



# THE RISE OF ISLAMIC BANKING IN THE TIME OF ECONOMIC CRISIS

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## ABSTRACT

*Islamic banking is a banking system in reference to the Shariat. According to Muslim ideology, currency has no intrinsic values - money, thus, may not be sell at earnings and is permitted to be used as per shariat only. The Islamic principle ban paying any charge for hire of money (riba) for particular period. The Islamic law also bans any investments in business that is believed haraam. This ideology has been obtained from the Quran and has been follows since then.*

*During the last twelve years the Islamic banking segment has grown quick, at globally. The study tried to examine factors affecting rise Islamic banks in the time of financial crisis. There is a common argument is that Islamic banking system is safer than traditional banks. The key reasons are their product structures that are basically asset backed financing. Research works before recent global financial crisis have in general summed up that the performance of Islamic banks have been far better than traditional banks. This research paper reveals that Islamic bank has suffered more than traditional banks in the time of global financial crisis regarding capital ratio, leverage and return on average equity, where as traditional banks have suffered more than Islamic banks. The study also tried to investigate the effect of Islamic banking on the economic development, by identifying and analyzing the key approaches that Islamic banks can be successful in India and other nations.*

**KEY WORDS:** *Islamic Banking, economic crisis, Riba*

## INTRODUCTION

Islamic Banking system functions on the principle of a profit and interest free financial system. Riba or interest as per Muslim principles mainly means something in “excess” – the investors must not craft an “excessive” income from the hard works of others. However, it is allowed to follows a structure of realistic earnings from investments where the investors take a hazard i.e. well determined. Therefore, Islamic banking system makes accessible accounts which give return or loss rather than interest rate. These banks utilize this currency gathered by them and spend in somewhat i.e. shariat compliant, that is not prohibited and does not occupy high menaces. So, business comprising alcohol, drugs, war weapons etc. with all other high risks and speculative practices are banned. Islamic Bank, thus, performs as a mediator by gathering the currency on behalf of their clients, depositing them in shariat compliant project and shares the margins with them.

The latest proposal of Reserve Bank of India for introducing of Islamic Bank window has received varied responses from several particularly in the light of the recent UCC dispute and is likely to take a political angle rather than an economic one.

Islamic banks search into conventional platform as a tending tropic recently because of the Reserve Bank’s decision to cancel consents to begin this type of banks in India. The decision came as blows to the supporters of Islamic banks, who opined for permitting Islamic banks stats that it attract investments from the Middle-East and also facilitates the 18 million Muslim people in the nation to keep in banking activity. The opponents did so on grounds of Islamic Banks being a needless good for the economic system. This initiative becomes as a noticeable success for the latter.

A lot of them are unwilling to join the banking service since conventional banks paying interest rate is against in Sharia rules. Proponents staunchly believe that if the Islamic banks are planned and executed in the nation, it

will assist attract FDIs and FIIs from wealthy countries like United Arab Emirates, Kuwait, Oman, Saudi Arabia etc. wherein these nations as well the depositors are maintaining on having financial transactions with Sharia-complaints financial companies. Islamic banks would also facilitate the poor and backward sectors of the community to benefit money without the obstacles of the interest payment.

### THE PURPOSE OF THE STUDY

The main purpose of the present study was to examine the reasons for rise of Islamic banking in the time of economic crisis. The study also tried to investigate the impact of Islamic banking on the economic growth, by recognizing and analyzing the possible ways that Islamic banks can be successful.

This study will also offers strategy and procedure to set up successful Islamic banking and the role of Islamic banking towards the economic growth, as much as this undertaking is primarily for academic uses, its findings and suggestions are significant for both practical utilization and future indications.

### OBJECTIVES

The main objective of this research project is to find out the role and impact of Islamic banks in Indian economy. The other objectives are:

1. To examine customer perception and level of satisfaction towards Islamic banks.
2. To examine how banks are applying these product in reference to Shariah principles so as to achieve their goal.
3. To examine the problems and prospects of Islamic banking in India
4. To analyze a significant association between Islamic banking and the economic growth in India

### Rise of Islamic Banking in Global Context

Nowadays Islamic banking has been expanding fast all over the globe. At present, the operations of Islamic banking system and their related financial companies has made a trillion-dollar business and is becoming an essential method for nations looking to boost their business with Islamic countries in Asia and the Middle East in particular.

