

Emergence of Islamic Banking: Why and How?

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Abstract

The article unveils the circumstances which led to emerge Islamic banking and finally comments on its future. Basically Islamic banking is the outcome of the efforts to materialize the concept of 'banking without interest'. In today's global society, economic life is absurd without banking which is fundamentally based on interest. But interest is prohibited in Islamic life. This dilemma caused the emergence of Islamic banking as an alternative discipline. Initially Islamic banking drive was confined within mere designing of different interest-free modules as alternatives to corresponding conventional banking products. At least some of those modules are now seen producing better result than those of traditional banking in terms of resilience, justice and distribution of wealth. Recent growth trend of Islamic banking is also excellent. All these indicate a bright business future of Islamic banking. But business success is not enough. Eventually to fulfil Shariah objectives of Islamic economics as a whole, Islamic banking must do more including gradual enhancement of PLS or profit loss sharing based activities.

Introduction:

Human civilization has evolved banking as an integral part of Economics since long. Of late, correspondingly, Islamic banking has also occupied its position in Islamic economics. Nowadays many academic curricula contain Islamic banking as an alternative to conventional or traditional banking. But with reference to the genesis of banking and that of Islamic banking, we must admit that conventional banking has got much longer history. Naturally the former has also passed through many more phases of evolution than Islamic banking. As evident from history as well as different texts on economics, 'interest' has been a very important issue therein. And undoubtedly banking has emerged as an industry basically based on this very concept of interest.

But Islamic code of life suggests an economy free from interest because the Quran directly prohibits it. Naturally in the economic theorem of Islam, there remained no room for interest and therefore no banking module was dreamed or visualized in Islamic economics. As the idea of banking was conceived on the basis of the very philosophy of interest, the former (banking) must not be referred to have ever belonged to Islam or the Islamic society. As rooted from the concept of interest, banking is certainly a creation of conventional economics.

On the other hand although banking did not prevail in the early days of Islam, different business modules (of Islamic economics) were available in the Islamic society since long.

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Some of those modules or modes were subsequently adopted in Islamic banking as well. That adoption was accomplished for the sake of avoiding interest of modern banking. Those modes were in the use of the ancient Islamic society, as different forms of practical business, trade and mercantile or commercial ventures. Even our last prophet Muhammad (pbuh) himself was also engaged in some of such businesses. But we cannot term any such business as banking of today.

Methodology

This paper is a small harvesting of the intakes the author has so far received by way of his study and review of different literature on Islamic Economics, Banking and Finance. The study of such human written literature has been reconciled with the study of the divine Quran, Hadith and their commentaries. Recently studied few such books & journals have been named in the References of the article. Finally the academic intakes have been reconciled with the author's practical experience in different banks and financial institutions the first one being Islami Bank Bangladesh Ltd. Association of the author with the Islamic banking leaders and resource persons has also given indirect input in the article through their interaction in formal, informal, national and international seminars symposia and road shows etc.

Objectives

The core objective of the study is to pinpoint the circumstances which caused the emergence of Islamic banking as an alternative discipline. To achieve this prime objective, the study covers the following objectives:

- i) To portray the scenario that has led the pious people to be associated with the banking industry.
- ii) To unearth the turning point that has moved the concept of 'Not to bank' towards 'Bank without interest'.
- iii) To give a focus on difference between Interest and Profit.
- iv) To see how interest based transactions of conventional banks have gradually been restructured into non-interest transactions.
- v) To indicate the inherent strength and beauty of Islamic banking vis-à-vis objective of Shariah vs Islamisation of the methodology for Shariah compliance.
- vi) To apprehend future of Islamic banking.

Genesis – Banking VS. Islamic Banking

If we look for the origin or background of Islamic banking, we must have a peep into the genesis of 'banking in general'. Primarily banking was merely a process of lending and borrowing of money. Perhaps the process originated in the hands of goldsmiths, merchants and Mahajans or any such affluent class of the society. Through evolution, it attained the institutional shape to bridge between the lender and borrower. Banking as of today is nothing but a corporatised, refined and extended shape of that intermediary function. However, at present, banking also encompasses many other ancillary services. Those services were subsequently adopted in banking according to the gradual demand of the day.

