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Article

Islamic Banking, a Fusion of Morals and Finance - An Analytical Study

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A B S T R A C T

In the contemporary eon, interest-free banking amenities were foremost presented by the Europeans as they were well cognizant of the fact that their Muslim counter-parts austerely verboten the practice of charging 'Riba' or interest on the lending. Islamic Banking has been an alluring form of banking practice since the early 7th century AD. Nevertheless, in the recent realm, its origin or approaching back to the limelight can be outlined back to the year 1971 when the Mit Ghamr scheme for savings was recognized in Egypt. The concerned research article purposes to deliver a transitory insight into the different instruments in Islamic Banking and also offers niceties regarding how Islamic Banking mechanism works. The concept of credit creation in Islamic Banking has been an area on which it has been persistently disparaged; the article also aims to shed light on the same.

Keywords: Contemporary, Lending, Riba, Islamic Banking, Credit Creation

Introduction

The initial epoch in the Islamic Calendar was chronicled on the day when the Prophet Muhammad relocated from the city of Mecca to Medina in seek of his inner pursuit. This auspicious date can be cast-off as a smidgeon to the geneses of Islamic Banking in the medieval world. As prompt as the seventh century AD, the earliest wife of the Prophet Muhammad, Khadijah Bint Khuwaylid was a trader and she was a maven in her business. According to some celebrated scholars, it was she, who shaped the elementary charter of shariah. She was born sometimes in 555 AD in Saudi Arabia (Chachi, 2005). The historical brochure states that she was an eminent figure in medieval corporate in the Middle East and lent credit to meek and meager businessmen without charging any kind of interest from them. If one attempts to apprehend Islamic Banking, he or she requires understanding the perceptions of Shariah first. Primarily, the concept of Shariah has been well demarcated in the Holy Quran in which it predominantly states that as per shariah money has no inherent value of its own and can only be recycled as a mere source of exchange (Imam & Kpodar, 2016). There are several other customs that are to be followed as per the Islamic rules of borrowing and lending which embraces the complete purge of 'riba' or interest. The concerned research article shall target to delve deep into the various impressions that have embedded Islamic Banking and shall also try to extricate the same from conventional Banking thereby providing abundant data to support its argument.

Research Objectives

Islamic Banking has remained a contentious form of banking for quite a time now. Some scholars approve of the moralities and ethics correlated to it while some define it as a simple play with expressions in banking to attain pecuniary goalmouths (Imam & Kpodar, 2016). The research article aims to accomplish the following objectives:

- To contribute insight into the origins of Islamic Banking and the bygone background of the same.

- To recognize more about how Islamic Banking drew mass attention in the present world of conventional banking processes.
- To converse the core notions and rudimentary definitions related to Islamic Banking.
- To intricate various points of distinction between Islamic Banking and Conventional Banking procedures.
- To gauge the performance of Islamic Banking in nations where it has been institutionally instigated.
- To stretch a brief inkling about the total assets under Islamic Banking in countries such as United Kingdom, Bangladesh, etc.

Review of Literature

In order to comprehend the rudimentary conceptions of Islamic Banking, this study shall brush up the research articles of some erstwhile scholars in this regard. The proper indulgence of the theory entails a fleeting abridgment of the discernment of other scholars in the recent past. Here are some of the most capable research articles on Islamic Banking.

According to Bidabad & Allahyarifard (2019), Islamic Banking is moderately diverse from conventional Banking establishments. Unlike conventional banking, in Islamic Banking time is not the solitary influence that effects the heightening of equity return but also the partaking of profit and loss between beneficiaries (Bidabad & Allahyarifard, 2019). The major ambition of the concerned study has been to decipher various approaches of assets and liabilities administration in Islamic Banking. The innumerable categories of assets and liabilities in Islamic Banking have been conferred in this paper. The paper also positions that it is completely against shariah to earn a profit on credit amenities. Moreover, profit and loss sharing have had a grander impression on value creation and ultimate customer fulfilment.

According to Khan (2013), the conformist method of Banking has been vertical on the masts of appropriating interest from its customers in order to make credit creation tranquil. However, the charging of interest or 'Riba' is verboten in the Holy Quran and subsequently in the shariah decree of Islamic borrowing and loaning (Khan, 2013). The study also dialogues about the budding grip of Islamic Banking over the global finance business. It backs-up its arguments by providing some specific data on the accumulative growth of Islamic Banking trends in various parts of Europe, the Middle East, and even the United States of America. The article has further showcased the progression of credit creation as per conventional banking measures and also tried to extricate Islamic Banking from the same. Certain core elements of Islamic Banking such as mudarbah, musarakha, and murabaha have also been discoursed.