The asset of worldwide Islamic banking breached the US\$ 1.5 trillion mark in the year 2016, whilst traditional banking assets amounted over US\$ 35 trillion. The development in Islamic banks' assets was far more than traditional banks, assisted mainly by the unbanked Muslim people, development of "halal" related products sector, government support and because of various Shariah complaints investment opportunity.



Source: Prabhu Mallikarjunan (2019)

### Chinese Experience

China started Islamic banking in 2008 global economic slowdown, after which there was a renewed discussion on the importance of Islamic banking in assisting to steady the global economic system due to its strong moral and religious ideologies. Although the traditional banking industry was lose around US\$ 3 to US\$ 4 trillion because of the economical slowdown, no Islamic banks needed bailouts at the scale experienced by some of global banking sector in emerging nations.



Due to this situation, the China government started many Islamic funds to magnetize global investors. The Gulf countries were give fast response, with Bahrain's Shamil Bank started its US\$ 100 million Shamil China Reality Mudarabah, the first-ever Islamic property gift for investment in Chinese realty sector. After China joining the Islamic Financial Services Board, a proposal was made to access the revisions essential to the law to ease the growth of Islamic banking in China. Though the China government has only done a few follow-ups on revisions, Islamic banking from around the world has started to invest in China.

After the expansion, Chinese banks have more and more acknowledged the significance of tapping into this increasing market, which represents approx. 1% of worldwide assets (\$2 trillion) and which is projected to rise to more than \$3.2 trillion by 2021.

In the present time, business among China and the Middle East has considerably increased. For instance, commerce among the UAE and China has risen 5-fold over the last 10 years – an increasing rate of 395 per cent. This will only have a positive impact in growing Islamic banking in China.

### **Islamic Banking in United Kingdom**

Islamic bank introduced in United Kingdom in 1980. Being home to more than 3 million Muslim people, the United Kingdom is a leading hub for the Islamic banking in EU. It also has a fully Shariah-compliant retail bank: Al-Rayan Bank. UK is today the leading center for Islamic banking in the West, comprising British higher learning institutions leading the non-Muslim world in the educating of Islamic banking.

The important factors that may influence Islamic banks progressing in the UK, include the consequences of Brexit votes, the Britain's financial view, and customer needs. The complete Sharia complaints assets in the UK was approx. \$5.5 Billion (£4.1 bn) in 2018. More than 72 sukuku were listed on the LSE with total of USD 53 billion.

### **LITERATURE REVIEW**

Souiden and Marzouki (2015) Islamic banks are considered as an arrangement of banking activity that is reliable with the principles of the Islamic rules and its use through the growth of Islamic finances. The principle which identifies ethical value in every business has wide worldwide appeal. Shariah bans the receiving of interest charges (riba) for the loan and acceptance of cash, as well as conducting business that give goods or services consider opposing to their philosophy. Though this ideology was applied as the base for a thriving economy in past, it is only in the late 20th century that many Islamic financial institutions was made to give a substitute basis to Muslim people while Islamic banks are not limited to Muslims.

Khan (2017) proposes that banks play a significant and active part in the economic development of India. Islamic bank is a typical idea. Islamic banks have materialized as an aggressive and a potential alternative for the traditional banking system in the last 3 decades.

Hussain (2014) proposes that Islamic banking in UK will grow if financial institutions generate more consciousness between the clients about the accessibility of the products and services.

Also, Abdulrahim & Robson (2017) explained the importance of service qualities amongst the U.K. clients and exposed that the recognition of services depending on proper service delivery by the institutions. In UK several Islamic financial items have been adopted by non-Muslim clients looking ethical substitute product. Moreover, deposit accounts provided by Islamic banking institutions have been specifically popular because of the competitive profit rate provided on deposits.

Alam (2019) proposed that this tendency is observed mainly in Islamic nations as Islamic banks are one of the most carried out features of Muslim people. Though, currently, the expansion and reputation of Islamic banking system has extended to several emerging nations in Asia and Europe too.

Narayan and Phan (2017) in their research paper carried out an primary investigation of the literature about Islamic banks. The basic objective is to give a perceptive of the literature, recognize key problems and limitations, and investigate possible directions for future study.

