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A Study on Islamic Banking's Growth, Challenges and Potential in India

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Abstract
The possibility of Islamic banking in India is based on two main reasons, namely, (1) India can be a vital and huge market for Islamic banking because of the large Muslim population and (2) Islamic banking is based on interest-free loans, which would be preferred by the Muslim community as well as the non-Muslim community. This paper depicts the real picture of the basic principles and concepts of Islamic banking or institutions and the possibility of Islamic banking in India. This paper shows the different financing modes of Islamic banking and favorable and unfavorable points which are helpful to increase the awareness of Islamic banking among the Muslim and non-Muslim community because India is a potential and significant market for Islamic banking financial institutions. Unfortunately, the banking of Islam has been misinterpreted in India like a religious charitable project limited to poor of the nation and the economically disadvantaged community of Muslims. Even years of effective Islamic banking operations and amazing global expansion haven't been enough to dispel this notion.
Key Words: *Islamic Banking, Religious Banking, Basic Principles etc.*

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1. INTRODUCTION

Islamic banking is a type of banking that adheres to the principles of Islamic law (Shariah) and puts them into practice through the development of Islamic economics. Islamic banking, commonly referred to as interest-free banking, encourages profit sharing. Interest is prohibited by Shariah (Islamic Law) and is considered Haraam (forbidden) in Islam. It's fascinating that sharia banking continues to thrive despite the absence of interest. They are not only lucrative, but they are also rapidly expanding in terms of capital, assets, and customers. In the 1980s, Islamic financial institutions reached their pinnacle of development. Takaful/Islamic insurance was recognised Shariah compatible by the Organization of Islamic Conference's (OIC) High Council in 1985. The first Islamic bank was founded in MitGhamr, Egypt, in 1963, but it did not last long. Islamic banking is now widely used in many nations. Islamic banking is gaining traction in a growing number of traditional financial systems. It is spreading not only in countries where Muslims are the majority, but also in countries where Muslims are a minority. Over the last few years, Islamic banking as a concept has gained traction around the world, including in India. some foreign banks with operations in India, like HBSC, Citibank, Standard Chartered Bank provide interest-free accounts in West Asian nations, Europe, and the United States. The IMF has expressed a strong desire to help countries that have adopted Islamic banking achieve macroeconomic and financial stability. Indian banks are also becoming more aware of the notion, and it's widely believed that there is a huge possible market for products of Islamic banking in India. Many banks in the country have expressed an interest in pursuing this type of interest-free banking. Scheduled commercial banks, on the other hand, will not be able to follow Islamic banking principles even to a limited degree unless adequate norms or regulations are in place to govern this nature of banking.

1.1 Islamic Banking: An Overview

The Islamic banking system began in 1963, but the modern practices began in 1975, when the banks were set up and bound to work as per Sharia rules and principles. Since its establishment, the Islamic banking system has become one of the fastest rising industries in the banking industry globally. The industry projections suggest that the Islamic banking or financial institutions' assets owned by commercial banks around the world will carry on to increase as new geographies unlock to the practice.

Islamic banking has been an Islamic financial system that organises economic and banking activities in accordance with Islamic Shari'a's regulations and principles. It adheres to Islamic jurisprudence's views and principles in matters related to business or trading, treated as fiqhal-muamalat, or the Islamic laws or regulations on business transactions. The Quran, Sunnah, and other Islamic sources of law and regulations, like Ijma' (The way of accepting suggestions among scholars of Sharia), Qiyas (Means-similarity), and Ijtehad (Means-personal reasoning), jointly provide the structure from which fiqhal-muamalat (Means-Islamic jurisprudence) rules or practices are developed.

All banned activities, like gharar (uncertainty), riba (interest) and funding of banned (haram) trading and businesses, like pornography, alcohol, speculating, gambling, and so on, are avoided in the Islamic banking world.

The primary difference between the conventional banking system and the Islamic banking system is that conventional banking is totally man-made while Islamic banking is founded on Sharia principles and laws. Accordingly, all parts of banking transactions, like business style and product features, are taken from Shari's law and principles. This is a major deviation from traditional banks.

Islamic banks do not compromise with the Islamic rules and laws of Shari'a though they are profit-making organisations. Islamic banking is a structure of business in which goods and services are sold and capital or money is invested in order to make Shari'a-based profits.

2. REVIEW OF LITERATURE

The Shariah, or set of rules and laws that govern the political, economic, cultural, and social aspects of Islamic society, is the foundation for an Islamic financial structure. Shariah is totally dependent on the rules and practises of the Quran, as well as the Prophet Muhammad Sahab's interpretations (more popularly and familiarly known as Sunnah). In Islamic jurisprudence, scholars explore the principles in the light of the Quran and Sunnah.

