

A STUDY ON THE ACCEPTABILITY OF ISLAMIC BANKING IN INDIA

SYED KHALID IQBAL

M.Phil Scholar, Institute of Management Studies,
Devi Ahilya Vishwavidyalaya (DAVV), Indore
Khalidiqbal6696@gmail.com

ABSTRACT

Islamic Banking has become the buzz world in the field of banking and finance around the world. For a country like India which has a large Muslim population, Islamic Banking will facilitate financial inclusion and at the same time provide access to untapped savings of millions of people who remain outside the ambit of the financial system due to their reservations against interest-based transactions. Due to regulatory and other issues, Islamic Banks are yet to be allowed to begin operations in India. However, there is growing awareness, in India, with regard to Islamic Banking and the principles on which it is based. An attempt is therefore made to study the acceptability of Islamic Banking principles in India.

Keywords : Islamic Banking; Interest-free Banking, Islamic Finance

INTRODUCTION

Islamic Banking, also known as Interest-free Banking, is an alternative system of banking and finance which prohibits receipt or payment of interest in any of its operations. Prohibition on interest (the Arabic term for which is 'Riba') is the fundamental principle of Islamic Banking. Islamic Banks perform the same intermediary functions like other commercial banks but they do not receive a predetermined interest from their borrowers nor do they pay a predetermined interest to their depositors. Rather, lending and borrowing are based on profit-sharing agreements with depositors and borrowers. The philosophy of Islamic Banking has no concept of Riba or interest because, a financial system which guarantees a fixed rate of return to the lender, places the burden of risk solely on the borrower. Interest-based transactions represent a system that is unfair and exploitative and leads to accumulation of wealth in the hands.

Islamic Banking represents an economic philosophy where the investor is not only concerned with the returns on his investment but also takes into account the nature of the business in which he/she is about to invest, its policies and objectives, the types of products/services it will produce/ provide, and the

possible impact of such activities on the society as a whole. Justice and fair play are the guiding principles in all transactions. Both the borrower and the lender share in the risks and profits of the business and a financier becomes entitled to profit from a business only if he is willing to accept the risk of loss. To expect a fixed rate of return in the form of interest irrespective of the profit or loss from the enterprise makes the lender an economic parasite and opens the floodgates of exploitation and inequality. The burden on the borrower gets multiplied due to the compounding of interest.

Explaining the injustice of interest-based financing, President Obasanjo of Nigeria, stated at the G8 Summit at Okinawa in 2000 that - *“All that we have borrowed up to 1985 or 1986 was around \$5 billion and we have paid about \$16 billion, yet we are still being told that we owe about \$28 billion. That \$28 billion came about because of the injustice in the foreign creditors’ interest rates. If you ask me what the worst thing in the world is, I will say it is compound interest”*.

Islamic Banking made a formal beginning as late as 1975 with the establishment of the Islamic Development Bank. In the next ten years, more than 50 Islamic Banks came into existences and by 2017, more than 500 Islamic Banks ^[3] (including Islamic windows) were in operation worldwide. Although a good number of Islamic Banks are in Muslim countries, they are now also in operation in U.K., Germany, Denmark, Switzerland, Luxembourg and even Australia. The phenomenal growth of Islamic Banking over the past decades has compelled the banking industry, investors, regulators and governments to view Islamic Banking as a promising segment in the banking industry. Islamic Banking is the buzzword in the field of Banking and Finance around the world.

A wide range of interest-free financial products and services have been developed to meet customer needs and provide alternatives to products offered by conventional banks. Some of the commonly used instruments of Islamic Banking & Finance are : Mudarabah (Profit Sharing), Murabaha (Cost-plus Financing), Musharakah (Equity Partnership), Istisna (Commissioned Manufacture), Ijarah (Lease/Hire-Purchase), Bai' Salam (Forward Contract), Sukuk (Islamic Bond) and Takaful (Insurance).