In a paper, Ebrahima (2015) investigates the opportunities and limitations confronting Islamic banks in United States and illustrates lessons that International Financial Institutions can be taught from latest worldwide

economic crisis. The study compare the Islamic and traditional home loan transaction was carried out to determine if dissimilarities in transactions permitted the decrease of effect of latest economic crisis on IFIs. Dipika (2017) illustrates the challenges of Islamic banking in India. The non-banking institution came out that functioned as per Shariah law but couldn't flourish much due to regular amendments that happening and the several limitations that were obliged on the N.B.F.Cs.

**RESEARCH METHODOLOGY**

**Research Design**

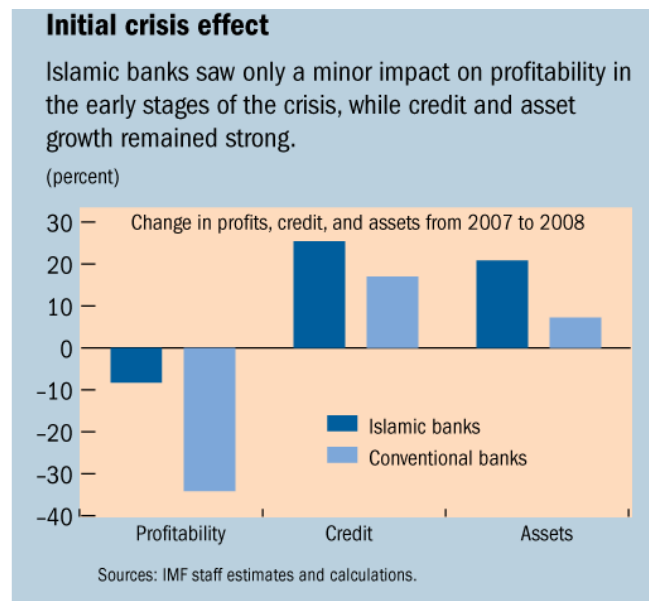
The design of this study is exploratory research. This is normally applied to explain ideas and opinion of the research problem or the universe or to give insight on how to do more conclusive (casual) study.

Primary sources: Through structured questionnaire.

The data has been gathered from the businessmen, servicemen, professional and investors of Delhi

Secondary sources:

- Books related to financial management
- Magazines related to banking, Islamic banking and Indian economy
- Indian and International journals
- Research papers, articles
- Websites

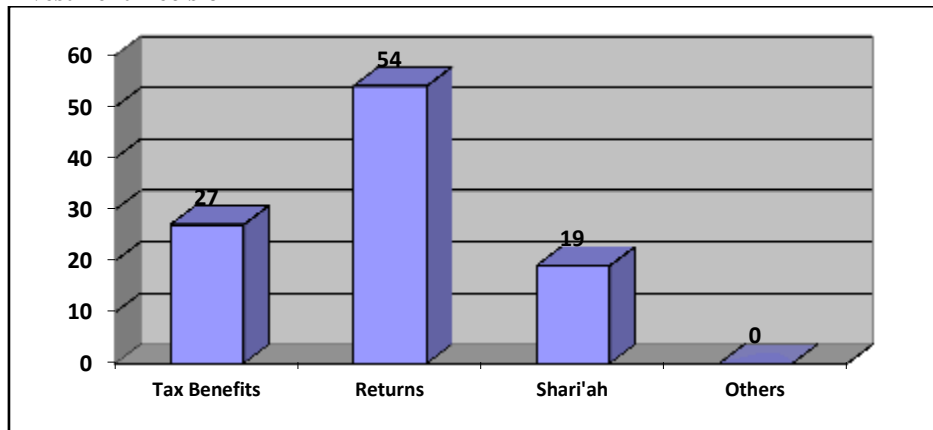


**Investment objectives of Islamic Banks**

	<b>Respondents</b>	<b>In %</b>
Capital Gain through long term asset	35	35.00
Capital Gain through short term asset	37	37.00
Stock trading	20	20.00
Others	8	8.00
<b>Total</b>	<b>100</b>	

