as per the standards.

6. Physical verification of the whole process to ensure that the preparation, processing or Manufacturing is done using equipment and facilities that are free from contamination with non-halal (illegal) activities.

7. To verify that during processing, packaging, storage or transportation of the product should be physically separated from the non-halal (illegal) activities.
4.13. PRACTICES AND OPPORTUNITIES RELATED TO THE AVAILABILITY OF ISLAMIC BANKS.

Islamic finance has emerged as an effective tool for financing development worldwide, including in non-Muslim countries. Major financial markets are discovering solid evidence that Islamic finance has already been mainstreamed within the global financial system – and that it has the potential to help address the challenges of ending extreme poverty and boosting shared prosperity. The Islamic finance industry has expanded rapidly over the past decade, growing at 10-12% annually. Today, Sharia-compliant financial assets are estimated at roughly US$2 trillion, covering bank and non-bank financial institutions, capital markets, money markets and insurance (“Takaful”).

In many majority Muslim countries, Islamic banking assets have been growing faster than conventional banking assets. There has also been a surge of interest in Islamic finance from non-Muslim countries such as the UK, Luxembourg, South Africa, and Hong Kong. Over the past decade Islamic finance has emerged as an effective tool for financing development worldwide, including in non-Muslim countries. Major financial markets are discovering solid evidence that Islamic finance has already been mainstreamed within the global financial system and that it has the potential to help address the challenges of ending extreme poverty and boosting shared prosperity.

Islamic finance is equity-based, asset-backed, ethical, sustainable, environmentally- and socially-responsible finance. It promotes risk sharing, connects the financial sector with the real economy, and emphasizes financial inclusion and social welfare.

The following key principles guide Islamic Finance:

i) Prohibition of interest on transactions (riba).

ii) Financing must be linked to real assets (materiality).

iii) Engagement in immoral or ethically problematic businesses not allowed (e.g., arms manufacturing or alcohol production).

iv) Returns must be linked to risks.

4.13.1. Strategy in Islamic Finance:

The World Bank Group involvement in Islamic finance is directly linked to the Bank’s work on reducing poverty, expanding access to finance, developing the financial sector, and building financial sector stability and resilience in client countries.

By helping expand the use of Sharia-compliant modes of financing in World Bank Group operations, we are helping deliver benefits to client countries in three areas:
The sustainable development of Islamic finance offers benefits for economic growth, reducing poverty and fostering shared prosperity. Islamic finance can significantly contribute to economic development, given its direct link to physical assets and the real economy. The use of profit-and-loss-sharing arrangements encourages the provision of financial support to productive enterprises that can increase output and generate jobs. The emphasis on tangible assets ensures that the industry supports only transactions that serve a real purpose, thus discouraging financial speculation.

Islamic finance helps promote financial sector development and broadens financial inclusion. By expanding the range and reach of financial products, Islamic finance could help improve financial access and foster the inclusion of those deprived of financial services. Islamic finance emphasizes partnership-style financing, which could be useful in improving access to finance for the poor and small businesses. It could also help improve agricultural finance, contributing to improved food security. In this regard, Islamic finance can help meet the needs of those who don’t currently use conventional finance because of religious reasons. Of the 1.6 billion Muslims in the world, only 14% use banks. It can help reduce the overall gap in access to finance, since non-Muslims aren’t prohibited from using Islamic financial services.

It helps strengthen financial stability. As the 2008 global financial crisis ravaged financial systems around the world, Islamic financial institutions were relatively untouched, protected by their fundamental operating principles of risk-sharing and the avoidance of leverage and speculative financial products.

Despite its recent years of rapid growth, Islamic finance is still in its early stages of development, and it will need to address several challenges. We are supporting our client countries to strengthen the legal, regulatory and institutional foundations of Islamic finance. We have also expanded our efforts in promoting the systematic and sustained use of relevant knowledge of Islamic finance to raise awareness, build consensus and promote the worldwide use of Sharia compliant financing instruments.

As part of its work on Islamic finance, the World Bank, in partnership with the government of Turkey, established the Global Islamic Finance Development Center in 2013 as a knowledge hub for developing Islamic finance globally, conducting research and training, and providing technical assistance and advisory services to World Bank Group client countries interested in developing Islamic financial institutions and markets.

4.13.2. Islamic Finance Principles and Instruments

The term Islamic finance is used to refer to financial activities conforming to Islamic Law (Sharia). One of the main principles of the Islamic finance system is the prohibition of the payment and the receipt of riba (interest) in a financial transaction. The term riba covers all forms of interest and is not limited to usury or excessive interest only. The most critical and significant implication of banning interest is the indirect prohibition of a “pure” debt security. The key point to bear in mind is that Islamic law doesn’t recognize money and money
instruments as a commodity but merely as a medium of exchange. Hence any return must be tied to an asset, or participation and risk-taking in a joint enterprise (such as partnerships). A pure debt security is replaced with an “asset-linked” security, direct financing of a real asset, and different forms of partnerships of which equity financing is the most desirable.

