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Is there a critical but analytical evaluation of Islamic financial instruments? A Comparative Literature Survey of Islamic Finance and Banking

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ABSTRACT

When the Idea of Islamic finance was put into practice on a large scale, few of Islamic financial instruments did exist. The pioneers of the idea were not given blueprint of Islamic finance in practice. Most of Islamic financial instrument as one sees today were developed in the daily practices of Islamic finance and banking. From time to time, these instruments have been developed according to nature of business of particular Islamic financial institution and needs of particular markets.

On the contrary, many other forms of Islamic financial instruments have gained popularity but they are subject of on-going discussions. Although, their legal form may be acceptable by Shariah point of view but their economic effectiveness is not different from interest based financial instruments which Islamic financial theories propose to try to replace. The present study deals with many other of the main financial principles. It then analyses and assesses how many prevalent and inherent Islamic financial products utilised today stays as commercially competitive.
Keywords: Islamic Financial Instruments; Islamic Finance; Islamic Banking; Islamic Markets; Financial Institutions.

I. INTRODUCTION

Islamic markets provide various instruments to content providers and users of funds in a diversity of ways: trade financing, sales, and investment. Basic instruments involve cost-plus financing (i.e. murabaha), profit-sharing (i.e. mudaraba), leasing (i.e. ijara), partnership (i.e. musharaka), and forward sale (i.e. bay' salam). These instruments assist as the fundamental building blocks for emerging a broad array of more compound financial instruments, signifying that there is countless potential for financial invention and growth in Islamic financial markets.

This study will deliberate the major proscriptions within Islamic finance and how the Islamic financial products stand by these prohibitions. The study highlights about critical and analytical analysis and evaluation of Islamic financial instruments based on comparative literature study.[1]

Below the western economic system credit unavoidably involved fixed rate of return for the usage of rented money. So long as the European realms conquered over the states where Muslims had mislaid their dominion, the conservative economic system sustained to prevail. Though, the renaissance of Islamic thought enthused the Muslims to regroup their financial system.[2]

Since year 1975, when the first Islamic commercial bank was recognized in Dubai, Islamic finance has originated a long way. It has developed rapidly in current decades and its worldwide assets are now assessed to be about US $1.5 trillion across the banking sector, money markets, and Islamic insurance.

II. METHODS AND MATERIAL

A. Need and Importance of the Study

Defining the Islamic financial system just as "interest-free" does not give a real picture of the system as a complete. While avoiding the receiving and payment of interest is the center of the system, it is maintained by different principles of Islamic teachings supporting individuals' privileges and duties, property rights, reasonable distribution of wealth, risk-sharing, completion of obligations and the holiness of contracts. Likewise, the Islamic financial system is not restricted to banking but includes insurance, wealth formation, capital markets, and all kinds of financial intermediation and proposes that moral and principled aspects in the controlling framework are too necessary in addition to judicious and complete controls.

B. Problem Statement

The problem statement of present study includes critical and analytical evaluation of Islamic banking and Islamic financial instruments to be carried out through comparative literature survey of Islamic finance and banking.

C. Objectives

One of the most significant objectives of Islam financial instrument and banking is to understand greater integrity in human society.

The general objectives of Islamic finance transactions may be shortened as below:

- To be factual to the Shari'ah principles;
- Must be free from unjust improvement;
- Must be founded on true agreement of all parties; must be an essential part of an actual trade or economic activity like a sale, rent, production or partnership.

D. Hypothesis

It has been assumed that significant element of Islamic finance is that profit or reward can only be requested in the occurrence where either possibility of loss has been assumed. Profit is so expected by the provider of capital and wages or payment by labor or manager.

E. Research Methodology

Sources of data collection are:

The data, which is collected for the determination of study, is classified into 2 bases:

Primary Sources

The primary data comprises information survey of the first three references mentioned under reference section.

Secondary Sources

The secondary data has been collected from sources like internet, research reports, articles from newspapers and websites.

III. RESULTS AND DISCUSSION

There are actually two crucial factors intricate within the transaction of Islamic financial instruments and banking.