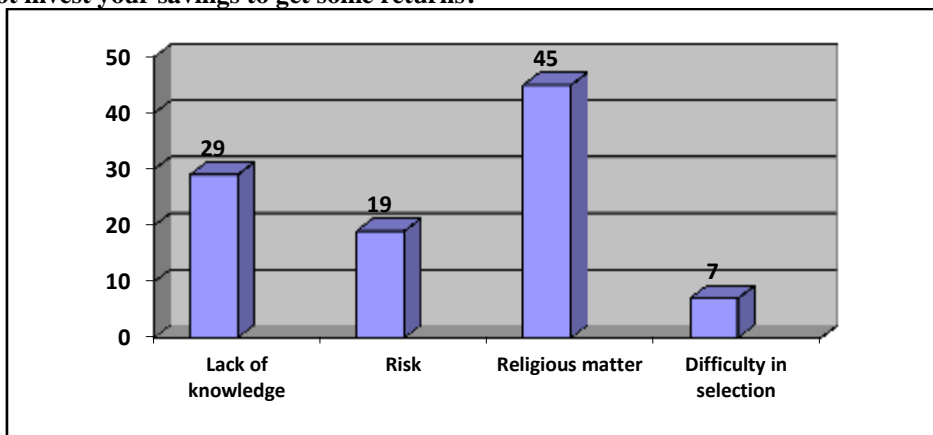
The above table shows that respondents in Delhi to whom we met were short-term as well as stock trading as the responses of some individuals was that they fully relied on this profit which they get from stock trading.

### Criteria of Investment Decision



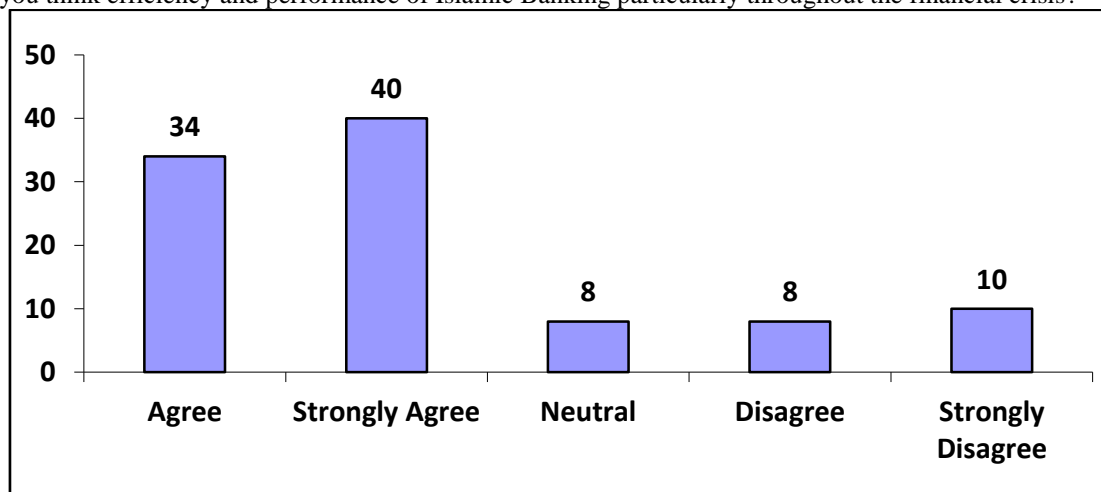
The above graph shows that better return was the major concern of investing in Islamic banks. 29% respondents take Shari'ah into concern while 27% investing for tax benefit.

### Why do not invest your savings to get some returns?



The above graph shows that most of the respondent reply was that are not having so much income and knowledge about the products and because of religious matter.