If we talk of corporate form of a banking institution, as we understand it today, Islamic banking had never been a visible parallel organisation to conventional banking until, say the latter half of the last century. So it is very important to study the circumstances which necessitated the emergence of Islamic banking as a separate discipline. As the study reveals, we must recall those religious people who used to mark their erstwhile bank accounts with a noting of 'No-interest'. Many people were rather beyond the purview of banking channel for long, to save themselves from falling into the religious curse. Banking and Islam were then treated mutually exclusive. Adopting one of them automatically rejected the other. Thus the two words namely bank and interest became synonymous.

Turning point

In course of time, banking emerged as a very important activity of human civilization. Gradually taking part in banking activities became essential to remain associated with the economic wheel of the modern global village. Banking thus appeared as the part and parcel of human livelihood. Such an emerged importance on banking activities made that pious group change their earlier view of refraining from the purview of banking. They then rather thought it better to get associated with the global finance industry; but obviously not at the cost of religion. Consequently, instead of banking in general, interest was particularly targeted as the vital issue to address. Prohibition of interest in Islamic life then turned their concentration exclusively to interest instead of banking at large. 'Not to bank' concept was thus revised as a move to 'bank with religion' or 'bank without interest'.

As the prime source of income of a bank is interest, and interest arises from loan / lending & borrowing, loan transactions of conventional banking were identified first. Then it was decided that loan transactions must be avoided as a way of earning in religious banking. So lending system was required to replace by any other permissible mechanism. It is worth mentioning that other subsequently extended ancillary functions and non-funded business activities of modern banks were initially set aside in the secondary tier of the drive to make 'banking without interest' possible. These activities were regarded as non-prime issues because interest as a direct element, was absent from most of those ancillary services. It was also perceived that loan or 'qard' might exist in interest-free banking only as an exceptional case i.e. as a non-business and non-earning benevolent transaction.

From another aspect it has also been viewed that banking has emerged as a business; a commercial venture. Now, to save a target group from interest-income, banking must not be transformed into a non-business charitable organisation. Interest-free banking must not mean cost-free, income-free banking. Rather banking is to remain a business or commercial organisation; but that business must be based on Islamic fundamentals. A business would naturally have an expectation for a permissible return. Then the question came, in Islamic banking business, what return to expect, instead of interest? Very logically 'profit' was identified as the first solution to replace interest. That idea necessitated differentiating between interest (riba) and profit.

Interest vs. Profit

The difference between interest and profit thus came into discussion at large on many occasions. The issue also got place in many a text on Islamic banking, Economics, Finance as

well as other socioeconomic and religious studies. A synopsis of outcome of such studies and researches to differentiate between 'interest' and 'profit' is portrayed in the following paragraphs.

Interest in the Quranic language is 'riba'. Naturally it is an Arabic word, which literally means excess, addition or increase etc. As a religious jargon, riba denotes an excess or addition related to loan. Expressed in another way, we may say that in English riba is called interest, which is defined as a charge on borrowed money. Purview of interest covers simple interest, compound interest and exorbitant interest or Usury as well. Interest implies a predetermined positiveness or mandatory increase from a deal in money.

On the other hand, 'Profit' is an English word. Profit means an advantage or benefit, financial gain or an excess of returns over outlay. Profit is the money gained in business or from selling something for more than its original cost and/or 'an excess of income over expenses'. Prominent dictionaries also define 'profit' in the similar terms. For example,

Oxford Advanced Learner's Dictionary of Current English by A.S. Hornby defines Profit as 'the money that you make in business or by selling things, especially after paying the cost involved.'

Chambers 21st Century Dictionary defines Profit as 'the money gained from selling something for more than its original cost' and/or 'an excess of income over expenses.'

A deal exclusively in money, known as a financial transaction, is not enough to result in a profit. There must be a real transaction. That is, to enable a deal to generate profit, there must be an underlying asset related to that deal. When the concept of profit enters into the realm of business it must get the shape of an equation. The equation is 'Profit = Revenue minus Cost'.

Thus a profit may possess any sign. Negative profit, if any, is termed as loss. So, profit is the result or outcome of a venture, business or trade etc. Outcome of a business is naturally expected in the positive form of profit; but both way i.e. positive or negative (loss) is practical.

