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ISLAMIC BANKING: ON ITS WAY TO GLOBALIZATION

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ABSTRACT

This paper aims to highlight the growth of Islamic banking, which is growing more rapidly than the average baking sector in most of the countries. Beside this the study also constitutes a general review that bears special features, facts and figures over the recent development of Islamic Banking across the globe. Islamic Banking system is well known for its free banking system as it's based on shariah which disallows the acceptance of Riba or interest on deposits and loans. Islamic Banking helps to gain profits to small investors also who are, generally, unable to trade due to the low budget or insufficient time. People having significant levels of capital could increase there value of sum by investing in the Islamic Banks which act as Managing Companies. However, these profits would only be reaped and blessed if the Islamic Banks bind to all the Sharia'h's prescriptions and proscriptions that are related to Finance and to related ethical considerations. Islamic banks have increased its presence and position around the globe via Islamic windows and/or offering specific Islamic financial products by acting as full-fledged Islamic licensed banks. These banks are not only enjoying the moral and material support from the Muslim governments but also from the public, western market players and regulations. Islamic banks due to its dynamic features, captures the advancements of Islamic banking and financial industries across the markets, sectors, systems, tools, and over more than 75 countries from Asia, Africa, Europe and North America. Islamic finance comprises of the banking system, Islamic insurance, capital market products and services to society all over the globe. Since the inception of Islamic Finance the development is said to be phenomenal with a double digit annual growth. Islamic finance is comprised of instruments, infrastructure, institutions, and markets that apply Sharia rules and principles. To promote the welfare of the people the purpose of sharia lies on safeguarding their faith, life, wealth, posterity and intellect. In short Islamic banks are broadly refers to a financial market transactions, operations and services that comply with Islamic rules, principles and codes of practices. As per the laws and rules of the Muslim religion, it requires certain types of activities, risks or rewards to be either prohibited or promoted.

Keywords: Islamic Banking, Islamic Finance, Islam, Government, Sharia, Globalisation.

INTRODUCTION

Islamic Accounting

Islamic Accounting defined as the "accounting process" which provides appropriate information (not necessarily limited to financial data) to stakeholders of an entity which will enable them to ensure that the entity is operating within the bounds of the Islamic Shari'ah and delivering on its socioeconomic objectives.

Islamic Banking

Islamic banking is a banking activity or a system of banking that is in consonance with the basic principles of Islamic Shraiah(rules and values set by Islam). Islamic banking is also known as interest free banking system as the Shariah ,which prohibits riba(excess interest),gharar (uncertainty),maisir (gambling)and other non –halal activities. Thisprohibition is mentioned in the Quran and hadith andmust be strictly followed by the financial institutions. Under this banking system the contract between the financers and borrowers are governed by shared business risk and returns from the entrepreneurial investment. This type of banking basically differs from the conventional banking whereby the relationship is normally based on capital investment gains arising from the time value of money.

According to the General Secretarial of the OIC "An Islamic bank is a financial institution whose status, rules and procedures expressly state commitment to the principle of Islamic Shariah where the receipt and payment of interest on any of its operations is banned.

According to "Dr Shawki Ismail Shehta "Islamic banking is natural, imperative and indeed, for an Islamic bank incorporate in its functions and practices commercial investment and social activities, an institution design to promote the civilized mission of an Islamic economy."

According to "Dr. Ziaul Ahmed , "Islamic banking is essentially a normative concept and could be define conduct of banking in consonance will the ethos of the value system of Islam."

In short it is a banking which avoids receipts and payments of interest in its transactions and conducting operations in a way that helps in achieving the objectives of an Islamic economy. In other words it is a banking system based on Islamic principles where profit or loss sharing (PLS) is major feature ensuring justice equity in an economy. That is the reason why Islamic banks are often known as PLS-banks.

HISTORY AND EVOLUTION

The origin of Islamic banking system started during the period of the prophet Mohammed (peace and blessings be upon him), when the Prophet (peace and blessings be upon him) himself carried out trading operations for his wife.

"Mudarbah" (Islamic partnerships)is widely appreciated by the Muslim business community for centuries but the concept of "Riba" or interest has gained very little diligence in regular or day-to-day transactions.