Bley & Kuehn (2004) In the United Arab Emirates, the focused on students' knowledge and their perceptions about Islamic finance and conventional banking. Students with good academic success record showed a better reply towards good understanding of the Islamic banking practices and concepts.

Mohammed & Razak (2008) have done research on the Muslim community and non-Muslim community clients' acceptance of Malaysian Islamic banking, focusing on the operation and characteristics of Bai Bithaman Ajil, a unique Islamic banking product. Customers were found to be dissatisfied in this study, as shown by their lack of desire to utilise Bai Bithaman Ajil, which the researchers projected would be replaced by Musyarakah Mutanakisah Partnership.

Qureshi (1946) Instead of expressing well-thought-out ideas, the early authors were simply thinking aloud. The book which was expressed by Qureshi-Islam and the Theory of Interest (Qureshi l946), for instance, saw Islamic banking as a social service that should be encourage and subsidised by the governments, similar to education public health. Because the bank could not pay interest to account holders or levy interest on loans made, Qureshi adopted this stance. Qureshi also mentioned bank-businessman partnerships as a viable option, with losses shared if any.

Ahmad (l952) Ahmad foresaw the development of Islamic banks on the basis of a joint stock corporation with limited liability in Chapter VII of his book Economics of Islam. In his suggestion, individuals may deposit their money in individual's account on partnership basis, with shareholders receiving more dividends than account holders from the profits earned, in addition to current accounts on which no dividends or interest should be given. Ahmad, like Qureshi, mentioned probable collaboration agreements with businesspeople seeking funding from banks. The partnership idea, on the other hand, was left unexplained, as was who would suffer the loss, if any. It was recommended that banks use current account funds to settle bills of trade without collecting interest.

Siddiqi (1968) In l968, Siddiqi made a groundbreaking attempt in Urdu to provide a reasonably complete overview of Islamic banking. Mudaraba and shirka were key to his Islamic banking strategy. His approach was fundamentally based on a two-tier mudaraba financier-entrepreneur connection, but he went to great lengths to explain the mechanics of such transactions using several hypothetical and mathematical instances.

3. Objectives of the Study

- To discover the benefits of the Islamic Banking in India.
- To know fundamental principles and concepts of the Islamic banking.
- To learn more about Islamic banking's possibilities in India.
- To investigate Islamic banking's funding options.
- To have a better understanding of the issues that Islamic banking faces in India.

4. Research Methodology

The study of this paper is based on secondary data which was collected from different-different sources such as internet, published thesis, research paper, articles, news paper etc.

5. Limitations of the Study

- The study of this paper is based on secondary data.
- Non-availability of data everywhere.
- To explore the financing modes of the Islamic Banking in India.
- To review and predict the potentiality of Islamic Banking in India

6. History of Islamic Banking

Due to the Ottoman Empire's heavy trade with Spain, a variety of interest-free banking arrangements, which are based on profit and loss sharing, were shaped. Therefore, these networks produced funds for trade and other economic activity.

When the Asia and the Middle East became more important economic partners for European organizations, The Europeans searched banks in these areas; more banks were interest bearing based.

As economic demands increased, ignoring banks was no longer an alternative for local or home entrepreneurs. As a result, local interest-based banks grew throughout the area. In addition, when countries have won independence from colonial rule or administration, the necessity for financial institutions becomes more critical. Individuals, corporations, and governments, whether they wanted it or not, were all forced to use these organisations. Some experts called for a more enticing, interest-free banking alternative.

During the next few decades, this type of banking became increasingly common. Egypt's Mit Ghamr savings programme became the first well-known financial institution not long after. In a cooperative organization, all depositors may acquire small loans for practical productive purposes. Furthermore, this cooperative made profit-sharing investments in a number of projects. In 1971, the Nasser Social Bank incorporated this concept.

From 1975, more than fifty interest-less financial banks have opened, mostly of them are located in Muslim countries. The Islamic banks began to set in the Western Europe in the early 1980s. Furthermore, Pakistan and Iran have set an Islamic banking mechanism in all of their financial institutions.

Since the late 1990s, customers have been finding the benefits of this sort of financial banking, which has been growing at a 10%-15% yearly pace. In addition, the number of financial institutions that provide Islamic financial services is increasing, and many traditional banks are increasingly providing Islamic financing options. Here, Islamic banks have set themselves up as a viable alternative to the conventional banking mechanism. Sharia counselling and structuring institutions such as ijaraloans.com have become more popular in the last few decades, keeping focus on transforming into a one-stop shop for Muslim community customers who, perhaps, are looking for Islamic financing solutions.