So unlike interest, profit does not originate from the money per se. Profit originates from a venture where money is used as equity or capital i.e. as a factor of production. When money gets the form of capital or investment, it bears the expectation of reward (profit) and at the same time the risk of incurring loss as well. Profit results from equity sharing and/ or trade and hence permitted by Shariah but interest is not. The Quranic verse is '...And Allah has permitted trade and forbidden interest ...' (Sura Baqara: 275).

Divergent views on bank interest

In the meantime, before the above conclusion on interest and profit was arrived, a fresh controversy raised on the issue. Scholars were divided as to whether bank-interest at all to fall within the prohibited 'riba'. Thus an apparent divergence of thought emerged on the issue. One group was of the opinion that riba must include all sorts of interest irrespective of their any qualified terms like low, high and/ or for commercial or consumption purpose etc. The other group argued that at least a few specific type of interest, like bank-interest, must remain beyond the purview of Quranic prohibition of riba. The latter also tried in particular, to

establish the religious base for justification and hence to legalize bank-interest. Although they firmly believed that riba was completely haram (forbidden), they did not agree that bank-interest would also similarly be a forbidden item. Some of their key arguments to keep bank interest beyond the purview of Quranic riba are as follows:

- i) Bank interest has reduced the exorbitant (say 10% per month i.e. 120% per annum) rate of interest prevailing in the erstwhile informal / individual sector. Thus bank interest has rather relieved the society from unbearably high rate of mahajani interest.
- ii) Only the compound interest and exorbitant interest or usury are prohibited in the Quran. So simple interest and/or low interest of bank would not be regarded as prohibited one.
- iii) Bank borrowing is substantially used in the commercial sectors resulting in increase of the GDP (Gross Domestic Product) for benefit of the mass people of the country. Such a good deed must be permissible.
- iv) Banks are approved or licensed by the government and hence cannot be outright ignored. Bank interest is also unavoidable in the modern society. Religion cannot bar an unavoidable action or item.
- v) Differential or subsidized (rates of) interest, specially meant for weak sector or a distressed group, targeting welfare must not have been adjudged unjust or unlawful by the religion.
- vi) Interest within the range of inflation rate is rather a justice to the lender/ creditor in consideration of purchasing power or time value of money.
- vii) Intergovernmental interest-based loans are not supposed to be harmful or unjust, although individual or personal deals may have the scope to cause harm to each other.
- viii) Charging interest on rich borrower is not unjust and so on.

All such arguments to legalize bank interest continued for quite a long period. The arguments were placed from personal levels to institutional, national and even to the global (such as the OIC, Organisation of the Islamic Cooperation) periphery. The scholars who believed in the unconditional prohibition of interest (including that of the banking sector), acknowledged the possibility of doing any isolated material good deeds by way of dealing with bank-interest. But at the same time they opined that no such plea of doing welfare could at all suffice to overrule the Shariah prohibition of interest.

Global consensus on unconditional prohibition of interest

The Quran declared interest unconditionally prohibited. Had it been desired, the Quran could make the prohibition of interest conditional. For example, there are so many 'if's in the Quranic verses which derive the rules of inheritance / succession as outlined in Sura Nesa (verses 11-12). These are in fact different conditions to determine how much of a deceased asset each successor will get under different circumstances. But prohibition of interest is not subject to any such condition. So mere human arguments cannot make a revealed prohibited item of riba permitted (halal) on any plea. The scholars, however, brought all the arguments of the opponents under threadbare analysis and frequent review. Then they reached the consensus that interest must have been unconditionally prohibited as directed by the Quran, the prime source of Shariah (Islamic jurisprudence).

Yes, there are some people who do not yet believe that bank interest is also prohibited. But any such view or opinion is now considered extremely personal and mere a one-sided or cornered opinion. Any such inference is strongly separated from the mainstream consensus and hence treated as an exception. The global convergence of the concerned scholars confirms the unconditionality of prohibition of interest. Moreover, *riba* and interest are only the word meaning of each other in Arabic and English. They must not be differentiated. And interest must have been prohibited irrespective of its low or high rate, its usage for consumption or commercial purpose, be it applied in inflationary or non-inflationary economy, exercised personally or institutionally and so on. This has been the official verdict of the contemporary leading Islamic scholars.