REVIEW OF LITERATURE

Islamic Banking has not been formally launched in India as the much-needed clearance of the RBI is yet to be granted. However, of late, the concept of Islamic Banking has generated much interest in India – among Muslims as well as non-Muslims alike. It has also aroused much interest and curiosity among

academicians and researchers and various studies have been conducted to study the nature and scope of Islamic Banking in India and the awareness about this concept in the country.

Azeez N.P. (2018) tried to study the level of awareness and perceptions about Islamic Banking in India and found that people are by and large, ill-informed and harbor apprehensions about the secular nature of this banking model. He felt that efforts must be made to increase awareness about this banking system so that the people get an opportunity to make an informed choice.

Dipika (2017) observed that "Islamic Finance, despite its name, is not a religious product." She conducted a SWOT analysis of Islamic Banking in India which revealed that the strength of Islamic Banking lies in the fact that its financing is asset-based and not debt-based hence it is more stable compared to conventional banks. The weakness of Islamic Banking is that at present banking regulations in India do not permit interest-free banking. She held that substantial Muslim population in India is a huge opportunity for Islamic Banking and it can attract those who remain outside the ambit of the conventional banking system. However, the biggest threat to the introduction of Islamic Banking in India is the political divide. In the final analysis, the SWOT analysis weighed in favour of the introduction of Islamic Banking as the weaknesses and threats are relatively less significant as compared to its many strengths and huge opportunities for Islamic Banking in India.

Sharma, et. al, (2015) studied the global scenario with regard to Islamic Banking and the challenges to its introduction in India. They lamented that despite registering impressive growth in different parts of the world, Islamic Banking has not found favour with Indian authorities. They opined that India could attract trillions of dollars in equity finance from the gulf countries and also gain diplomatic advantage if Islamic Banking is introduced in India.

Khan (2013) opined that although there is a huge scope of Islamic Banking in India, it is not possible unless efforts are made by the government and RBI. He also suggested that Islamic Banking should not be viewed from a narrow religious prism but should be treated as 'Interest-Free Banking' in the broadest economic sense.

Khan & Hussin (2013) tried to evaluate the prospects of and challenges to Islamic Banking in India. Their study concluded that there is huge potential for the growth of Islamic Banking as a parallel banking system with conventional bank.

They argued that India has an advantage due to its significant Muslim population. Moreover, substantial funds which otherwise remain idle or are invested in Gold and jewellery can flow into the market if Islamic Banking is introduced in India. They further concluded that financing the unorganized sector can get the much-needed boost through Islamic Banking which promotes equity finance.

Gupta (2017) examined the various obstacles in introducing Islamic Banking in India and suggest ways in which such obstacles could be overcome. He suggested that considering the many challenges, initial steps like introducing interest-free products through Shariah-compliant windows in commercial banks may be taken which may lay the ground work for future expansion of Islamic Banking in India on a large scale. He opined that considering the potential benefits, India should embrace Islamic Banking and argued that India may even become a leading player in Islamic Finance in the Asian market.

Bhasin and Nirupama (2018) concluded that it would be in our national interest to allow operation of Islamic Banks parallel to traditional banks. They were of the view that social well-being is the main focus of Islamic Banks and their participation in the banking sector will provide a boost to infrastructural development in the country.

Haque, et. al (2017) conducted SWOT analysis and tried to explain how Islamic Banking is suitable for a country like India. They drew attention to the fact that India has a large Muslim population and Islamic Banking can provide effective banking solutions in development projects.

Shahid and Raj (2019) discussed the important products of Islamic Banking and tried to analyze its benefits and limitations of introducing this banking system. They concluded that if India is to become an economic giant, it needs to allow Islamic Banking as it will provide an alternative and promote financial inclusion.

OBJECTIVE:

The objective of this study is to assess the acceptability of Islamic Banking in India. Since Islamic Banking is yet to be introduced in India and as suggested by various studies in the past, there is not much awareness about Islamic banking. Therefore, an attempt has been made to study the level of acceptance of the core principles on which Islamic banking is based on the basis of which acceptability or otherwise of Islamic Banking in India can be assessed.