7. ADVANTAGES OF ISLAMIC BANKING

7.1 Fairness and Justice

The profit-sharing concept underpins the Islamic banking model, where the bank and its customers share the risk. This financial intermediation system aids in the allocation of income and wealth in a proper and equal manner.

7.2 The concept-Banking for All

Islamic banking is founded on Shari'a principles and is open not only to the Muslim community but also to non-Muslims.

7.3 Transparency in Banking Transactions

The main aim of Islamic banking is to do business transparently. The final goal is to educate and help you through the process so that you are completely aware of the risks and expenses which are associated with the goods and services of Islamic banks.

7.4 Moral Magnitude Ethical

Keeping focus on moral mechanisms and well-built ethical business transactions, it has to be decided which activities help to sponsor play an important role in motivating socially acceptable investments with good individual and corporate behaviour.

7.5 Discouragement of Speculation

Speculative or gambling transactions are sources of instability as well as capital misallocation, which cannot be avoided. Islamic financial institutions are banned from doing these kinds of transactions, instead focusing on investing in the real economy to promote socioeconomic justice.

8. BASIC PRINCIPLES OF ISLAMIC BANKING

In Islamic finance, Sharia law is strictly adhered to. Today's Islamic banking is totally based on a predetermined set of rules and laws, which are not always illegal in a few of the countries where Islamic banks operate:

8.1 Making Payment of Interest or Charging

According to Islamic laws, lending money on interest payments is treated as an exploitative practise which enriches the lender at the expense (which is paid by the borrower in painful conditions) of the borrower. As per Sharia law, interest is treated as usury (riba) and is totally banned.

8.2 Making Investment in Businesses Involved in Forbidden Activities

Identified activities like the manufacturing and sale or buying of alcohol and pork are banned in Islam. The events are considered haram, or banned. Finally, it is totally illegal to invest in such types of businesses.

8.3 The Term-Speculation (Maisir)

All kinds of speculation or gambling, which is known as maisir in Islamic banking, is totally restricted under Sharia of Islam. That is why Islamic banking or financial institutions are banned, which shows their involvement in transactions in which the possession of goods or products is contingent on a future occurrence.

8.4 Risk V/S Uncertainty (Gharar)

According to Islamic financial standards, participating in business transactions is prohibited which are based on fully risk or uncertainty. Gharar works like a statistic which helps to determine the validity of uncertainty and risk in investment. Gharar involves derivative transactions and short-selling, which are not allowed in Islamic banking.

Islamic banking is based on two more essential concepts in addition to the restrictions stated above:
Material finality of the transaction: Every transaction must be tied to a true underlying economic transaction.
Profit/loss sharing: In Islamic finance, parties who enter into contracts split the profit/loss and risk of the transaction. No one may profit more than the other from the transaction.

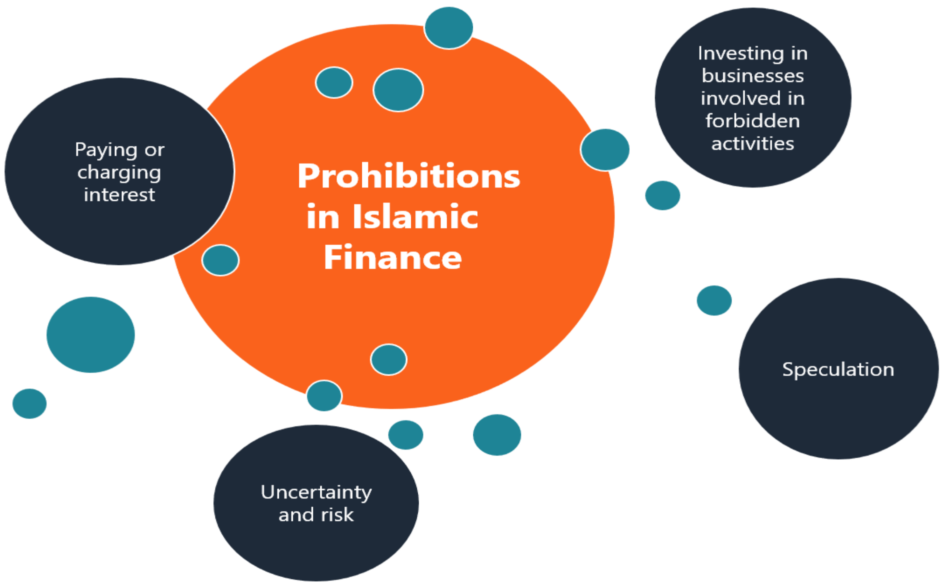

Figure: 1, Source: Self Prepared

9. Concepts of Financing Arrangements

It is very clear that Islamic finance depends on a set of limits and regulations which are not part of regular banking. And matchless arrangements have been created to follow the below mentioned principles.