The first model of Islamic banking system came into picture in the year 1963 in Egypt. At that time Ahmad Al Najjar was the chief founder of Islamic bank and the key features of the bank was profit sharing on the non interest based philosophy of the Islamic Shariah. Islamic banks are more than financial institutions rather than commercial banks as they pay or charge interest on transactions. In the year 1974, the Organization of Islamic Countries (OIC) had established the first Islamic bank called the Islamic Development Bank or IDB. The basic aim of this bank was to provide financial assistance and support on profit sharing basis.

In 1970, Many Islamic banks established throughout the Muslim countries, including the first private commercial bank in Dubai (1975), the Bahrain Islamic bank (1979) and the Faisal Islamic bank of Sudan (1977).

OBJECTIVES AND FEATURES

The main objective of establishing Islamic banks all over the world is to promote, foster and develop the application of Islamic principles, laws and traditions to the transaction of financial banking and business affairs. Its aim is to promote investment companies, enterprises and concerns which shall themselves be engaged in business as are acceptable and consistent with Islamic principles, laws and traditions. The objective of Islamic banking is as under:

1. To offer contemporary financial services in conformity with Islamic Shariah.

2. To contribute towards economic development and prosperity within the principles of Islamic justice.

3. To facilitate efficient allocation of resources.

4. To help achieving stability in the economy.

5. To ensure equitable distribution of income and resources.

Features

Some of the features of Islamic banking are discussed here under:

1. It prohibits Interest based lending.

2. It prohibits speculating based trading.

3. Profit or Loss sharing models or Agency type models.

4. All financial structures must have underlying Shariah compliant assets.

5. It is a Multi-Purpose Bank.

Importance

Islamic banking and the finance industry is growing rapidly. Many international and local institutions have stepped into this multi-billion dollar booming industry by establishing its Islamic wings and units. International giant banks such as HSBC (HSBC Amanah), Citi Bank (Citi Islamic), Al Rajhi bank and many other banks including Standard Chartered have already established their Islamic units and functioning in the Middle East region.

The principle of Islamic banks is of justice which is an essential requirement for all kinds of Islamic financing. In profit sharing of a financed project, the financier and the beneficiary shares the actual or net profit or net loss rather than putting the risk burden only on the entrepreneur. As per the principle of fairness and justice the actual output of a project should be fairly distributed among the two parties. Not only this, Islamic banks also eliminates the barrier between those who save and those who invest, and bring them closer to the real market. The ultimate outcome of Islamic banking is to pay a high return on investments of the investors, which is unlikely in a conventional banking where the bank deals with their depositors on a pre-determined fixed rate of interest.

Financing and deposits are extended under the profit and loss sharing arrangement. The banks are likely to know their fund users better in order to ensure that the funds are used for productive purposes and vice-versa for investors. In this way, it develops better relationship between the financial intermediary and the fund provider's or consumers. Islamic banking also promotes productive economic activities and socio-economic justice.

Islamic banks do not have fixed obligations such as deposits and interest payments. Due to which the banks are able to allocate resources to profitable and economic activities. It is also good for Islamic financing, as the payment obligations of the entrepreneur are associated with the revenue.

Islamic bank makes transparency to the account holders on the investments and profits realized on investment. This profit is then shared between them in the pre-agreed ratio.

Major Modes of Islamic Banking

Islamic banking or financing activity that complies with sharia (Islamic law) and its practical application through the development of Islamic economics. Some of the modes of Islamic banking or finance include Mudarabah (Profit and loss sharing), Murabahah (cost plus), Musawamah (bargaining) and Ijar (leasing).

Mudarabah (profit sharing)

"Mudaraba" or Profit-and-loss sharing contract is a kind of partnership where one partner gives money to another for investing it in a commercial enterprise. Under it the capital investment normally comes from both partners. It is a contract, with one party provides100 % capital and the other party provides the skill and knowledge to invest the capital and to manage the investment project. The profits which are generated are shared between the parties according to the pre-agreed ratio. In case of a loss, the first party "rabb-ul-mal" will lose his capital, and the other party "mudarib" will lose the time and effort invested in the project.

Murabahah

This type of partnership is also known as capital and labour. This concept refers to the sale of goods, where the purchase price, selling price, other costs, and the profit margin are clearly stated at the time of the sale agreement. Since 1975, Murabahah has become "the most prevalent" Islamic financing mechanism· Under this system the lender or buyer pays the bank or seller profit for the goods over a period of time, compensating them for the time value of money in the form of "profit", with a fixed rate of profit determined by profit margin for the purchase of an asset, this is a fixed-income loan. The bank cannot charge additional profit on late payments; however the asset remains as a mortgage with the bank until the default is settled.