RESEARCH METHODOLOGY

For the purpose of this study, a questionnaire was framed which contained five statements/questions designed to measure the acceptance or otherwise of Islamic

Banking principles and the respondents were asked to give their responses on a five-point scale from “Strongly Agree (1)”, “Agree (2)”, “Neutral (3)”, “Disagree (4)” and “Strongly Disagree (5)”. The questionnaire in Hindi and English was sent online to about 1000 respondents through Google Forms. Responses were received from 857 respondents and after removing duplicate entries, 812 responses were found valid which form the basis of this study.

The basic principles on which Islamic Banking is based include prohibition of interest and borrowing and lending on profit and loss sharing basis rather than on fixed rate of interest. Through the questionnaire, the respondents were asked a hypothetical question whether they would like to invest in a Bank which offers share of profit/loss rather than fixed rate of interest on their deposits. At the same time, they were also asked whether they would like to borrow from a bank which offers interest-free loans on Profit/Loss sharing basis. It is felt that responses on these questions would indicate the acceptability or otherwise of the principles of Islamic Banking in India.

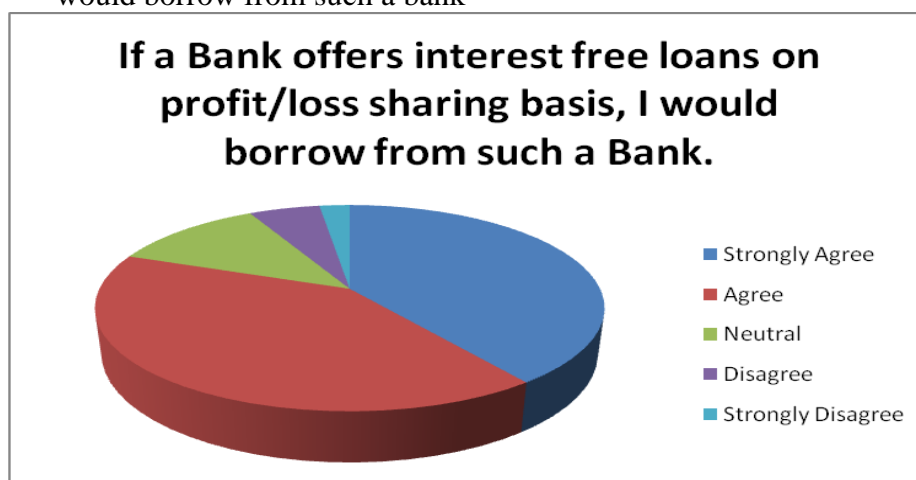
FINDINGS

Q 1 : If a bank offers interest-free loans, on Profit/Loss sharing basis, I would borrow from such a bank

The responses this question are summarized in the table below:

	Frequency	Percent	Valid Percent	Cumulative Percent
1.00	19	2.3	2.3	2.3
2.00	44	5.4	5.4	7.8
3.00	94	11.6	11.6	19.3
4.00	332	40.9	40.9	60.2
5.00	323	39.8	39.8	100.0
Total	812	100.0	100.0	

Table-1: If a bank offers interest-free loans, on Profit/Loss sharing basis, I would borrow from such a bank