9.1 Partnership with a P/L split (Mudarabah)

Mudarabah is termed as a profit/loss-sharing partnership deal where one party (financier or rab-ul mal) provides funds to another party (labour provider or mudarib) who is accountable for its administration and investment. Profits are divided in a predetermined ratio between the parties.

9.2 Profit-Loss sharing joint venture (Musharakah)

Musharakah is a sort of joint venture where, all partners invest their capital and P/L are distributed equitably. The major popular joint ventures are mentioned below:

A "diminishing partnership" is a kind of business that is commonly used to purchase the real estate property. Here, bank and the investor take over a property together. In exchange for payments, a bank then progressively makes transfer its share of the property's equity to the investor. Musharkah (permanent musharkah): This type of joint venture does not have an end date and will continue to function as long as the parties involved in it on an initiative for a long-term basis are generally funded using it.

9.3 Leasing (*Ijarah)*

A lessee makes lease the property from a lessor in the return for a succession of purchase payments and rental payments, culminating in the transfer of ownership of property to the lessee.

10. Investment Avenues

On account of the severe limitations imposed by Islamic Sharia Law, standard investment channels like debentures, bonds, trading in options, and derivatives are illegal in Islamic finance. There are two major investing options in the Islamic finance:

10.1 Equities Shares

Sharia law makes allow for the purchase of company stock. Companies must avoid engaging in activities that are banned in Islamic law, like interest-based loans, gambling, or the alcohol based production . Under Islamic finance, personal equity investments are allowed.

10.2 Fixed-Income based Instruments

Because Islamic banking forbids financing with interest payments, there are no traditional bonds. Sukuk, or "Sharia-compliant bonds," is a sort of bond that exists. The bonds represent a percentage of ownership in an asset, not a financial obligation.

11. India is the Next Destination for Islamic Financing

Dow Jones Islamic Index was established in 1998, and Mr. Jew was CEO of its rather than a Muslim. It didn't have any Indian companies listed on it. And I had brought this up in a Dow Jones news conference in London.

Surely, We may be a game player in the $3 trillion Islamic financial business, which is expected to develop, instead of debating about Hindu and Muslim. As we know that Indian Stock Market is the most Sharia compliant in the world — more than the countries like Bangladesh, Pakistan, Turkey, Malaysia, or Bahrain. The Bombay Stock Exchange (BSE) already runs Islamic finance training centre. India wants huge money for investments to fund in its infrastructure projects, and where Islamic finance can be of employ.

According to RBI, the Islamic window can offer Mudarabah finance. And India can be a big market of Islamic finance experts provider to the world. The Europe, United States of America, China, etc, are gaining the benefits and receive capital through Islamic finance, India can do also.

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According to Indian censes, India is keeping the largest Muslim populations in the world but most of the part of this population not able to access the banking services because of Islamic principles or norms, because paying and receiving interest is banned in Islamic Finance.

12. Islamic Banks' Financing Options

Islamic banks use a variety of methods to fund projects.

12.1 Financing Based on Expected Returns

In this system, a bank assesses the predicted rate of return on a determined a project, it is necessary to provide finance and lends making finance on the condition that a minimum rate of return is due to the bank. If a project earns more money than projected, the extra money is refunded to the consumer. The bank will accept a lower interest rate if the profit is lower than predicted. In the case of a loss, the bank will bear some of the responsibility.

12.2 Finance for Investment Purpose

There are three methods for doing so: A bank forms a joint venture with another bank or organization in Musharakah, with both the parties making participate in many sense of the project to differing degrees. P/L are distributed according to a set of rules. That is comparable to the joint venture concept. The venture is a separate legal concern, and after an initial period, the bank may gradually withdraw.

12.3 Financing for Trade Purpose

This can be accomplished in a variety of methods, including leasing, in which a bank purchases an item for a customer and leases it to him for a certain period of time, after which the lessee pays the remaining balance and becomes the owner of the object.

- When a bank purchases a product for a customer, the consumer goes agree to reimburse the bank for the price of purchase plus profit at a later date.
- A hire-purchase loan is a kind of loan in which the bank buys an item for the customer and rents it to him for a certain amount of time, The customer then becomes the proprietor of the object.
- Through the credit letter a bank gives guarantee for import of an item for a customer using its own money for transactions, in exchange for sharing the profit from the sale of this item.
- Loans with a service fee are the most prevalent kind of lending, in which the bank lends money without collecting interest but compensates for its costs by charging a service fee. This charge may be subject to a government-imposed limit.
- No-cost loans, where, every bank needs to set a percentage of funds to provide without cost loan to needed, like entrepreneurs, small farmers, producers and others, as well as needy clients.

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