

An Islamic Perspective of Business Finance **(A Comparative Study with Conventional and Capitalistic Financing)**

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ABSTRACT

India is big country with the population of 1.210 billion of which about 172 million (14%) are Muslims. We are having the conventional system of banking and finance which is based on only interest. A common practice seen here is anyone who is having any surplus money would be interested in starting the finance business instead of investing in productive projects and developing the economy. In this paper we are trying to provide information about the Islamic beliefs on loans, currency, investment and banking and finance besides how to use the money in the various Islamic investment modules. The emphasizing on important investment modules in Islamic Banking and Finance where by practical application can be done to achieve the objective real growth and development of economy.

Keywords: Islam, Islamic banking and finance, Musharakah, Mudarabah & Murabahah.

INTRODUCTION:

The development of any country depends on the strong banking and financial system in the economic structure. It is the open fact that, the present conventional Indian banking system facing great problems with growing NPA's (Non Performing Assets) or Bad Loans. It has become common for the entrepreneurs or companies to take corporate loans and finance their business ventures and projects. As long as projects gives profits its fine but when they starts giving losses, the companies stops making the payment of interest on loans and it will become an NPA. The banks cannot able to recover these loans from the borrowers due to many reasons. Finally governments will come in to the picture with financial infusion to the banks with hard earned tax payer money.

India is very big country with 1.210 billion population of which roughly 172 million Muslims are residing in India (as per 2011 census). Islam is the only religion in the world provides guide lines and rules and regulations for financing and business and it encourage people to Invest money in productive projects to develop the economy of the particular country. Past three decades had seen the growth and emergence of Islamic banking and financial system in the countries like, Saudi Arabia, Kuwait, Malaysia, Indonesia, Sudan, South Africa etc. as challenge to the conventional and capitalistic banking and financial system.

LITERATURE REVIEW:

Dr. Anwar Iqbal Qureshi(1945): He was an eminent professor and economist worked in Osmania University in the Department Of Economics. In his book titled "Islam and the Theory of Interest" First Edition, he explained clearly the fundamental of Islamic economics and finance. He provided information about the ill impact of interest on the society in particular and country in general.

Muhammad Muslehuddin(1974): He is a great Economist provided fundamentals of Islamic economics by comparing it to modern economics thoughts in his book titled "Economic and Islam". His theory of Islamic economics and finance can use as basis for the researchers to understand the economic problems of the country and Islamic solutions to the problems.

Muhammad TaqiUsmani (1998): he is one of the most prominent authors in Islamic Banking and Finance. He is retired judge of Pakistan Supreme Court with vast experience of Islamic banking window implementation in Pakistan. In his book titled "An Introduction to Islamic Finance" he has clearly explained the how Islamic finance can be adopted in modern world as mode of finance in different ways by taking all the four Islamic school of thoughts.

Zamiriqbal and Abbas mirakhor (2011): in their book titled "An Introduction to Islamic Finance Theory and Practice" Second Edition, it is clearly explained that, how the allocation of production, exchange and distribution of economic resources can be done in Islamic way. They even explained about the modern and conventional financial structures can be dealt with Islamic perspective.

RESEARCH METHODOLOGY:

The main objective of this study understand the conventional and Islamic banking and financial system to compare both the systems of finance and in the present situation how the Islamic banking and finance can be used as an alternative to conventional and capitalistic financial system. Secondary data collected from Literature Review of various books and research papers published on this subject and compared with the conventional and capitalistic finance to evaluate how the banks and financial institution can adopt the Islamic way of financing to get the sustainable growth and earn profits keeping the society away from the evils of Interest and trading in Haraam (Prohibited) things.

Islamic Banking and Finance:

Islamic banking and finance is refers to following the ways laid down by Islamic law (shariya) while providing the loans and finance. The basic principle which differentiates Islamic banking and finance from the conventional is, Interest which is prohibited by the Islamic law (shari'ya). Following are the basic principles followed by Islamic banking and financial institution while working.

Interest (Usury):

In the Holy Quran Almighty Allah says: "Trading is permitted and Interest (usury) is prohibited". It is quite clear from this verse of Quran that, Allah has permitted and encouraged to do trading or Business instead of dealing in Interest (usury). Based on the Holy Quran's order finance cannot be provided on interest which contradicts to main theme of conventional banking and finance.

Currency:

Another reason of prohibition of interest is, Islam consider currency as means of exchange and measure of value. Whereas conventional banking and financial system consider currency even as value for store which gives the room for charging interest.