Finally with the consensus of the OIC countries, particularly through establishment of the IDB (Islamic Development Bank) in 1975, it was globally concluded that bank-interest should also fall within the purview of *riba*. The OIC's official definition¹ of Islamic bank has made a clear indication that an Islamic bank must be devoid of interest. Had the bank interest considered permitted in the definition given by the OIC, there must not have been any commitment to ban the same in any operation of an Islamic bank. Their definition clearly indicates the ban of interest in Islamic banks. Therefore, interest must be avoided irrespective of the sectors where it originates from or wherever the concerned fund is used in. Thus the concept of interest was globally clarified and disseminated among the stakeholders.

Thus few but very essential things were made clear. Firstly, profit is entirely unlike interest. Secondly, for prohibition purpose there is no difference among *riba*, interest and usury. Thirdly, bank interest is also haram as prohibition of interest in the Quran is unconditional. Finally it was also clarified that one need not leave religion to remain with banking i.e. banking could be possible without interest. This clarification initiated collective drive to also replace bank interest by profit. The drive suggested turning the loan transactions of conventional banks into equity sharing ventures to earn profit instead of interest.

Drives to design alternative module of banking

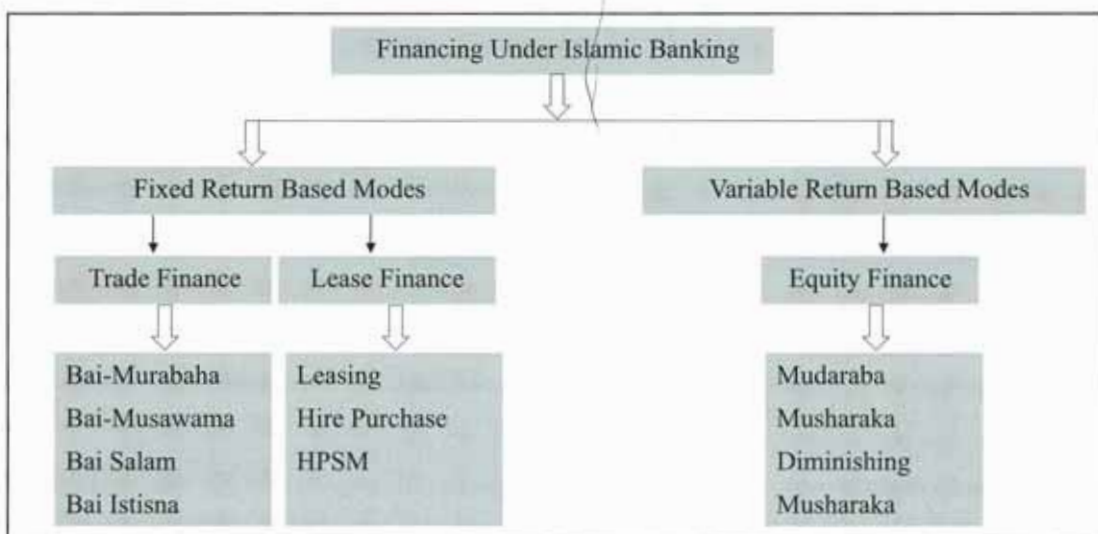
An alternative module of banking then started designing. Under this module, banking transactions no more remained in the form of borrowing and lending. Rather money should flow as capital or equity and have a form of partnership between the religious bank and its clients. Those clients may belong to any side of the bank's Balance Sheet i.e. asset client and/ or deposit client. On the deposit side, the depositor would get share of income the bank earns by utilizing the former's fund. Similarly on the Asset side, loans (financial transactions) were also converted to capital. That is, Islamic finance would mean to make investment in the form of partnership or equity finance. On the asset side, however, other few ways to finance were also initiated. One such way was to convert the loan or debt transactions into real transactions, backed by underlying asset. Such an idea developed efforts to convert or restructure conventional interest based loan transactions, broadly into either of the two ways. Firstly, to transform financial transactions (debt finance) into real (asset backed) transactions. This transformation includes i) Trade finance (through buying & selling) and ii) Lease finance or renting of non-fungible² assets. Secondly, to adopt equity finance investment or profit-loss sharing partnership business.