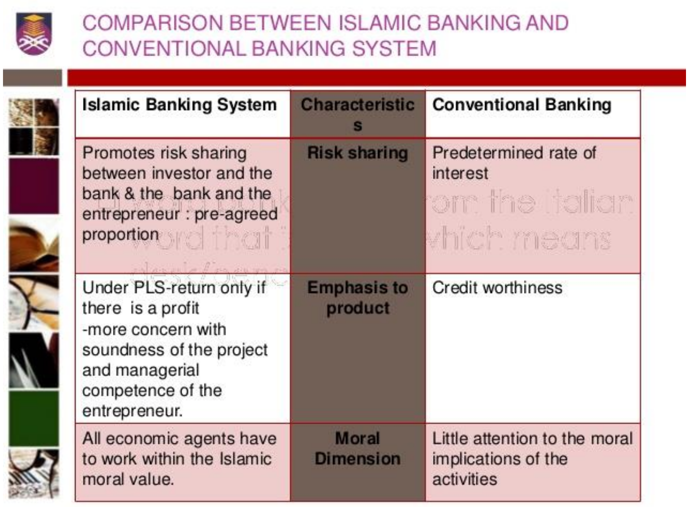
Firstly, the statistic ownership transferences to the bank before to being traded to the customer, is vital. This is for the reason, as Warde notes, it likens to the bank 'retailing the customer the indicated good' as if they were a dealer totalling a mark-up on a product.

Whereas the bank is in possession of the produce it is visible to the 'risks intricate in possession of the asset', if even for a little while, qualifying the mark-up. Secondly, there are a number of issues that must be borne by to guarantee that the ban of Gharar is content and the deal is 'certain'. It validates that despite the intelligent differences many resemblances remain, also to the point that the bank can employ the consumer as its manager to carry out a pronounced deal of the work on its behalf.

The most significant feature of Islamic Banking is that it endorses risk sharing among the provider of funds and both the financial intermediate (i.e. the bank) and the user of fund in conservative banking the risk is all abide by the financier. Islamic Banking and Finance is almost vague from conservative banking and finance. What creates it Islamic is Sharia arbitrage. Though, the level of likely arbitrage varies among numerous products, with many products debatably offering a better system than western complements. For instance, the schemes inside Islamic finance, where possession is joint in an asset or undertaking with a bank and profits are depended on the achievement of the venture, appear a reasonable method of investment with combined risk and very dissimilar from western alternatives like a bond or a loan. Though, in realism for totally sole products to have arisen by the growth of Islamic finance, assumed the relatively small period in which Islamic finance has been obtainable may be an impractical expectation.[1]

The beginning of Islamic finance movement covered the way for altering the traditional system of finances into an Islamic one which could guarantee a corruption free financial system. The exertions ultimately fructified. Firstly, the formation of Islamic development bank in year 1975 and then the creation of Oar-ul-Mall AI-Islami in year 1981 encouraged the muslims to accept their individual system of finance. [2]

Following table shows the comparison of conventional and Islamic financial systems:



Islamic Banking System	Characteristics	Conventional Banking
Promotes risk sharing between investor and the bank & the bank and the entrepreneur : pre-agreed proportion	Risk sharing	Predetermined rate of interest
Under PLS-return only if there is a profit -more concern with soundness of the project and managerial competence of the entrepreneur.	Emphasis to product	Credit worthiness
All economic agents have to work within the Islamic moral value.	Moral Dimension	Little attention to the moral implications of the activities

The table below compares few of the distinguishing features of conventional and Islamic finance -

- ***Conventional System:***
  Money is a product besides medium of exchange and store of value.
- ***Islamic System:***
  Real Asset is a product. Money is just a medium of exchange.

- ***Conventional System:***
  Time value is the basis for charging interest on capital.
- ***Islamic System:***
  Profit on exchange of goods and services is the basis for earning Profit.

- ***Conventional System:***
  Interest is charged even in case, the organization suffers losses.
- ***Islamic System:***
  Loss is shared when the organization suffers loss.