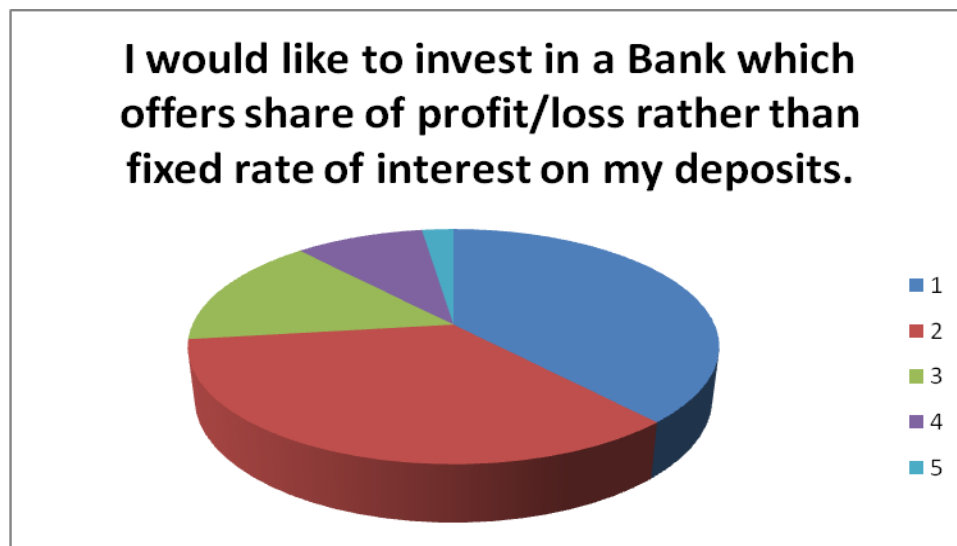
Results reveal that 80.7% of respondents expressed their willingness to the proposition (Strongly Agree-39.8% & Agree-40.9%) while 7.7% disagreed with the proposition (Strongly Disagree-2.3% & Disagree-5.4%). 11.6% of the respondents were neutral. Thus, more than 80% of the respondents are willing to borrow from Banks on Islamic Banking principles.

Q 2: I would like to invest in a Bank which offers share of profit/loss rather than fixed rate of interest on my deposits.

The responses this question are summarized in the table below:

	Frequency	Percent	Valid Percent	Cumulative Percent
1.00	19	2.3	2.3	2.3
2.00	76	9.4	9.4	11.7
3.00	124	15.3	15.3	27.0
4.00	282	34.7	34.7	61.7
5.00	311	38.3	38.3	100.0
Total	812	100.0	100.0	

Table-2: I would like to invest in a Bank which offers share of profit/loss rather than fixed rate of interest on my deposits.



Results reveal that 73.0% of the respondents agreed with the proposition (Strongly Agree-38.16%; Agree-34.89%), 11.7% disagrees (Strongly Disagree-2.3%; Disagree-9.4%) and 15.3% were neutral. Thus, majority of the respondents are willing to make deposits in a bank which offers share of profit/loss rather than fixed rate of interest.

Based on the assumptions, Chi-square test was applied and the results for the same are as depicted in the table below:

q1 * q2 Cross Tabulation

Count	q2					Total
	1.00	2.00	3.00	4.00	5.00	
1.00	4	3	1	4	7	19
2.00	4	20	6	9	5	44
3.00	0	17	41	27	9	94
4.00	5	24	57	183	63	332
5.00	6	12	19	59	227	323
Total	19	76	124	282	311	812

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	409.805 ^a	16	.000
Likelihood Ratio	354.010	16	.000
Linear-by-Linear Association	167.167	1	.000
N of Valid Cases	812		

a. 6 cells (24.0%) have expected count less than 5. The minimum expected count is .44.

Interpretation: P value is less than 0.05 and so the two questions are dependent.

The two questions with regard to willingness to borrow from a bank on Profit and Loss sharing basis and willingness to make deposits in banks on Profit and Loss sharing basis rather than fixed rate of interest are dependent. Banking involves accepting deposits from customers and lending the accumulated funds to applicants. Both aspects are important for successful banking operations. Loans can be advanced by banks only out of deposits received from customers and interest on deposits can be paid only if the bank lends the available funds on a higher rate of interest. As discussed above, results of the study reveal that an overwhelming majority of the respondents are willing to borrow as well and make deposits in Banks on Profit and Loss sharing basis. Thus, the findings suggest that the basic principles of Islamic Banking have wide acceptability in India.

CONCLUSION

Despite the fact that Islamic Banking is yet to be formally introduced in India, findings of this study suggest that there is wide acceptance of the core principles on which it is based and it can fairly be concluded that if and when Islamic Banking is introduced in India, its prospects are bright. With emphasis on interest-free, ethical and non-exploitative banking, Islamic Banking may be the

right alternative to conventional banking for a country like India It may be ideal for financing development projects, financing micro, small and medium enterprises (MSMEs), agricultural finance, etc, No doubt, there exist several barriers, but with some flexibility and regulatory changes, these can be addressed and overcome.

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