### Do you think efficiency and performance of Islamic Banking particularly throughout the financial crisis?



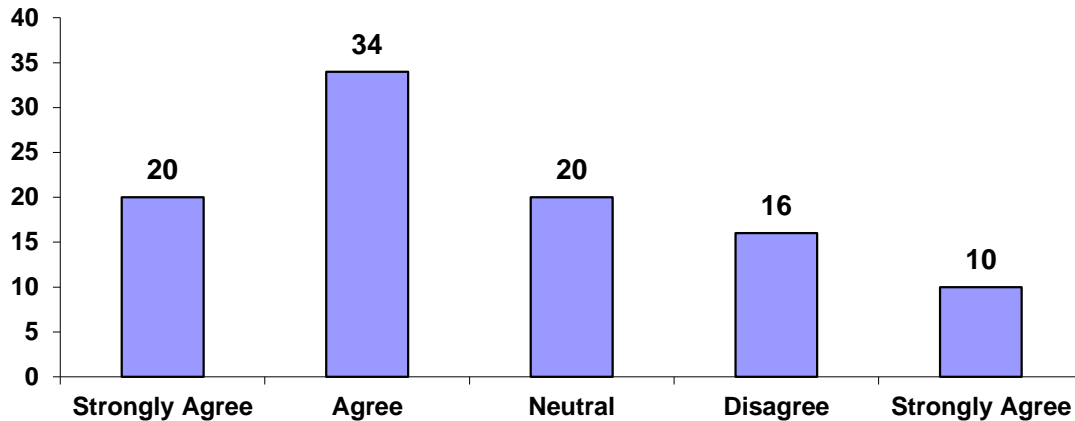
### Interpretation:-

The survey shows that 74% of the respondents agreed that efficiency and performance of Islamic Banking particularly throughout the financial crisis while 18% disagree the statement.

Do you think Islamic banking can give crucial solution to the financial issues in the current Indian economy?

Interpretation:

54% of the respondents strongly agreed the fact that Islamic banking can offer crucial solution to the financial issues in the current Indian economy.



## FINDINGS

Islamic banks can improve Indian economy by enhancing real sector financial system rather than only the financial segment. There are some costs in executing Islamic financial system but the expected value of such a reform is very high. Various modern Sharia-compliant mechanisms are being expanded throughout the globe from which Indian regulators can study and encourage.

The financial performance of Islamic banking sector internationally showed sturdy growth compared to traditional banks in the time of global financial crisis.

The less participation of people in Islamic banking is either due to religious matter or because of not having surpluses.

- ❖ The survey found that 60% of Muslim respondents agreed that they does not invest in any financial products.
- ❖ They have Lack of information about Islamic banking.
- ❖ The majority of the respondents despite having awareness about the Shari'ah based banking, they favour to invest in Non Shari'ah services.
- ❖ Businessmen favour reinvest in business rather than investing in Islamic banks.
- ❖ The findings of the study reveals that efficiency and performance of Islamic Banking particularly in the time of the financial crisis.

## CONCLUSION

Islamic banks are playing a key role in creating Islamic principles by connecting the economic value with societal and ethical values. Indian financial sector has an enormous market prospective for Islamic banks. Islamic banks continue to be a charming success story characterised by growing share of Islamic financial marketplaces. It is growing recognition particularly in high developed markets, as a successful means to construct a financial inclusive system and substitute the old shade financial system. R.B.I must consider Islamic banking as an important option to undertake the economic and social issues.

Islamic Banks of UK, United States, China, Thailand, Singapore and USA might be obvious examples for Indian authorities. The significance of Islamic banking in India in the situation of "Economic crisis" that has happened in recent times further boosts the necessity of Sharia banking.

Participatory financing is a sole aspect of Islamic banks, and may provide responsible financing to communally and economically significant development projects.



Though a drawback the equities have is the hazard related with them. So as to surmount this threat, one requires to take direction from Shari'ah compliant who can direct and guidance them on what to purchase and most significantly when to purchase and sell. If this part is effectively and sensibly looks after, then there is no better choice than equity for the Muslim people.

To sum up, the initiatives in setting up Islamic banks in a secular state of India might face many political, legal and social challenges. But, the support of the government in executing Islamic finance would get various advantages to Indian economy.

## RECOMMENDATIONS

So as to manage in international marketplaces successfully, it is enviable that the range of operations of Islamic banking sector should be considerably improved. Therefore, serious concern must be provided to mergers. Islamic banking sector have to raise their range as well as outline strategic alliances with other financial institutions. It will help to construct bridges among existing Islamic banks and those traditional financial institutions that are attracted to do banking on Islamic ideologies.

The major challenges being confronted by Islamic bank is the lacking appropriate legal structure to manage cases of overdue payments and bad loans promptly. As Islamic banks can't charge interest on the late payments, they confront a larger threat of defaulting as well as loss in profits.

An additional significant policy concern relates to taxation. In the traditional banking system, interest paid by companies is treating as tax deductible expenditure. Related action should be offered to the dividends paid out by banks.

Islamic banks would be more effectual in India by introducing new financial products to attract deposit as Credit cards, Pension Schemes, and Child Education loans and give more to expand the living condition of middle class persons.

The awareness about interest free Islamic banking ideologies should be carried out in worldwide to endorse Islamic banks. Various traditional bank's ideologies do not assure constancy in banking sector unlike Islamic banking values. In this way the study can be carried out on the advantage and role of Islamic bank over the traditional banks in endorsing the strength of banking industry.

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