

A Study on Islamic Banking: Hindrances and Solution in India

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ABSTRACT

Economics is the most relevant and discussed topic in this era. Conventional banking system and Islamic banking system are the most competitive sector in banking sector. Adam smith is known as the father of modern economics but ibn kahldoun had written about economics before Adam smith in Arabic language. John Maynard Keynes one among the prominent economist says that Adam smith is not the father of economics he is just a editor. This shows that Islam and economics have a very old relation before the time of Adam smith. Islamic finance is a system of finance based on sharia or Islamic law, aims at accomplishing social and economic virtue and righteousness in all economic affairs. It takes in to account not only the moral and ethical consequences of financial transactions but also makes sure that the financial and economic contracts and transactions should be just, impartial and fair to all parties involved and promises that the financial and economic rewards are fully associated with the intensity of liability, risk and responsibility borne by all parties. Islamic finance system includes Islamic banking, Islamic insurance, Islamic investments, Islamic venture capital investments and other non banking and regulatory institutions etc... Islamic Banking and how it differs from conventional banks Islamic banking was first introduced in 1963 but it was known as no interest banks. And these no interest banks were later known as Islamic banks. These banks did not last long, it was collapsed by 1971. The main difference between Islamic banks and conventional banks is interest. Even other religions object interest. Religions like Jews says that “seeking more money is wrong”, Hindus/Brahmins says that “who accept interest will be scolded or punished” and Maoist says that “interest is an organ of explosion” and Aristotle said that “birth of money for money is forbidden”. Even though these religions object interest Islam was the one publicly and even at present objects interest system more. This is why no interest banks were later known as Islamic banks.

HINDRANCES

Regulatory and legal barriers.

- India’s banking system is governed by different acts and rules such as 1949 banking companies act, 1934 Reserve bank of India act, 1881 negotiable instruments act and 1961 cooperative societies act. It is not possible for a interest free bank by following these rules and acts. No other options are allowed in Indian acts for a interest free banking which is the devotion that differ Islamic banks from conventional banks.
- According to Indian banking companies act section 5(b) and 5(c) restrict banks investing and accepting from profit and loss share business. And according section 8 of D act No banking companies are allowed to purchase, sell or exchange immovable assets visibly or invisibly.

- According to section 9 of D act, can use immovable assets only for private uses. This is against the IJARA system in Islamic bank.
- According to section 21 of D act interest should be given for all deposit and this is against the motive of Islamic banking.
- According to section 17 of Reserve bank of India act 1934 and section 24 of banking companies' act 1949 a certain portion of investments in bank should be deposited in governments and public sectors debenture. These deposits are compelled to accept interest. Which means each bank should keep cash reserve ratio and statutory liquidity ratio. But in islamic banks keeping of CRR and SLR ratio are risky because of the capital investment behaviour. Because the investments are completely invested in immovable assets or investment enterprises.

Discriminatory approach towards credits and share funds.

In islamic banking profit and losses are equally divided. Also they use it in profit and loss partnership method. But in conventional method they impose income tax and deduct the tax in capital from the income tax and remove the interest in it. This method is not applicable in islamic banking. Income tax is increased from 20% to 30% recently.

In mudharaba method the investors cause loss due to deduction of the loss in industry from capital. And to reduce profit the industrials may create fake accounts. And methods to prevent these sort of things are not available much in india. In islamic banking there will be special supervisors to watch and observe these sort of malpractices.

Credit qualification: In conventional banks special correspondents are deputed for checking the qualification of creditors like are they capable of paying back but in islamic banks in india this type of agencies are not seen much.

Transparency: authentic transparency of working in business enterprises is important in islamic banks in business like other systems. Statutory or legitimate account keeping method, professional trained workers in locker rooms of documents and will papers, economic experts, scientific and order income and expense records, faithfulness and transparency in profit and loss sharing, following present laws and rules, following islamic sharia laws etc are important for creating trust and faith in depositors. But the indian government has not kept any controlling systems in these things.

SWOT Analysis.

The strength, weakness, opportunities and threats of Islamic banking in India. Applying SWOT analysis in Islamic banking in India will facilitate to examine logically whether Islamic banks will flourish or flounder if it is brought into India.

STRENGTH

- High population of Muslims in India: India is the second largest country in terms of Muslim population in the world.
- Good number of rich Muslims in the country: while taking the overall Muslims, they are underprivileged than any other community in India but there are a lot of Muslims

individuals who are in the utmost rank in the directory of richest Indians. It is worthy to note here that the highest demand for Islamic banking from Kerala is from the richest persons of the state.

- Unclaimed interest in the conventional bank: there are millions of rupees as interest unclaimed belongs to Muslims in different banks of the country especially in Kerala. This proves the negative attitude of people towards interest and the sanguinity towards interest free system.
- Peoples strong belief in religion: Major religions that are popular in India do not support interest or usury in dealings, people in India have a strong faith in their own religion; this point out a good future for interest free finance.
- Large number of religious institutes: India has, the Muslim inhabited states in particular have large digit of religious institutes where the principles of Islamic finance can be taught and skilled professional can be geared up easily. This facilitates high potential growth for Islamic finance in India with skilled staff and professionals.
- Secular minds of politicians: Majority of Indian politicians are secular minded and they stand for secularism, Islamic finance is a secular notion which gets up for the development of the country and its citizens, therefore protest from most of the political parties is not exceed.
- Urgent need: Due to high poverty rate, Indian people urgently require an interest free system. Indian is mainly depended on the agriculture, and Islamic finance system has various products that help the agriculture industry and farmers without paying interest.
- Support from the people because of its moral and ethical mechanism: the compassionate, civilized, moral and ethical factors are far above in the Islamic finance system than its counterparts.