Capital & Entrepreneur:

Islam does not recognize Capital and Entrepreneur as separate factors of production. Every person who contributes the capital to commercial enterprise assumes the risk of loss, hence eligible to a proportionate share of profit. Whereas conventional view is Capital and Entrepreneur are two separate factors of production. Capital will get Interest Entrepreneur will get profit.

Haraam (prohibited things in Islam):

Islam clearly prohibited any kind of trading, business and giving and taking finance in the activities involving gambling, speculative transactions, hoarding of materials, short sales, pork, wine & alcohol, pornography, entertainment and any intoxicating items etc.

It is clear from the above basic principles that, Islamic banks neither provide nor receive any fixed percentage of interest and any kind of activity which is prohibited in Islam.

General questions strikes in the brain of a new person who wants to know about Islamic Finance, how finance will take place without any component of interest and who will provide loan for free or without interest. The

answers this question is, Islam is the only religion in the world provides guide lines and rules and regulations for financing and business and it encourage people to Invest money in productive projects to develop the economy of the particular country instead of giving interest or predetermined rate of return based loan leaving how and where the money is use.

MODES OF ISLAMIC FINANCE:

Musharakah. (Joint Venture or Partnership):

It is a most ideal form of financing advocated by Islam. It refers to sharing of profits and losses in joint ventures. Here the financier instead of giving fixed or predetermined rate of loan will invest his money in a joint venture on the condition of sharing actual profits and losses. It is a relationship established by the parties through mutual contract and it contains all the necessary requirements of valid contract such as capability of the parties, free consent and no fraud and misrepresentation etc.

Basic Concepts of Musharaka:

1. The profit sharing ratio must be agreed at the time of signing the agreement.
2. Fixed lump sum amount for any partner as profit NOT ALLOWED
3. Any fixed amount drawn by the partner will be adjusted to actual share of profits one may deserve at the end of the period. Amount drawn less than the actual share of profit can be withdrawn or more should be returned.
4. Only Actual profits accrued to the firm are distributed among the partners.
5. Share of profit can be any ratio agreed by the partners i.e. it may differ from the ratio of investment.
6. In case of sleeping partner share of profit cannot be more than investment.
7. In case of loss all the partners has to suffer the loss exactly to their ratio of INVESTMENT.
8. The share capital of Musharakah can be contributed either in cash or in the form of commodities or kind subject of the determination of market value as share of the partner in the capital.
9. As far as the management of Musharakah is concerned all the partners can participate or any one of them acting for all can participate.
10. Every partner has right to terminate the Musharakah at any time after giving other partners a notice of termination.
11. Any partner dies during the Musharakah the contract with died partner terminated. The legal heirs will have the option either to draw the died partner share or to continue with the contract of Musharakah
12. If any partner becomes insane or incapable in discharging commercial transactions, the Musharakah stands terminated.
13. If one of the partners wants to terminate the Musharakah, while other partners wants to continue, this can be resolved by mutual agreement. The partner who wants to terminate Musharakah can sell his share to the partner who wants to continue the business.
14. The selling price of the leaving partner must be determined by mutual consent. If there is a dispute about the valuation of the share and the partners do not arrive at an agreed price, the leaving partner may force other partners to liquidate or distribute the assets.
15. If the assets of Musharakah are in the form of cash, will be distributed in the pro rata. If the partners agree to liquidate assets and distribute, can be done accordingly. If the partners want to distribute assets as they are, can be done accordingly. If one of the partners want liquidation and others wants to distribute assets as they are, the distribution of assets will be preferred.