Ijarah

Ijarah means lease, rent or wage. Generally, it refers to selling the benefit of use or service for a fixed price or wage. Under this concept, the customers make use of service of assets or equipment such as plant, office automation, and motor vehicle for a fixed period and price.

In short, it is a contract or the legal right against a lawful or a specified return for the effort or work expended and for the benefits that are proposed to be taken.

Musawamah (Bargaining)

It is the negotiation on the selling price between the buyer and the seller without any reference by the seller to either costs or asking price. Under this the seller may or may not have full knowledge of the cost of the item being negotiated, they are under no obligation to reveal these costs as a part of the negotiation process. It is the most common type of trading negotiation seen in Islamic commerce.

In other words, it is the regular or general sale of goods in which the price of the goods or commodity is bargained between the buyer and the seller.

Islamic Banking and Conventional Banking

In comparison with conventional finance methods, Islamic financing is not centered only on credit worthiness and ability to repay the loans and interest; instead the worthiness and profitability of a project which is the most important criteria of Islamic financing while the ability to repay the loan is sub-segmented under profitability.

Islamic banks are restricted to goods and services and refrain from financing alcoholic beverages, tobacco or morally unacceptable services such as pornography and casinos, irrespective of whether or not such goods and services are legal or not in a given country.

Islamic bank not only consider the credit worthiness and interest rate as standards; they also apply Islamic moral/ethical criteria in their provision of financing. This adds another merit for Islamic banks since there is a beneficial impact on the productivity in the economy as it reduces the social and economic cost of such harmful products and activities

Islamic bank offers the same facilities as conventional banking system except that it strictly follows the rules of Shariah or Fiqh al- Muamlat Islamic banking is claimed to be more development oriented than its conventional counterpart. Under Islamic bank Profit Sharing is the promoter since it establishes a direct relationship between the benefit of the bank and the entrepreneurs. Conventional banks are based on debtor and creditor relationship between depositor’s borrowers and the bank on the interest is considered as the price of credit, reflecting the opportunity cost of money. (a) Islamic banking system is essentially a profit and loss sharing system and not merely an interest-free (Riba) banking system; and (b) investment (loans and advances) this system of banking serves simultaneously both the interest of the investor and the local community. The financial relationship as pointed above is referred in Islamic jurisprudence as Mudarabah.

For a clear understanding a summary of the difference between Islamic banksand Convention banks, are provided below:

Table 1: Difference between Islamic and conventional banks

	Islamic Banks	**Conventional Banks**
Functions and operating modes	Must be based on shariah principles.	Fully based on man-made principles.
Aims	Profits are maximized subject to shariah restrictions.	Profits are maximized without any restrictions.
Rules of Accounts	Governed by undertaking contracts and by determining the terms and conditions.	. Governed by the product terms and conditions.
Fundamental function	Important to understands the customers' business. Participation in partnership business.	Borrowing and lending money with compounding interest.
Investor Assurance	Investor and management shares the risk, hence profit rates are only indicators.	Here the interest rates are predetermined.
Loan/financing rate	A. Floating profits rates. (Musharakha, Ijarah) Fixed profit mark up (BaiBithaminAjil, Murabahah)	It usually based on floating rates, BLR+/- rates.
Relationship	Could be: A. Buyers and sellers, B. Traders and Investors, C. Partners.	Debtors and creditors.
Deposits rate and guarantee	Hibah (gift) may be given as non-guaranteed return; rate of return must be indicative rate. Wadiah deposit accounts are guaranteed only.	Deposits and fixed interest rates are fully guaranteed.

GLOBALIZATION

Globalization is an increasing interaction of people through the growth of international flow of money, ideas and culture. It is an economic process of integration which has social and cultural aspects. It involves goods and services, economic resources of capital, technology and data. Besides cultural and economic activities, transport, telecommunication infrastructure has been major factors of globalization.

Many scholars have placed the origins of globalization in modern times, others trace its history long before the European Age of Discovery and voyages to the New World, some even to the third millennium BC. In the year 1820s large-scale of globalization started. During the 19thand 20th century, the connectivity of the world's economies and cultures grew very rapidly.

In 1970s globalization established its meaning.