Financing modules

Lending function of conventional banking, based on interest earning, was restructured having, among other forms, the following avenues for application of fund:

In a nutshell major financing modes under Islamic Banking are :

Bai Murabaha (Sale on disclosed profit): Bai means trading or sale. Murabaha means profit (i.e. cost plus). So Bai-Murabaha means sale at a profit or it is a mark up sale. It is thus a trade on cost-plus concept. Under this mode, bank sells goods (as opposed to money) at a profit to its particular client. Here the seller (bank) must declare the amount of cost of the goods and profit thereon distinctively. Again under murabaha, sales price once fixed cannot be changed / enhanced afterwards for extension of time for repayment, if any



Bai Musawama³ (Sale without reference to cost price): In a sale, if the mandatory stipulation of declaration of profit amount is waived (or not asked for) unlike Murabaha, it is called the 'Musawama' sale or Bai-Musawama. Most of our day to day shopping (say in the shopping malls) fall under Bai Musawama mode of transaction. An Islamic bank uses this mode, where it does not or cannot disclose the applied profit or mark up for any reasons what so ever.

Bai Salam (Sale on Advance payment of price): It is a trade whereby the seller undertakes to supply some specific goods to the buyer at a specific future date against receipt of advance payment. Thus under Bai-Salam, the price is paid on spot (advance) and delivery of goods is deferred. Islamic banks use this mode of investment in some specific sectors including agriculture. Bai Salam is also called Bai –Salaf.

Bai-Istisna (Advance sale of items to manufacture): Bai Istisna is also a kind of sale on advance payment like Bai Salam. But there are some specific differences between the two. The subject of Istisna is always a thing which needs manufacturing while Salam can be applicable for anything, no matter whether it needs manufacturing or not.

Lease, Hire Purchase and HPSM (Hire Purchase under Shirkatul Melk or Equity participatory Hire Purchase): Among rental based finance, the common ones are Lease and Hire Purchase.

Arabic terms of them are 'Ijara' and 'Ijara – bil – bai' respectively. Although both of these mechanisms of financing have been allowable in Islamic banking (if customized for Shariah), in Bangladesh a new hybrid product has been designed and it is named HPSM. This mode is a synthesis of some features of Hire-Purchase and some features of a specialized partnership called Shirkatul Melk. Mudaraba (Partnership between equity and skill / labour with profit-sharing agreement): In Mudaraba investment, bank is the provider of fund and the client is the manager of fund. The provider of fund is called Saheb/ Rab Al Maal and the manager of fund is called the Mudarib. Profit of the business is distributed between the two, according to a pre-determined ratio. Genuine loss, if any, is to be borne by the bank as the sole provider of the fund. It is therefore called profit sharing mode.

Musharaka (A partnership agreement to share equity and profit & loss): Musharaka investment is a partnership or joint venture where bank and the client both provide fund in equal or unequal proportion and share profit as per agreed ratio. Genuine loss, if any, is borne by the partners according to their capital ratio. It is called profit loss sharing or PLS mode of investment.

Mudaraba and Musharaka are the modes of Investment where the concept of 'Risk and Reward of Ownership' becomes transparent. This is why under these modes of investment the genuine loss of business, is compulsorily borne according to the capital ratio of the parties concerned irrespective of any other terms and conditions of the business.

Diminishing Musharaka: This is one of the varieties of Musharaka. It is a sort of venture capital. Under this mode, the share of a party (out of two or more) of the partnership gradually diminishes paving the way to the other party /parties to exclusively own the business.

Deposit collection modules

Any one of the above mechanisms, so far discussed, may be applicable only when bank plays the role of the provider of services or it lies at the paying end. But as in the role of recipient, a bank can neither receive a trading commodity nor can it receive other capital goods or non-fungible items. Rather deposit to bank, for the purpose of business (as opposed to custodian through Locker service) means deposit of money only. So in deposit collection (as opposite to financing/ lending function), Islamic banks have designed the following mechanisms:

1. Al-Wadiah (As substitute of Current Account)
2. Qard (As another substitute of Current Account)
3. Mudaraba (As substitute of all interest bearing deposit Accounts)

Al-Wadiah: Islamic banks operate Current Accounts on the principle of Al- Wadiah. Under this principle an Islamic bank commits to refund money deposited with such accounts on the demand of customers. On the other hand, the bank takes authorisation from customers that the bank may utilize their money. Customers do not bear any loss in respect of any such account.