Contrast of two financial systems Conventional Banking and Islamic Banking:

Reserve ratio=10 percent of deposits.

Conventional Finance	***Islamic Finance***
Bank 2 Deposit = $20	Bank 2 Deposit = $90
Bank 3 Deposit = $4	Bank 3 Deposit = $81
Total deposits = $125	**Total deposits = $1,000**

The Islamic financial organization institutions must be intended to substitute a sound growth with well expanded and well combined at national and also global levels. On a global viewpoint, international organization institutions are those that together enable monetary and financial policy making at the country level, and endorse financial integration by providing universal values, guidelines, best performs, and provision coordinating nationwide policies. In current years, other than Islamic development banking, numerous institutions have been recognized to reinforce the Islamic banking and finance. Several of them create effort to regulate Islamic financial regulatory practices in regard of accounting business governance, capital adequacy prerequisite, and risk managing standards.

These institutions have subsidized many efforts that outcome to the enhanced growth of industry of Islamic finance. Accounting and Auditing Organization for Islamic Financial Institutions (known as AAOIFI) was formed to offer accounting and reviewing standards for many Islamic financial agreements. The International Islamic Financial Market (known as IIFM) was recognised to endorse Islamic financial market by giving worldwide standard and helpful framework for the market and to safeguard the sustained growth of the market in line with Shariah rules and values. International Islamic Rating Agency (known as IIRA) supplying a valuation of the risk profile of Islamic financial companies as well as their financial produce that can be cast-off for investment results. IIRA carries out rating, evaluating, improves and quickens the growth of Islamic financial market. Liquidity Management Center (known as LMC) allows Islamic financial institutions to accomplish their liquidity by short and medium period liquid investments by offering secondary market that are organized in compliant to the Shariah laws. General Council of Islamic Banks and Financial Institutions (known as GCIBFI) improve market considerate of Islamic finance. Islamic Financial Services Board (known as IFSB) is functioning as international standard setting of controlling and supervisory agencies that have a chief interest in safeguarding the moving performance and constancy of the Islamic financial institutions that secondarily pay to the operational of the Islamic capital market. Lastly, Islamic Research and Training Institute (known as IRTI) support and promote the growth of industry by endorsing Islamic finance research and training.

Following Figure Showing Institutions for Islamic financial instruments :

