

A comprehensive review of Non-Interest Banking in India: Requirements, Potential, and Hurdles

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ABSTRACT

The primary objective of this paper is to investigate the rationales behind both the adoption and the obstacles hindering the implementation of Islamic banking in India. Central to this exploration is an examination of the prospects for Islamic banking within India's socio-economic landscape, particularly considering the nation's status as home to approximately 207 million Muslims, constituting the world's third-largest Muslim population. Leveraging resources such as Google Scholar, a review of existing literature has been conducted to delineate the global trajectory and expansion of Islamic banking, albeit with a notable gap in research pertaining to its progress within the Indian context. Islamic banking, fundamentally rooted in Islamic law (sharia) and ethical principles, embodies a financial system distinct from conventional models. This article endeavors to offer a succinct overview of the current state of Islamic banking worldwide, accentuating its potential significance and necessity within India while concurrently shedding light on the accompanying challenges. By illuminating the discourse surrounding Islamic banking, this study aims to contribute to a deeper understanding of its viability and implications within India's dynamic financial landscape.

Keywords: Islamic banking, sharia, Islamic ethics, Islamic finance, India.

I. INTRODUCTION

Out of the 195 countries worldwide, over 105 nations, comprising approximately 53.84% of the total, have already embraced Islamic banking, indicating a global trend towards its adoption. This widespread acceptance prompts an inquiry into the underlying reasons driving both developed and developing countries to implement Islamic banking practices. Curiously, India, a nation boasting the distinction of being the seventh largest by land area, the second most populous, and renowned as the world's largest democracy, has yet to fully embrace Islamic banking, despite being home to the third-largest Muslim population globally. India's unique socio-cultural fabric, characterized by its celebrated ethos of unity in diversity, encompasses a myriad of cultural traditions, linguistic diversity, religious plurality, and diverse belief systems. Within this democratic framework, there exists ample room for both Islamic banking and conventional banking systems to coexist harmoniously, allowing individuals to democratically opt for the financial system that aligns with their specific needs and preferences. This inclusive approach would enable Muslims to invest in accordance with Islamic principles, while simultaneously offering alternatives within the conventional banking realm for those who opt for interest-based transactions. By fostering an environment where diverse financial ideologies can peacefully coexist, India has the opportunity to leverage its democratic ethos to accommodate the diverse financial preferences of its populace, thereby promoting financial inclusivity and

ensuring equitable access to banking services for all its citizens.

Islamic banking is a banking system that run on the bases of doctrine of Islamic law (shariah) and governed by Islamic economics (Kamarulzaman and Madun, 2013). The primary doctrine on which Islamic banking is constructed upon is prohibited of interest and sharing of profit and loss of business (Khattak and Rehman, 2010). On the basis of speedy growth in the past few decades, Islamic banking term to be an integral part of global mainstream in banking system (Gilani, 2015; Rammal and Zurbruegg, 2006). The majority of Indian Muslims currently opt for non-interest-bearing investments or choose to donate the interest accrued on conventional investments as charity. This prevailing practice presents a clear opportunity for Islamic banks to attract funds that traditional banks may struggle to access. Indians commonly engage in participatory banking through the establishment of cooperative banks, non-banking financial institutions, and microcredit facilities. Leveraging this existing infrastructure can provide a strategic entry point for introducing Islamic banking principles into the Indian financial landscape. By aligning with the participatory banking model already prevalent among Indian Muslims, Islamic banks can effectively tap into a previously underserved market segment, thereby expanding their reach and impact within the Indian financial sector.

The introduction of Islamic banking in India holds the potential to significantly enhance financial inclusion, not only among diverse segments of society but also by attracting foreign investment, particularly from Gulf Cooperation Council (GCC) countries. This influx of foreign capital could prove instrumental in realizing India's aspirations of establishing itself as a prominent financial hub on the global stage. Moreover, the adoption of Islamic banking principles has the capacity to address the longstanding issue of imbalance between the labor and capital ratios in the country. This imbalance, pervasive across various sectors including agriculture and other informal industries, presents a formidable obstacle to economic growth and development. By embracing Islamic banking, India can potentially revolutionize its approach to addressing this challenge, thereby fostering greater efficiency and productivity in these crucial sectors of the economy. Additionally, Islamic banking's emphasis on profit-and-loss sharing rather than interest-based lending can serve as a catalyst for entrepreneurship. By providing financial support based on the principles of equity and risk-sharing,

Islamic banking can incentivize individuals to pursue entrepreneurial ventures, driving innovation, job creation, and economic prosperity. In essence, the introduction of Islamic banking in India represents a transformative opportunity to not only promote financial inclusivity and attract foreign investment but also to catalyze sustainable economic growth and empower entrepreneurial endeavors across the nation.

Objective of the Study

- Investigating the widespread interest of both developed and developing nations in adopting Non-Interest banking.
- Examining the quality of life of Muslims residing in India.
- Analyzing the factors contributing to India's reluctance in adopting Non-Interest banking.

II. LITERATURE REVIEW

Islamic banking is one of most studied topic in the field of research from last decades almost more than 65 years old. The first Islamic bank was establish in Egypt in 1963 from there onwards the study of Islamic banking started many scholar have given their view on the adaptation and growing popularity of Islamic banking all over the world (Samir Shaikh) Islamic banking surprise by showing a new phenomena in the world of banking by the speedy progress (Mohamed Arif 1988). Till 1990 more than 45 countries have already adapted Islamic banking and Islamic investment mostly in Muslim countries but their subsidiary and holding companies are found mostly non-Muslims countries (Mohsin S Khan, Abbas Mirakhor 1990) and Islamic banking gaining acceptance not only in Muslim countries but also in non Muslim countries (Zamir Iqbal, Abbas Mirakhor 1999). It improve income distribution in the country and term to be suitable for small units that they can obtain finance without any collateral securities as it is not necessary it will result in emergence of fast economy growth (Abdel Hamid Abdouli 1991) taking the example of Bahrain Islamic Bank (BIB) research was conducted to investigate the reality of micro level of claim (high performance and stability) by considering different methods like financial analysis and portfolio analysis (Seref Turen 1996) another research in Bahrain on 300 customer who are well educated 80% of them are between 25-50 age they have been the satisfied customer for more six years of Islamic banking and they continued (Saad A Metawa, Mohammed Almosawi 1998).