Qard: Islamic banks may also collect Current Account deposits on the basis of Qard Hasan. According to Shariah principle of Qard Hasan, money deposited in such an account is a benevolent loan from the depositor to the bank. As such unlike Al Wadiah, in case of Qard the bank need no authorisation or any specific permission of the depositors to use the borrowed fund. The bank owes the client only the principal amount borrowed.

Mudaraba: In case of practising Mudaraba, as a mode of collecting fund the bank receives deposits from the depositors with the authority that the bank will have exclusive right to manage or invest the fund. Profit resulting from deployment of such deposits is shared between the bank and the depositor at a pre-agreed ratio. Loss (if any), not resulting from the negligence of the bank or any of its representative, is to be borne by the depositors. In Islamic Banking Savings, Special Notice, various Term deposits and deposits under different Schemes are conducted on this principle.

Each mode or mechanism that has been adopted in Islamic banking (be it either as a source or application of fund), has got specific rules and regulations to be complied with in the light of respective aspects of Shariah. An Islamic banker must, therefore, be conversant with the modus operandi and stipulations of the concerned modes of Shariah. This is essential because those transactions actually run according to their respective original discipline, where they are adopted from. Those modes may come from different bai or trade and/or other business concerned.

Alikeness of Interest and Profit

It is worth mentioning that operation of asset-products (lending) of Islamic banking in most of the cases, cannot demonstrate the visible difference between Islamic banking and the Conventional one. Failure of an Islamic bank to often explicitly demonstrate its distinction mainly lies in dominance of its fixed return based methods (Murabaha and Leasing/ Hire Purchase) over variable return based equity finance (Mudaraba & Musharaka) methods. Fixed return based Islamic modes often make confusion among the stakeholders and as such the question of alikeness or resemblance of profit and interest is raised by different quarters.

Beauty of Islamic Banking and ISR method of profit distribution

On the other hand, when we point at the Liability (borrowing) side, particularly in deposit mix of any Islamic bank, there is substantial dominance of sharing (Mudaraba deposit) method. By virtue of yielding variable return, (linked and proportional to the bank's income), this Mudaraba principle of collecting deposit may be the milestone to show the difference and the inherent beauty of Islamic banking. This is because variable return on Mudaraba deposit makes stronger sense of rationale and justice over the predetermined fixed rate of interest (irrespective of the profitability of the bank) of Conventional banking.

So, as far as the Mudaraba deposit product is concerned, the cost thereon (i.e. the rate of profit on Mudaraba deposit) must not be a predetermined fixed rate. It is a fully dependent variable. So, to find the cost of deposit under Mudaraba contract, it needs a two tier calculation. Income or revenue derived from deployment of the concerned deposit is to workout first. Only then it is possible to finally arrive at the emerged Rate of Profit for the fund provider. Thus the cost of Mudaraba deposit, in Islamic banking is an output as opposed to input (as in case of a Conventional bank). We, therefore, demonstrate the cost of mudaraba deposit as a function of investment income. Mathematically it is

$DC = f(I_R)$ where,

D_C = Cost of Mudaraba Deposit,

f = function of (dependent on) &

I_R = Revenue (or income/ yield) from Investment.

Islamic bank's cost of Mudaraba deposit (D_c) is presented to the Mudaraba depositors as their profit on concerned deposit. This cost on the part of bank, is correspondingly profit on the part of the depositors. IR is the gross return of the bank, earned from deployment of the Mudaraba deposits.

This equation establishes the direct relationship between the profit on a client's deposit and the bank's yield earned by deployment of that deposit. For bank, it is like 'Pay as you earn.' For example, let the function (f) is defined simply as the product of (i) income sharing ratio or ISR^4 between the bank & depositor and (ii) bank's investment yield. The ISR for different types of depositors may vary. A simplified hypothetical different ISR may be as follows:

Table-1 : Income Sharing Ratio (ISR) For Different Mudaraba Depositors

Types of Deposit	ISR (Depositor: bank)	ISR Defined As		Total
		Depositor's Share	Bank's Share	
Mudaraba SND	30:70	30%	70%	100%
Mudaraba Savings	60:40	60%	40%	100%
Mudaraba Term	80:20	80%	20%	100%

Table-1 above reveals that if an Islamic bank earns Tk.100 by investing the Mudaraba SND Deposit, the bank would distribute Tk.30 as profit to the concerned depositor and retain the rest Tk.70 as the bank's share. If the bank's fund is from Mudaraba Savings account, then the deposit would earn a profit of Tk.60. In case of Term deposit, the depositor would be entitled to profit of Tk.80. Corresponding retention of earning by the bank would be Tk.40 and Tk.20 for Savings and Term deposits respectively.