According to Chong & Liu (2009), the most imperative trait of Islamic Banking is its code of profit allocation and loss deportment. As per the study, the shariah rule of Islamic finance positions that shariah acquiescent borrowing and lending must include the assembly between an individual with leftover wealth and another individual with financial prerequisites. As per the study, Islamic Banking encompasses more of a partnership where both the parties stake equal perils rather than confining to a C2B relationship (Chong & Liu, 2009). The study further shapes that the first Islamic Banking try-out was accomplished in the early days on the year 1963 in the Land of the river Nile. In 2008, when this concerned paper was captured down, Islamic Banking had its foot grounded in more than 50 countries including Jordan, Iran, Pakistan and Bangladesh, and so on. The researchers have also gabbed about the various core concepts in the shariah built Islamic financing. It states that the charging of interest is strictly proscribed in the Islamic laws and the Islamic Financial Service Board (IFSB) looks after the compliance of such rules at the world-wide level.

Research Methodology

Islamic Banking has been a profound area of confab in the recent past. A form of banking exercise that uniquely rests on the ethics cited in the Holy Quran and extricates itself from the orthodox banking system. This research article purposes to deliver a focal point of discussion on Islamic Banking and the countless core elements of the same (Imam & Kpodar, 2016). The data that has been used in this research article is predominantly secondary in nature and has been collected from the Islamic Financial Services Board. The concerned study also aims to testify the contemporary accomplishments of Islamic Banks in the United Kingdom, Bangladesh, and Egypt.

Findings and Suggestions

In the late 1920s and 1930s, some Islamic Banks were time-honored in Egypt and Palestine as 'Banque Misr' and Arab Bank correspondingly (Safiullah & Shamsuddin, 2018). The foremost motives for the rejuvenation of Shariah acquiescent banks were:

- The instituting of the Islamic Development Bank.
- Trudge in oil prices in the Middle East; which led to the underpinning of the Dubai Islamic Bank in 1975, and the Kuwait Finance House in 1977.
- The rigorous exertions of the Islamic investment research scholars.

Islamic Banking and Credit Creation

As per some distinguished intellectuals, Islamic Banks and the unadventurous banking system are nothing but identical except for the incriminating of interest on financing. Scholars have reasoned for a considerable extent of time that Islamic Banking also crafts credit like the conventional banking system. However, instead of expending interest, it uses other tools from its Shariah codes such as Mudaraba, Musharka, Ijarah, and Wadiah, and so on (Lajuni et al. 2017). The stream of money in the open money market is well-ordered by the Central Bank of the Islamic Banking system. In this regard it is imperative to apprehend the overhead cited tools in Islamic banking in brief.

Mudaraba

It generally implies that in lending credit, the financier and the pledger admit to all perils and returns in the venture by the same token. It involves loss bearing and profit sharing for both the parties.

Musharka

It can be simply termed as the Islamic substitute of Joint-venture.

Ijarah

In unpretentious expressions, it is the added name for leasing any property.

Wadiah

It is the replacement for the safe-keeping of rudiments in Islamic Banking. It is comparable to the locker scheme that is provided in conventional banking trade.

Islamic Banking and Time Value of Money

Unlike Conventional banking system, Islamic Banking does not rheostat the drift of money in the market with adaptations in the rate of interest. This gives in for a query apropos how proficient the concerned system is as far as directing inflation or deflation is concerned. According to Khan (2013), Islamic Banking does control price rises by tumbling its financing in ventures and when a condition of deflation is perceived, the apparatuses of Shariah are used to boost-up financing and the flow of money in the open markets. However, such amplifications are still dubious. Modern scholars still qualm the significance of the concept of interest-free financing in the modern-day set-up of finance.

An Estimation of the Accomplishments of Islamic Banks in Nations where it has been Institutionally Instigated

The research artefact shall now, aim at providing a bird-eye interpretation of the performance of Islamic Banks in few countries in the current past so that their credibility can be vindicated. The total assets of these banks in the recent past will be showcased with their capital adequacy ratios to provide auxiliary evidence. Indicators such as Return on Equity, Liquid Assets Ratio, and Net Profit Margins shall also be provided for enhanced acceptance.

Egypt

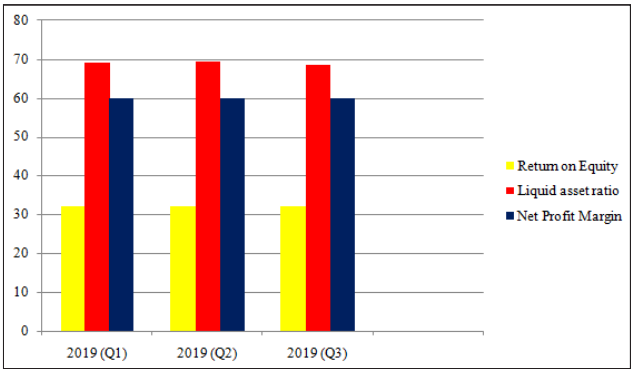

Figure 1.Islamic Banking Portfolio in Egypt

Source: (Islamic Financial Services Board, 2020)

It can be established from the overhead figure that the Return on Equity of Islamic Banks in Egypt has been more or less unswerving in all three quarters of the year 2019, with an average of around 32.30%. Likewise, the Net Profit margin has also persisted perpetually at around 60.10%. (Maghfuriyah, Azam & Shukri, 2019) The only deviation that can is pragmatic is in terms of Liquid Asset Ratio which dwindled to 68.90% in the third quarter. The Capital Adequacy ratio has been 8.52%, 8.66%, and 8.93% correspondingly in the three quarters of 2019 which is at par as per the guidelines of Basel II but underneath par as per Basel III, Table 1.

