A Review on the Benefits of the Islamic Banking

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ABSTRACT: Modern Islamic banking is just about five decades old, but in almost every part of the world, it has gained enormous interest. Today, Islamic banking has been one of the world’s fastest growing banking and capital markets segments. Spreads have increased in the last ten years, especially following the global financial crisis of the previous decade, mainly because Islamic banks have been found to be more resilient and less vulnerable to crises. The need to attract investment from the Middle East and Gulf countries, in addition to demand from the Muslim community, is another reason for its growth. Right from the industrialized western world like the United Kingdom to the Asian giants like Japan and China, Islamic banking has found its way. The paper aims to emphasize the Islamic banking needs to be accommodated by India too. If India attempted to shy away from Islamic banking, massive potential investments will be forfeited. The paper highlights the advantages of the introduction of Islamic banking in India and discusses the problems that Islamic banking still faces in India.

KEYWORDS: India, Islamic Banking, Islamic Finance, Islamic Micro-Finance, SWOT Analysis.

INTRODUCTION

Basically, acting as an intermediary between investors and savers is the primary role of financial institutions, including banks. Most of the savers are households and millions of savers are aiming to put their investments in the future and want to make some money to invest in them as well. On the other hand, investors are the thousands of entrepreneurs who are looking for cash to fund existing projects or set up new businesses, etc. This makes it easier for financial intermediaries, enhancing growth and trade, to transfer funds from their owners to their customers [1]. Traditional banks usually lend at a fixed interest rate to businessmen and take deposits from the public on the basis of giving them a return that is much lower than the interest rate charged on loans to businessmen [2]. The difference between the two is explained by banks as covering the risk, the administrative cost, and earning profit. However, the basis for this exchange need not necessarily be focused solely on interest. Modern Islamic banking is a relatively recent phenomenon and is the result of the quest for an interest-free alternative to conventional banks, as giving and taking interest is prohibited in Islam. Islamic banking is focused on sharing profits and losses. Modern Islamic banking originated in Egypt, but the Middle East nations played a major role in spreading and formalizing it [3]. Islamic banking continues to increasingly change into a growing array of conventional financial systems. Not only in nations with Muslim majority populations, but also in other nations where Muslims are a minority, it is growing [4].

Businesses face the burden in a traditional banking system, as expenses are incurred on profit expectations does not accrue or may not. As well as interest, the owners of money are guaranteed their principal. This is unjust when one party assumes all risks and the other receives a risk-free return on their capital. On the contrary, Islamic banking implies that those who want to make a profit must also expose their principal to risk, since the only way to earn money on money is through business. A choice in Islamic banking is to guarantee principal only if zero returns are stipulated. Otherwise, if anyone expects to earn a return on the money, they should use it themselves or let someone else use it in trade or business, etc. and share both the return and the risk. Interest-driven financing is unfair. One party assumes the risk in this arrangement while the other receives a risk-free return. One party can lose, but the other continues to gain more and more cash, which contributes to wealth concentration. In Islamic banking, by comparison, both the risk and returns are shared.
Inclusions:

It is possible to incorporate Islamic banking for more inclusive development. Islamic banking, along with control over inflation, can provide equitable growth. Unfortunately, India is home to 21 percent of the world's unbanked population, the largest number of financially excluded adults in any single country. As compared to traditional finance, financial inclusion is more specifically emphasized in Islamic finance. The reasons why Islamic finance scores higher than traditional finance to improve financial inclusion are because it is interest-free, and two pillars of Islamic economics can be called risk-free wealth sharing and wealth redistribution. The central economic concepts of Islam entail risk-sharing. Islam specifically bans interest-based contracts of all sorts. The explanation for this is that a party wishing to be a benefit receiver should also be prepared to share the loss, if any, and thus mutually allow and promote profit-sharing and risk sharing. In the traditional scheme, only one party (the borrower) assumes the risk and the other earns a fixed rate of return on investment (interest). Many financial instruments, namely Mudarabah, Musharakah, Murabaha, Ijarah, Salaam, etc., have developed over time and are practiced in Islamic banking today. However, Islamic micro-finance and micro-insurance, or micro-taka, are more relevant in the sense of financial inclusion.