Practically bank earns from the pool of combination of funds of all types of deposits. Let us assume that the aggregate yield on Investment⁵ of the bank for a particular period is 16%. Then the rates of profit (as cost of deposit in the equation) for the above 3 types of Deposits for that period would arrive as under:

Table-2: Calculation of Rate of Profit on different Mudaraba Deposits

Types of Deposit	Yield Rate	Depositor's Share	Rate of Profit (Cost) on Deposit
1	2	3	4= (col.2× col.3)
Mudaraba SND	16%	30%	04.80%
Mudaraba Savings	16%	60%	09.60%
Mudaraba Term	16%	80%	12.80%

Alternatively to express purely on mathematical terms we may just put the values in the equation to find profit rate on any sort of deposit. For example, the rate of profit on Mudaraba Savings A/c (with an ISR of 60:40 i.e. 60% for the depositors) would be

$$\begin{aligned}
 D_c &= f(I_R) \\
 &= \text{ISR} \times \text{Yield} \\
 &= 60\% \times 16\% \\
 &= 09.60\%
 \end{aligned}$$

Thus we observe that cost of deposit (i.e. profit given on Mudaraba deposit) can visibly differentiate Islamic banking from its Conventional counterpart. In Conventional, it is prefixed interest rate; but in Islamic banking, cost of deposit can never be an independent variable and as such must not be predetermined. It is variable, dependent on the bank's yield / income. A single characteristic of cost of Mudaraba deposit being the function of investment income or yield can be treated as the 'Litmus-test' for judging authenticity of practically complying with Mudaraba principle by any Islamic bank.

Adoption of different business modules from other fields of Islamic Economics

Let us now talk of the asset side issues of an Islamic bank. Financial transactions of loans of conventional banks are also converted into capital or equity finance to make the related transaction shariah compliant for Islamic banks. This is also done from the same spirit to share income between the bank and the client. In fact this is the main theme or essence of Mudaraba or profit sharing concept of Islamic banking, be it as a source or application of fund. As stated earlier some other permissible ways to finance are also adopted by Islamic banks. One such way is to make real transactions like trade, instead of loan or debt transactions. Each of such real transactions has got specific modus operandi adopted from the respective discipline of Islamic economics. Of course, there has been customization of the features while practising those in the banking arena. This customization has been imperative because those modes are in fact hired or adopted from other fields (not banking). Concerned modus operandi therefore must follow their respective original discipline of business or trade of Islamic economics.

Primary achievement vs. spiritual foundation of Islamic Banking

Achievement of the drive for Islamic banking primarily lies in washing out or gradually abolishing 'interest' in the realm of alternative banking. Interest-free banking is typically called Islamic banking. Yes, a bank to be truly Islamic, it needs to possess other qualities; but the most essential criterion is to be free from interest. It is also true that initially Islamic banking was a project to make 'banking sans interest' possible; not to make it superior or competitive even. Alternative modes were designed or adopted just to avoid interest. Out of such alternatives as stated above, the asset-based real transactions (as opposed to mere financial transaction) and profit-loss sharing features (as opposed to fixed interest based method) of Islamic banking transactions, have by this time, been adjudged as better alternatives. Equity finance of Islamic banking transparently differentiates. Any mode of equity finance also exhibits the inherent beauty of Islamic Banking. This beauty is demonstrated by virtue of its yielding variable return, as opposed to the predetermined fixed rate of interest in conventional banking.

If this equity sharing concept of Islamic economics can be properly applied accompanied by adequate legal support, it is very likely that gradually Islamic banking would enter into the mainstream. The growth rate of Islamic banking for the recent decades indicate the rising

trend of gradually increasing its stake in the total banking. Islamic banking can bring about a new paradigm of justice and equity in the society through operation of profit loss sharing based business modules of equity finance. In fact sharing mechanism is the generic term of true Islamic banking, where Mudaraba and Musharaka products can be treated as its organic or indigenous products. They may, however, be surrounded by derivatives like HPSM and bai or other trade-based products.