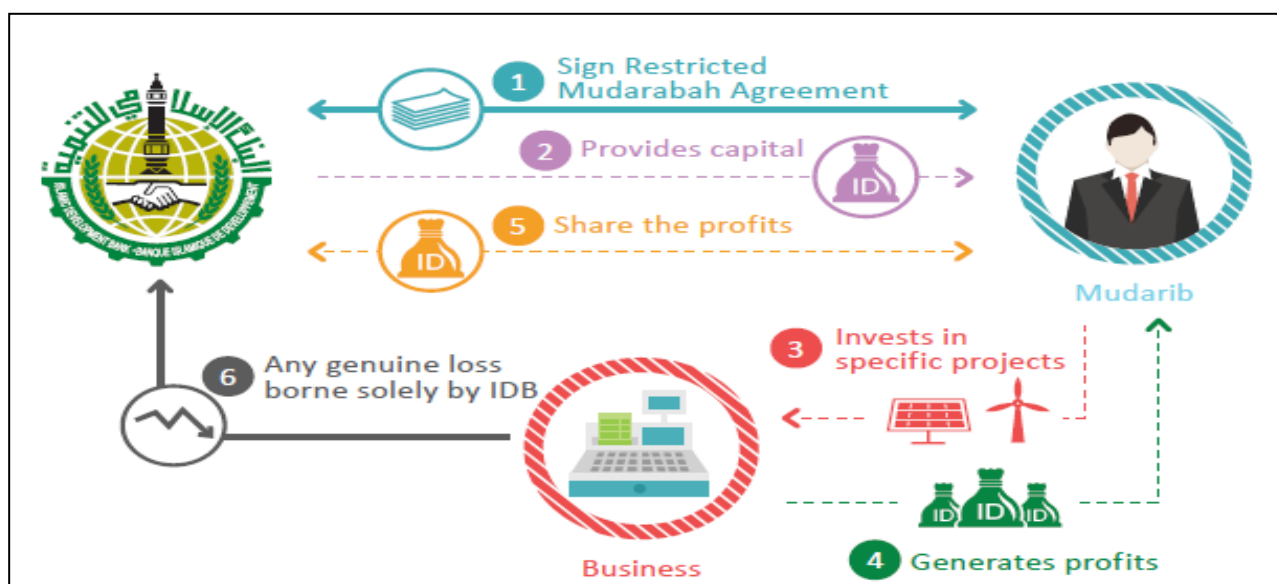
Mudarabah(Joint Venture or Partnership):

It is special type of partnership where one partner provides funds to another for investing in a commercial enterprise. The fund provider is called as “Rabb-ul-mal”, while the management is a sole responsibility of other partner called as “Mudarib”

Basic Concepts of Mudarabah:

1. Investment is the exclusive responsibility of Rabb-ul-mal
2. Mudarib will carry out the management activities while Rabb-ul-mal has no right to take part in management.
3. Loss, if any, is suffered by the Rabb-ul-mal only, as Mudarib does not invest anything. Efforts and work of Mudarib will be lost and will not get any fruits for him.
4. Mudarib should work with due diligence which is required normally for the business of that type while for negligence and dishonesty he is liable for the loss.

5. The liability of Rabb-ul-mal is limited to his investment.
6. Mudarib has to bear the debt incurred without the consent of Rabb-ul-mal.
7. Rabb-ul-mal is the sole owner of goods purchased by Mudarib.
8. Mudarib is entitled to his share of profit only, if, he could able to generate profits.
9. Mudarib cannot claim any share in the assets or in its increased value if any.
10. Mudarib or Rab-ul-maal CANNOT claim any Salary, Fee or Remuneration
11. Restricted Mudarabah: if Rabb-ul-mal specifies any particular business for Mudarib, he shall invest the money in that particular business only.
12. Unrestricted Mudarabah: when Rabb-ul-mal left the option open for Mudarib to undertake whatever business he wishes.
13. The Mudarib is authorised to do anything which is normally done in the course of business. However, if he wants to do anything which is beyond the scope of normal routine of the business, he cannot do without the express permission of Rabb-ul-mal
14. The profit Ratio can be anything mutually agreed.
15. The contract of Mudarabah can be terminated at any time by either of the parties by giving notice to other party.



Source: Islamic Development Bank, Saudi Arabia.

Murabahah(cost - plus sales):

It is a particular kind of sale where the seller discloses his actual cost of acquisitions of commodity and profit added to the cost while selling the commodity to buyer. The payment of Murabahah may be of any form such as at spot, future date, defined time period or deferred payment.