Table 1.Capital Adequacy as per Basel Accord 2019

Variables	2019 (Q1)	2019 (Q2)	2019 (Q3)
Total Islamic Banks	3	3	3
Total ATMs	462	481	480
Total Workforce	5038	5023	6051

Source: (Islamic Financial Services Board, 2020)

Bangladesh

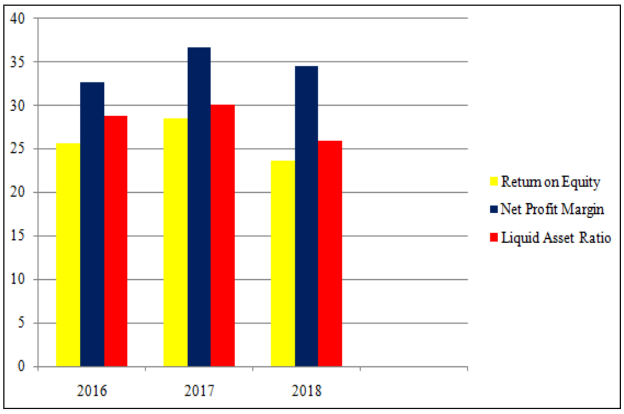

Figure 2.Islamic Banking Portfolio in Bangladesh

Source: (Islamic Financial Services Board, 2020)

From the above-cited graphical depiction, it is unblemished that there has been a high-pitched waning in all the three factors from 2017 to 2018. The Capital Adequacy Ratio in Bangladesh in 2016, 2017 and in 2018 has been 5.4%, 4.8%, and, 4.7% respectively; this is way underneath the commendations of the Basel Accords in any developing country (Basheer, KhorramI & Hassan, 2018). Therefore it can be assumed that the performance of Islamic Banking in Bangladesh has been sinking short to its conventional counterparts in the recent past, Table 2.

Table 2.Capital Adequacy as per Basel Accord

Variables	2016	2017	2018
Total Islamic Banks	8	8	8
Total employees	28177	30421	32157
Total Assets (In National Coinage)	2148044	2519391	2794265

Source: (Islamic Financial Services Board, 2020)

United Kingdom

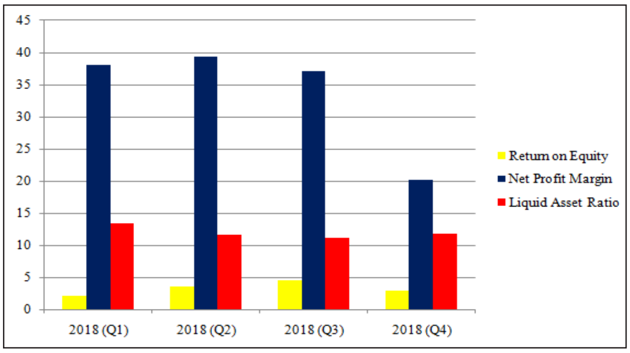

Figure 3.Islamic Banking Portfolio in United Kingdom

Source: (Islamic Financial Services Board, 2020)

It can be discerned from the overhead revealed graphical depiction that the Return of Equity for Islamic Banks in United Kingdom is substantially truncated than that of Islamic states such as Bangladesh and Egypt. Nevertheless, the Capital Adequacy ratio for all four quarters of 2018 has been 13.1%, 12.8%, 12.2% and 11.3% respectively (Ibrahim, 2019). Which, though is waning, is still above par than the Basel III Accords, Table 3.

Table 3.Capital Adequacy as per Basel Accord

Variables	2018 (Q1)	2018 (Q2)	2018 (Q3)	2018 (Q4)
Total Islamic Banks	5	5	5	5
Total Employees	207	273	384	414
Total Assets (In Pound Sterling)	4070.2	4133.6	4333.1	4531.3

Source: (Islamic Financial Services Board, 2020)

It can be unmistakably grasped from the above table that the number of employees operational in Islamic Banks is moderately low-slung than other Islamic countries such as Bangladesh. However, the performance of these banks in Non-Islamic states in the contemporary bygone has been reasonable to an extent.

Conclusion

The performance of Islamic Banking has been somewhat charming in most realms in which it has been instigated. In fact in India, Raghuram Rajan anticipated the institution of Islamic Banking for the enlargement of the financial sector. Conversely, these commendations are still unconvincing as the Banking Regulation Act makes the charging of interest obligatory. Though the accounts of Islamic Banking have shown lights of optimism, there are still certain interrogations that need to be countered. The philosophies of Shariah still do not rejoinder the modern-day occurrence of inflation and credit creation to an agreeable perimeter. However, if these minuscule blemishes are encountered, Islamic Banking could be an inordinate antagonism to its conventional equivalent.

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