Again, although profit-loss sharing is the main spirit of Islamic banking, some other fixed return based methods occupy the lion's share of the assets of any Islamic bank. There is no harm in using different systems or modes under the single umbrella of Islamic banking, provided that the individual modes or methods are treated with their respective extreme independence. A variable-return-based mode of finance should not be compared to a fixed return based one. They are independent ones. So, again a trait of a fixed return based method would not be expected from the variable return based one and vice versa. Similarly a specific character or feature of a fixed return based mode must not be pushed into a variable return based mode. For example, Mudaraba (Strictly a variable return based mode) depositors must not be offered a fixed rate of return in any way. Any such practice shall virtually kill the spiritual foundation of Islamic banking.

Conclusion and future of Islamic Banking

Although we must admit that Islamic banking is derived by way of intensive screening (mainly for avoiding interest) from the conventional banks of today, all the conventional modes need not to be essentially imitated and cultured in the realm of Islamic banking. Because in doing so, if there is any fundamental deviation from Shariah, on the plea of market demand to satisfy all the existing clients of the conventional banks, it may cause the ruin of the spirit. Extreme imitation of conventional modes merely with labels of Shariah compatibility may be enough for business success. But in terms of maqasad or objective of Shariah, dominance of profit loss sharing or PLS modes is essential.

In the backdrop of global financial meltdown since 2007, we have already experienced the comparative resilience of conventional banking and Islamic style of banking worldwide, as commented even by the Vatican. Final fate of Islamic banking depends to a great extent on the quality of the people who are entrusted with the responsibility to implement the system. Ideally Islamic banking is a value-based and ethically guided financial operation. So it demands strict adherence to the rule of 'principle to override or prevail over practice'. Islamic banking players must simultaneously deserve both, credit for fair play and / or discredit for infringement. Future is the Judge to evaluate the superiority between Conventional and Islamic banking. In the meantime both will run on their respective ways.

(Opinions expressed in the article are exclusively of the writer himself and not necessarily of the organisation he is serving)

Foot Notes

1. The OIC defines Islamic bank as "a financial institution whose statutes, rules and procedures expressly state its commitment to the principles of Islamic Shariah and to the banning of the receipt and payment of interest in any of its operations."

2. A non-fungible asset means an asset that can be used more than once and service thereof can be separated from the asset/s itself. For example, a car being non-fungible can be used more than once, but its CNG or fuel as a fungible item cannot.
3. Bai Musawama investment is not named in the practices of Islamic banking in our country. Instead, such an investment is rather widely termed here as Bai Muajjal. Literally muajjal means to defer and thus bai muajjal is a sale on credit, as opposed to sale for cash or spot payment. But to differentiate from Murabaha such a mode should rightly be termed as Bai Musawama. Because a Murabaha (for declared profit) can simultaneously be Muajjal (for deferring payment). So, differentiation between Murabaha and Muajjal does not make any sense. Obviously differentiating between Murabaha referring to cost and Musawama i.e. without reference to cost makes better sense.
4. The ISR or income sharing ratio is the proportion of distributing earning of a bank between the bank and the depositor. In fact sharing ratio is the essence of equity finance i.e. Mudaraba and Musharaka. Such a ratio is the basic principle for distribution of profit among the partners of any Mudaraba or Musharaka venture. The ISR does not mention any rate of profit on the deposit or capital. It is only a proportion of the yield to allocate between parties concerned.
5. We must bear in mind the wider purview of the term Investment in Islamic banking operations. Besides deployment of fund in Shares and Securities, as confined in the conventional definition of investment, most of all other means of financing also come within the purview of investment in Islamic Banking. All items taken together under the heads of Credit/ Loans & Advances and Investment in a Balance Sheet of a traditional bank are substituted by a single common term of Investment in case of an Islamic bank. In Islamic banking, all these are commonly known as investment. Only a few additions like Qard may be exceptionally apparent beyond the purview of investment in a Balance Sheet of an Islamic bank.

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