During the year 2000 the International Monetary Fund (IMF) identified four basic aspects of globalization:

1. Trade and transactions,

2. Capital and investment movements,

3. Migration and movement of people,

4. Dissemination of knowledge.

Environmental challenges such as global warming, water and air pollution, cross-boundary, and overfishing of the ocean are linked with globalization. The processes globalizing are affected by the business and work organization, socio-cultural resources, economics, and the natural environment. Academically globalization is subdivided into three major areas:

1. Economic globalization,
2. Cultural globalization, and
3. Political globalization.

"Globalization" came became popular in the 1980's, to describe the increased movement of people, knowledge and ideas, goods and money across the national borders that helps to increased *interconnection between* the world's population, economically, politically, socially and culturally. Although globalization is often thought of "the global marketplace and has many social and political implications. People in local communities associate globalization with *modernization*, which is the transformation of traditional societies into western industrialized societies.

Globalization is the terms of the challenges poses to the role of governments in international affairs and the global economy. Gobalization is having the potential to make societies richer through trade, knowledge and information to people around the world, globalization also contributing to the exploitation of the poor by the rich, and as a threat to traditional cultures by changing the societies.

Global Investors and Islamic Finance

Global investor, sukuk (Islamic bond) market isthe area of greatest interest within Islamic finance. Sukuk is an asset- based security, which represents ownership in a tangible asset. The face value of the bond isn't guaranteed in sukuk and the investor's shares the risk from underlying asset. Some sukuks are also issued with repurchase guarantees, which would help the investors in receiving the face value at maturity, like a conventional bondholder.

Usually, governments and its related entities in Asia and the Gulf Cooperation Council (GCC) traditionally issued sukuks, which is denominated in the local currency to domestic investors. At present the increased demand from the global investors has increased cross-border issuance of sukuks from non-traditional sources also.

In the year 2014 UK issued its inaugural sukuk with Hong Kong and South Africa expecting to conclude the sales in the year 2014.All three countries stated above are the major non-Islamic countries in the world, and their transactions indicate a significant change in the potential size, depth, and liquidity of the market.

Islamic institutions like the Islamic Corporation for the Development of the Private Sector offer help of sovereign sukuk finance to the countries that seek to issue sukuk. Sukuks are mostly denominated in the currency of the issuing country. The most surprising thing is that, 15% of the total issue value of sukuk in the year 2013 was US$28 billion which was sukuks denominated in US dollars, increased from 13.9% in 2012. In case US Fed continues to make good on its promise to taper QE program, and the interest rates indeed rise, the dollar value should continue to strengthen and benefit US dollar-denominated sukuks.

Issuance of sukuk is going forward in all governments and government related entities of all the GCC countries. Now days a number of large-scale projects are funded through sukuk issuance. Sukuk issuance is the potential way to achieve profit for the from high-quality sovereign and government-related entities in the United Arab Emirates and other GCC countries.

CONCLUSION

From the above study it is clear that Islamic banking is continuing to grow as a viable financial institution in areas with Muslim populations across the world. This paper attempted to add to the literature on Islamic banks by empirically investigating the determinants of the importance of Islamic banking, the effect on economic growth, and its impact on financial deepening.

Islamic banks are growing rapidly and affecting the societies in which they take root. Consequently, the impact of Islamic bank has become more apparent as the sector continues to grow globally.

Islam banking and financial system are more efficient and ethical comparatively to the interest-based conventional banking system. Over the recent years these banks has registered unprecedented growth in the economy due to the worldwide increase in oil prices, diversification of Islamic banking products, clients, markets, booming economies of the Middle East and other changes in the world of politics. Middle East and Asian countries government have become very pro -active in promoting Islamic banking and financial activities that are largely instrumental in strengthening their regional business and financial links. The success of Islamic banking and finance in the Middle East and Asian regions has put a profound impact on global financial markets.

Most of the Western financial institutions are using Islamic banking and finance to attract oil, wealth and local Muslim customers. Islamic financial institutions are also becoming partners with Western market players to promote Islamic banking, financial products and services in European and Western markets. The Western markets have turned up more conducive for Islamic banking and financial practice. Due to these developments Islamic banking and financial industries are getting an opportunity to become more competitive and integrated part of international financial markets.

Furthermore, As Islamic banking is practicing on Islamic principles and is gaining more recognition and attraction not only by the Muslim communities but also by non-Muslim societies. Not only this, Islamic banks are in more demand due to the advancement of technology and the evolution of financial markets of the new products or services to be introduced on timely basis.

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