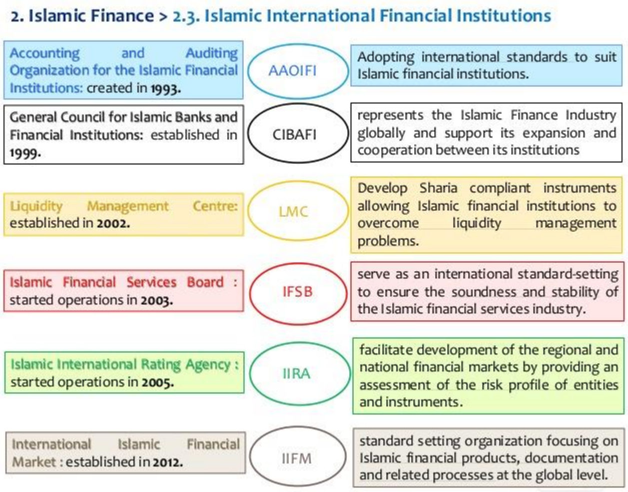


Figure 1 : Institutions for Islamic financial instruments

Findings

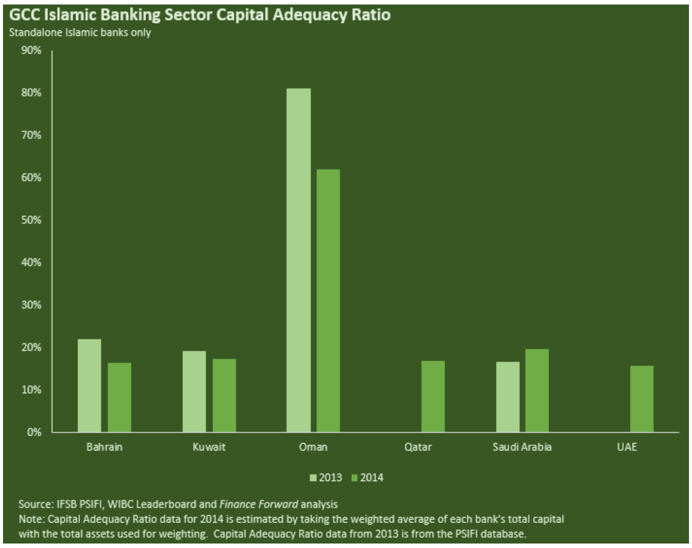
There has been huge-scale growth in Islamic finance instrument and banking in muslim countries and around the globe during the recent twenty years. This development is affected by factors counting the outline of wide macroeconomic and organizational improvements in financial schemes, the liberalization of capital activities, denationalization, the worldwide incorporation of financial markets, and the summary of advanced and new Islamic products. Islamic finance is currently getting new levels of superiority. Though, a comprehensive Islamic financial system with its recognizable instruments and markets is yet very much at an initial stage of development. Many difficulties and challenges connecting to Islamic instruments, financial markets, and rules must be addressed and solved.

Islamic finance has possibly been more effective in contributing an alternate viewpoint on finance than in giving a practically different method of financing. The importance of theory on social awareness, risk-sharing, redeployment of wealth and prospect, and making finance the servant and not the dominant of the real economy are what numerous observers wish to hear. But Islamic finance has set up it tough to implement theory into practice. The list of reasons varies from history, politics, law, taxation, regulation, consumer behaviour, and beyond. But a significant reason is that Islamic finance is usually made to fit into a scheme intended for conventional finance, and in the course of making enterprises, it appears to lose what its opponents regard as its material.[3]

The Islamic finance industry and its comparative literature as of year 2015 are importantly different in extent and depth from where they were in the initial 1970s or, for that substance, in the early of 1990s. The industry endures to grow, and there is no reason why, in the subsequent two decades, the field would not change significantly more from where it positions today. In the rouse of the global financial emergency, the ideas behind Islamic finance might request to those who seek for a comparatively controlled financial system and are worried about the wider impact of the finance industry on civilization.

Islamic bank uses Mudarabah as essential structure of investment credit. Investment deposit is alike to saving and time credit of conservative bank that they have to wage some return to investor. Yet with the aid of Mudarabah, Islamic banks do not wage the return in form of secure interest rate but in procedure of quantity of profit share.

Chart of Islamic finance today :



IV. RECOMMENDATIONS

The set of recommendations pursues to build the essential foundations in regards of capacity building, the establishment of infrastructure and controlling framework development, to attain the revelation and objectives outlined above.

V. CONCLUSION

Subsequently Islamic banking and finance has several unique features then it needs the exceptional products or instrument to track their business. These products and instrument have eminent in nature and feature from their conservative counterpart. Though there are numerous kind of Islamic financial instruments and all instrument have its individual Shariah requirement for legitimacy. But they share features or necessities that are risk captivating for attaining return. Islamic banking and finance system is comparatively new. It is not similar in many features. The system is yet not uniting in practice and rule. Over the years, a number of Islamic financial institutions have been made to supply the optimistic development to Islamic financial industry. Various institutions described above have funded many efforts that consequence to the enhanced growth of Islamic finance industry.

VI. SCOPE FOR FURTHER RESEARCH

Banking services and financial instruments for small and medium enterprises, which are yet only developing in Islamic banking, and ethical banking products like funds attentive on investments in supportable energy, is a future scope of research and offer an opportunity to widen the offering.

VII. REFERENCES

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Appendix

List if Abbreviations:

[1]. Anon AAOIFI- Accounting and Auditing Organization for Islamic Financial

[2]. Institutions

[3]. IIFM- International Islamic Financial Market

[4]. IIRA- International Islamic Rating Agency

[5]. LMC- Liquidity Management Center

[6]. GCIBFI- General Council of Islamic Banks and Financial Institutions

[7]. IFSB- Islamic Financial Services Board

[8]. IRTI- Islamic Research and Training Institute