In addition to prohibition of riba, there are several other important provisions which may affect financial transactions. These include the prohibition of ‘gharar’ (uncertainty or asymmetrical information), ‘maysir’ (gambling, speculation), hoarding, as well as trading in prohibited commodities (for example, pork and alcohol).

4.13.3. Shariah Instruments:

Basic instruments include: cost-plus financing (murabaha), profit-sharing (mudaraba), leasing (ijara), partnership (musharaka) and forward sale (bai’salam). These constitute the basic building blocks for developing a wide array of more complex financial instruments.

1. Murabaha – Trade with markup or cost-plus sale:

The purchase of an asset is financed for a profit margin, with the asset purchased on behalf of client and resold at a pre-determined price. Payment could be in lump sum or in installments and ownership of the asset remains with bank till full payments are made.

2. Ijara – Operational or financial leasing contracts:

Bank purchases asset on behalf of client and allows usage of asset for a fixed rental payment. Ownership of the asset remains with the financier but may gradually transfer to the client who eventually becomes the owner.

3. Mudaraba – Trustee financing contract:

One party contributes capital while the other contributes effort or expertise. Profits are shared according to a predetermined ratio and the investor is not guaranteed a return and bears any financial loss.

4. Musharaka – Equity participation contract:

Different parties contribute capital and profits are shared according to a pre-determined ratio, not necessarily in relation to contributions, but losses are shared in proportion to capital contributions. The equity partners share and control how the investment is managed and each partner is liable for the actions of the others.
5. Sales contracts:

Deferred-payment sale (bay’ mu’ajjal) and deferred-delivery sale (bay’salam) contracts, in addition to spot sales, are used for conducting credit sales. In a deferred-payment sale, delivery of the product is taken on the spot, but delivery of the payment is delayed for an agreed period. Payment can be made in a lump sum or in installments, provided there is no extra charge for the delay. A deferred-delivery sale is similar to a forward contract where delivery of the product is in the future in exchange for payment on the spot market.

6. Sukuk – Certificates of Ownership:

Sukuk are certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services, or (in the ownership of) the assets of particular projects. The returns on the certificates are directly linked to the returns generated by the underlying assets.12

4.14. PRACTICES AND OPPORTUNITIES RELATED TO THE ISLAMIC FINANCIAL PRODUCTS.

Basics of Islamic Finance Like conventional system, Islamic financial institutions also operate via various instruments depending on the type project and requirement of stakeholders. Some of them are discussed below:

a) Mudaraba:

Mudaraba is a profit and loss sharing contract between two entities namely Islamic financial institution, as an investor and an entrepreneur as second entity. Profits are shared between the two entities according to proportions agreed in advance. In case of loss, Islamic financial institutions bear the loss and entrepreneur sacrifices his efforts.

b) Musharaka:

Musharaka is similar to that of Mudaraba, but only with difference that bank is not the sole investor for entrepreneur. Two or more partner together contributes for the investment in a specific project. Profit is shared as agreed proportions in advance. While, loss sharing is limited to capital contributions made by various agencies.
c) Murabaha:

Murabaha is a type of cost plus sale contract. Under this arrangement customer asks the Islamic financial institution to purchase an asset for him and sell the same to him on deferred basis. Bank accumulates profit by charging predetermined amount above the actual asset cost. Amount of installments are non-negotiable.

d) Ijara:

Ijara contracts are almost identical to leasing contracts in conventional banking, in which the lesser gets periodical return from the lessee against the use of an asset. Financial as well as operation lease are permissible. Ownership risk of the assets is borne by the investor, while maintenance and operational expenses are borne by customer.

e) Istasna:

It is a type of enterprise contract in which the customer asks the Islamic financial institution to make a build a specific product for him as per the specifications. The institution would sale the asset to the customer on deferred basis.

f) Salam:

Salam is a contract of sale with delivery of goods on deferred basis. It is almost similar to Istasna, with a difference that goods or products to be procured are already of finished nature.

g) Sukuk:

Sukuk is a plural form of word Sak (bond), which in simplest terms is a Shariah complaint “Bond”. 13
4.15. Appraisal of the study (Opportunities of Islamic finance in India):