WEAKNESS

- Regulatory Barriers: Section 5 (b) and (c) of banking Regulation Act prohibit all banks to invest in profit and loss sharing basis. Similarly, section (6) and (8) of the Banking Regulations Act restrict the business of Indian Banks where and how to engage. These are totally on the contrary of Islamic Banking principles. Section (9) of the Act prohibits Indian bans to keep ownership of properties other than banks personal use; this will close the door of Ijarah and its types. Likewise, section (17) of the banking Regulation Act makes compulsory of keeping reserve fund. It creates the practical problem in the running of business. And section (24) of the banking Regulation Act and (42) of the reserve bank of India Act mandate some compulsory cash reserve for Indian banks; this would also create the problem of interest.
- Ignorance about Islamic finance: Indian people irrespective of Muslims or Non Muslims have no awareness about Islamic banking and finance. It would create problem while it is introduced.
- Lack of Experts: In India, there has not been to develop experts in the realm of Islamic finance except some diploma courses in very few universities.
- Unique risks faced by Islamic financial institutions: there are some risks which are faced by Islamic financial institutions only such as judicial issues, controversial opinions among the Muslim scholars, different sect in Muslim community etc...
- Criticism against the current practice: there has been criticism by the several Muslim scholars against the current practice of Islamic finance system. According to them, the current practice replaces the word 'Riba' with profit and loss sharing; no other further

changes are made. Some of the products also like murabahah are criticized by many of the scholars.

OPPORTUNITY

- Increasing popularity of Islamic finance and its products: All over the world Islamic finance and its products are spreading day by day. Even the secular and communist countries are opening new Islamic banks or Islamic windows to existing banks by modifying their regulatory frameworks. Reputed banks like Standard Chartered, HSBC and Citibank have operations of interest free window in quite a lot of countries including Europe and North America.
- Foreign inflow of funds: India would be attracted for foreign inflow of funds from gulf cooperation countries and other Muslim countries in addition to non Muslim countries. Islamic finance is unaffected by subprime mortgage crisis because of its strict rating policy and pre rating analysis of projects.
- Continuous demand for infrastructure finance: numerous products in Islamic finance are very useful for infra structural financing and as India is a developing country, it focuses on infrastructural developments. Islamic finance can do imperative role in this vicinity, that's why the Kerala government introduced the Islamic investment company.
- Demand for nitch products is increasing in India: Indian markets are showing the trend of high demand for nitch products; this is a good opportunity for Islamic finance products to capture high demand.
- Address the issue of financial inclusion: India is in its way of great effort to reduce the financial exclusion; introducing Islamic finance will address the issue in a certain extent.
- Bridges the gap of income disparity: the inadequate labor- capital ratio of informal sector workers who are associated with agriculture and tiny manufacturing industries can be resolved through the system of equity finance of Islamic finance system.
- Recent tradeoff reducing subsidies: politicians and policy makers think about the substitution of subsidies with equity finance scheme through specialized financial institutions. It will help to assess whether the fund is utilized in proper way and also motivate the recipient to expand in the accurate manner for which it has been endorsed. This will induce not only the individuals but also impact the economy as a whole.
- Lack of trust on conventional system: due to the recent financial crisis, the trust of the investors upon the conventional system has been diminished considerably.

THREATS

- It could be political issue: use of the word 'ISLAMIC' may provoke some parties against the system. This was the problem that motivated someone to move to court against the Kerala government decision.
- It may abuse to communalize the finance sector also: certain Indian people have an eagerness to communalize anything. If Islamic finance is introduced in India, these people may make an effort to set aside and communalize the finance sector also.
- Opposition from vested groups: in India, especially in rural areas some vested interest groups are living only with money lending business. They are fetching rich by exploiting poor and destitute. These people may combat against the interest free system as it affects adversely their business.

- Competition: micro finance is a good competitor in the field of Islamic finance. The beneficiaries of Islamic banking and conventional banking are almost same.
- May be accused as Islamic extremism: this system has been accused as the part of Islamic extremism and terrorism.

SOLUTIONS

In the world around 48 countries have fully fledged Islamic banks and in 30 countries partial Islamic banks are seen at present. 20 of them are from non Muslim countries like Germany, England, and Luxemburg, Austria etc... As said before these countries also faced regulatory problems but they altered the rules and laws which are in need to Islamic banking system. If Indian government follow the same method, it will be possible to start Islamic banking in India too. The main problem faced is how to introduce Islamic banking to the government in proper way. As a democratic country acceptance for Islamic banking will be favorable compared to other countries. Today it is considered as only for Muslims later it may become a favour for non Muslim Indians too. For that should introduce and make Islamic banking familiar for the public people. The most user-friendly and safe banking system is Islamic banking and it can be proved by taking proofs from the countries which have started it. And that's the only way to make Islamic banking familiar for the Indian natives. To create and bring under the Islamic sharia we should create an Islamic rating agency. Non banking financing company (NBFC), interest free micro finance, and Shariah compliant mutual funds can be included in the solutions for the hindrances in Islamic banking.

CONCLUSION

By this research could finalize that the Islamic banking is possible in India only after overcoming the barriers in and out of the system. From this SWOT analysis we could find that the strength of Islamic banking has 8 points and weaknesses are 5, opportunities are 7 and threats are 5. So possibility for an Islamic banking in India is more because the strength and opportunity are more according to the research.

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- [5] Aban Ahmed is a student of economics and Islamic studies. This paper is on the topic Islamic banking: hindrances and solutions in India.