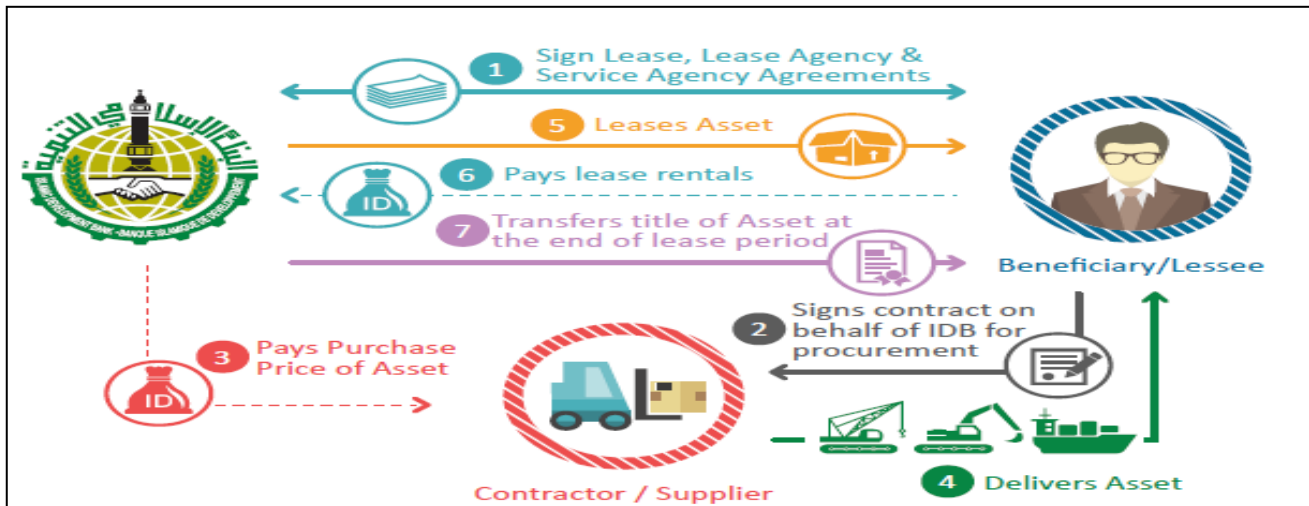
Murabahah is not mode of finance. whenever bank customer need finance to purchase material, instead of providing finance to purchase, the bank will purchase the material and sell to the customer at profit. This method is adopted to avoid interest.

The customer who needs the material knows better which type of material he wants hence, the banker will appoint the customer as his agent and material will be purchased by customer on behalf of the bank and it will be informed to the bank. Customer and bank will make an agreement of sale after adding the profit margin to it.

Ijarah (LEASING):

Ijarah refers to "give something on rent". Here the word Ijarah is used in two different situations, first one is used to take the services of an employee in consideration of salary or wage whereas the second situation is right to enjoy the use of another's property in consideration of rent.

Ijarah here refers to both the types of lease i.e. operating and finance. Many Islamic banks are using these two forms of lease to finance the business that are in need of finance to purchase the assets to operate the business. Instead of providing the predetermined interest based loan, the banks will appoint the business man as his agent and the asset is purchased by the agent and payment will be made directly by the bank to seller of the asset. Once the delivery of assets is taken by the business man, lease agreement will be signed by the bank and the business man.



Source: Islamic Development Bank, Saudi Arabia.

SALAM (FORWARD SALES):

Salam is type of sale where the seller agrees to supply the specific goods to the buyer at future date in exchange of advance price paid in cash on spot. The Holy Prophet of Islam has allowed this practice after the prohibition of Interest (Riba). The aim of this practice is to provide financial assistance to the farmers and small traders till they get their agricultural output. Salam is beneficial to farmers as they receive cash and assured of sale for their products and the purchaser of the products will get these products at a lesser price.

The modern banks and financial institution can use Salam as a mode of finance as the price paid in advance for purchasing the products would be generally less and difference in price is profit. It is the most needed way of financing agricultural formers as India is facing lot of problems with interest based lending which leads to formers suicide.

ISTISNA:

It is kind of sale where commodity transaction takes place before it comes in to existence. The word Istisna is used in manufacturing of goods. The manufacturer undertakes the responsibility of manufacturing good for the purchaser by using his own material and labour. With the necessary specifications of goods the selling price is determined by both the parties with their mutual consent.

Istisnacan be used as a mode of finance by modern banks by providing construction loans for house, factories and apartments etc. here the important point to be noted is, the payment of Istisna not required to be paid on spot, it may be paid on differed payment basis even.



Source: Islamic Development Bank, Saudi Arabia.

CONCLUSION:

Indian banking system is in peril situation due to increasing Non-performing assets. Every year the union government is providing the financial assistance to banks to overcome from the difficulty of liquidity.

Introduction of Islamic banking in India can reduce the Non-performing assets from the banking system as banks will play a role of developing the real economy with the financial modes such as Musharakh, Mudarabah, and Murabahainstead of simply providing to loan without any knowledge of where it will be used.

India is one of the largest Muslim populated countries and most of the Indian Muslims wants to invest their money in Shariya complying investments. Introduction of Islamic banking and finance in India will give a chance to Indian Muslims to participate in investment process of country besides India can attract investment from middle east countries such as Saudi Arabia, Dubai, Oman, Qatar and Bahrain.

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