Islamic law, by rules on resource allocation, development, trade and the distribution of resulting income and wealth, ensures equal justice along with economic growth. Islam strongly believes that the profits from the use of different resources by the more capable must be shared with the less capable, who have equal rights over them. Islam puts great importance on the redistribution of wealth and income and thus legislates institutions such as Zakat, Sadaqah, and Qard-al-hasan for this reason. These instruments are meant to increase access to funding while addressing equity and leading to the alleviation of poverty [5]. Zakat and Sadaqah are gifts, except for the poor, Qard-al-hasan is a loan without interest.

Upliftment of the Muslims:

The change in the conditions of the largest minority in India, Muslims, should be one of the most important factors for the implementation of Islamic banking. According to the Sachar Committee report, Muslims are the most deprived group in the finance sector. 80 percent of Muslims are financially excluded because of interest-based deposits and credit from commercial banks. Muslims lose about Rs 63,700 crores per year because they have a 47 percent credit deposit ratio against the national average of 74 percent, according to an RBI survey. With 31% of Muslims living below the poverty line and 40 percent of Muslims working as own-account staff, Islamic banking will cover this significant deficit.

Increase in Investments:

India is a developing nation and needs tremendous investment. The environment for investment in India is favorable. The legal system of India, which is the best in the country, safeguards foreign investors and even the surrounding economies. There are few opportunities for Islamic countries. India also has adequate administrative and technical skills. If India implements Shariah-compliant banking, the country will be able to put in more Arab petrodollars [6]. In order to draw petrodollars, western countries have also introduced Islamic banking. Not only will the introduction of Islamic banking please the 175 million Muslims living in India, but it will also draw non-resident Indian Muslims to invest in India. All of this would make investments available for more capital [7].

Agricultural Development:

Agriculture is one of the largest sectors of economic activity in India and plays a critical role in the economic growth of the country through the supply of food and raw materials. It provides a very large proportion of the population with jobs, resources for their own growth and even surpluses for domestic economic development. One of the basics of agricultural production, as in other sectors, is finance. The main source of the country's agricultural finance after independence was from non-institutional sources, consisting of money lenders,
merchants, land lords, etc. This, however, caused the farmers to be oppressed. Thus, through banks and other formal financial institutions, the government has launched schemes to make more credit available to farmers. It is, however, well known that this, too, does not always boost the farmers' plight. As farmers face crop failure due to severe weather conditions such as drought, floods, etc., India is witnessing an alarming rate of farmer suicides. Farmers are unable to pay the debt accrued and the principal. More than one thousand farmers have committed suicide in just two months this year. In the state of Maharashtra, in the past ten years, about ten farmers have committed suicides daily (National Crime Records Bureau). Islamic banking can prove to be beneficial in such a situation. The concept of both risk and benefit sharing is the foundation of Islamic banking. Islamic banking products are such that the borrower only needs to make payments when he collects returns on the money he has borrowed. In Islamic banking, the rate and time of return are not pre-determined, unlike in traditional banking. Islamic banking also has a commodity, Qard-e-hasan, where money is lent on zero returns and when the borrower has ample funds, the borrower is obliged to pay only the principal [8].

CONCLUSION

Islamic Banking is a Quran-inspired banking system that prevents interest in giving and taking, and focuses on the sharing of risk and return. Modern Islamic banking is just about five decades old, but today it has become one of the fastest growing segments of the world's banking and capital markets. It is steadily gaining popularity as a feasible alternative to conventional banking. Within a short time span, Islamic banking has expanded far and wide. It began in Muslim majority nations such as Egypt and the Middle East, but it has now spread to all parts of the globe, from developed western nations such as the United Kingdom and the United States of America to countries such as the far east of Japan and Singapore. These nations have made appropriate reforms to accommodate Islamic banking in their banking laws. The reasons for this were mainly two folds-to meet the demand of the local Muslim population and the second was to attract large petrodollar investments in their nations. A further important reason for the rapid adoption of Islamic banking is its performance during the global financial crisis of the last decade, in which Islamic banks and the Islamic windows of conventional banks have been found to be more stable. In order to see the potential investments, China and Hong Kong were also open to Islamic banking and finance. However, despite recommendations from high-level committees urging the implementation of Islamic banking, India has not yet started Islamic banking[9]. In order to accommodate Islamic banking, the 2009 Raghuram Rajan Financial Sector Reform Committee and the 2015 Deepak Mohanty Medium Term Route Committee on Financial Inclusion strongly recommended that the government make necessary amendments to the Indian banking laws.

REFERENCES