1. Co-operative Societies:

Depending on the effectiveness and robustness of promoting with state government regulators of co-operatives, it has been possible since the mid-seventies to run Shariah compliant demand deposit and service charge based loan schemes under co-operative credit societies. In the mid-eighties government passed the Multi-Activity Co-operative Societies Act which made it theoretically possible for co-operative societies in that State to liberally invest in a wide range of non-interest earning avenues and thus offer Shariah compliant deposit and profit based loan products. This was followed in early part of first decade of 21st century by central legislation giving wide powers for co-operatives to manage their affairs autonomously, paving the way for liberalized acts for co-operatives in a number of states. These and the Multi State Co-operatives Societies Act of the central government have made it possible for co-operatives to invest in other than interest-based loans, deposits and securities and offer Shariah compliant forprofit deposit and profit-based loan schemes.
2. **Mutual Funds:**

In the early nineties, GOI agreed to liberalization of regulation and to doing away with monopoly on mutual funds by government-controlled UTI (which did not offer any Shariah-compliant mutual fund). This led to entry of private players in this sector, with the theoretical possibility of floating Shariah compliant mutual funds. This in turn paved the way for the first effectively Shariah-compliant mutual fund from Tatas in 1996. Much later, in 2008, SEBI approved the first explicit Shariah compliant mutual fund from Taurus. Recently, SEBI has released some tentative rules preparatory to allowing Real Estate mutual funds, which could provide another Shariah compliant option in this sector in the near future.

3. **Venture Capital / Alternative Investment Funds**

Specific regulations were brought out to encourage venture capital funds towards middle of the first decade of this century. These were ideal vehicles to provide compliant avenues of investment to middle and higher middle income investors, as well as sources of funding for compliant entrepreneurs. SEBI also approved the first explicitly Shariah compliant venture capital fund in 2008. However at the beginning of the current decade, fresh regulation has raised the threshold of investment for individuals drastically. Due to the passage of the LLP Act a couple of years earlier, a ray of hope still remains of using LLPs as intermediate consolidation vehicles and keeping this avenue open.

4. **Partnerships and NBFCs:**

This field has seen progressive throttling of avenues of Shariah compliant investments by the regulator, RBI. In late 1980’s regulation tightened control over the possibility of deposit acceptance by partnerships for investment in Shariah compliant manner. This was followed by a complete choking off of such deposit acceptance by partnerships about a decade later. Similarly, in case of NBFCs, after allowing fairly liberal deposit acceptance by certain category of NBFCs in mid-1980’s, RBI progressively closed avenues of raising funds by NBFCs - as (profit-sharing) deposits and convertible debentures. By the turn of the century it had made Shariah compliant NBFCs quite unviable by insisting on declaration by them of specific rates of interest on their deposits. Since several years now it has not even been registering deposit-taking NBFCs. With the AICL case, RBI has shown its open bias against Islamic Finance by opposing even investment by NBFCs on variable returns basis. Its unstated campaign against Islamic Finance continues. Its latest and very recent salvo appears to be its insistence on an NBFC to eschew the Islamic practice of donating to charity any penalties charged from customers on delayed payments in the guise of concern for the NBFC’s financial viability.
5. Stock Market Investment:

The concept of business compliant investments in quoted and traded stocks was initially publicly promoted by the Barkat Investment Group in the late 1980’s. Its lead was followed by Idafa Investments with additional financial screening in the early years of the previous decade. Then in 2008 TASIS, India’s first corporate Shariah investment advisory firm pioneered systematic stock screening and stocks-related Shariah investment advisory services including calculation of interest purging for stock portfolios. In S&P began providing two Shariah Index for the Indian stock market. This was followed in 2011 by BSE TASIS Shariah 50, which proved quite successful and popular with investors. Now NSE is also providing its own Shariah index based on its Nifty 50, in collaboration with TASIS for Shariah compliant investors. Insurance An existing window under the earlier Insurance Act in the form of possibility of forming mutual insurance societies and mutual insurance companies for a possible introduction of Takaful operations in future shut down with introduction of IRDA Act towards the close of the previous century. Hope of introduction of Shariah compliant insurance ignited briefly with the clearance by IRDA in 2008 of the first potentially fully compliant pension investment scheme. However a year later as a result of a turf war between regulators, entry to additional investors in that scheme was barred. Since then Shariah compliant insurance remains a major void in the Shariah compliant finance landscape of India. Banking Shariah compliant retail quasi-banking options exist in the form of co-operative societies and societiesup to the scale of small co-operative banks. These are under threat from proposed unfavorable RBI regulation in the guise of control and monitoring of the microfinance sector. Regular Islamic banks remain a distant dream for pro-Shariah compliant finance lobbyists.

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[10] Ibid.