The tremendous progress has been witnessed during 1970 to 1995 not only conventional bank but multinational western bank also started to adapt Islamic banking technique (Munawar Iqbal, Auşāf Aḥmad, and Tariqullah Khan1998). A serious empirical study brought a conclusion that Islamic bank have shown fairly well progress in the period of 1990 to 98 when it is compare with the 'control group' of conventional bank (Munawar Iqbal 2001) there have been seen global crisis suffered in 1998 to 1999 but it recovered soon and performed really well after the downfall period it was discovered that the downfall was due to diseconomies of scale for small to medium Islamic banks which demands mergers (Donsyah Yudistira 2004).

A survey conducted in Singapore that if the Islamic bank is able to give the expected return so they continue to keep their money in Islamic bank so 62.1 per cent of Muslims said yes and 66.5 per cent of non-Muslims no conclusion say Muslims will support either it able to share sufficient profit or not (Philip Gerrard, J Barton Cunningham 1997) Islamic bank gaining momentum and facing a strong competition not only from other Islamic bank but from conventional banks as they are also providing services on shariah principles in their branch which they open in Islamic countries (Kamal Naser, Ahmad Jamal, Khalid Al-Khatib, Jordan, 1999). Later Islamic bank experienced the global growth rate of 10-15 per cent per year and no of countries increased to 51 even having consistent growth many conventional system is still unaware with the process of Islamic banking principles (Mr Juan Sole 2007) and it remained a mystery for many part of the world especially in the west and (M Kabir Hassan, Mervyn K Lewis 2007).

Islamic bank can create credit and can also control its credit creation activity in a same way as other banks but still central bank need to find different method to create credit (Zubair Hasan 2008) Islamic banking have brought a new innovation in the banking industry as transaction can pass by owning real physical assets and have their own risk and liquidity management tactic (Ben Arab Mounira, ELMELKI Anas 2008) the performance of Islamic bank and conventional bank should not be measured in same way as they both have different objectives. Shari member definitely have better quality of supervision and consultation when it comes to finance and commerce (Racha Ghayad 2008). In US Islamic bank is growing at 15% p.a and hold more than \$700 billion in assets. It is not just 'interest free' but involves ethical and moral issues that make it

more economically efficient than any conventional banking when it comes to economic equity and justice. (Feisal Khan 2010). Islamic Financial Services has been expanding all around the globe and has shown huge potential for developing economies. India, a developing economy, has shown less progress in Islamic Financial Services though there are several opportunities. The article examines the overview of the prospects of Islamic Financial Services in the Indian economy with a focus on regulations and conceptual understanding. (Shadab 2022)

III. RESEARCH METHODOLOGY

The current research represents a concise analysis drawn from secondary data sources, comprising previous research studies, scholarly journals, government publications, research papers, and data sourced from media and the internet.

FACTORS DRIVING THE ADOPTION OF NON-INTEREST BANKING BY COUNTRIES

Islamic banking has witnessed widespread adoption across the globe, with more than 75 countries embracing its principles. This surge in acceptance can be attributed to the remarkable performance of Islamic banking and finance, characterized by an impressive average growth rate of 15% in assets over the past few decades. This growth trajectory has presented an enticing opportunity for advocates of growth and development to explore Islamic banking as a viable alternative. Notably, both developed and developing nations have integrated Islamic banking into their financial systems, including prominent countries such as Germany, the UK, Europe, the USA, France, Singapore, Jordan, Indonesia, Egypt, Bangladesh, Bahrain, Pakistan, Nigeria, and Malaysia. International banking giants like HSBC Amanah, Standard Chartered Saadiq, Lloyds TSB Bank, and Citigroup have also diversified their offerings to include services aligned with Islamic banking principles. Western nations, in particular, have actively promoted Islamic finance, with the UK leading the way under the slogan "NO FAVOR, BUT NO DISCRIMINATION." Former prime ministers have even prophesized London's emergence as a future hub for Islamic finance—a prediction that has materialized with time. One noteworthy aspect driving the expansion of Islamic banking is its resilience, often observed when conventional banks encounter challenges leading to closures. Islamic banks have demonstrated their ability to step in and provide stability, thus solidifying their position as a reliable and

sustainable alternative within the global financial landscape.

- The assets of Islamic banking have increased at an average rate of 15% in last decade.
- The principles followed by Islamic banking are been derived from holy Quran and 'Hadeeth' which have been narrated by Prophet Mohammad.
- Islamic bank closely monitor their investment and insure firms who are investing is managed properly.
- It is also known as ethical banks. As it does not lend or lease any product that they do not completely own. It does not deal in traditional bond as trading in them is not allowed so they have their own version of instrument called Sukuk (Islamic bond).
- To spread financial inclusion interest free loans (Qard Hasan) are encouraged.
- In Islamic banking unproductive activities such as speculation or gambling are not supported as it is prohibited and productive activity like trade, commerce, entrepreneurship and societal development are been supported.
- It is based on sharing of profit and loss of business but prohibits paying and charging of interest.
- It does not charge any penalty on its borrower for late payment.
- More controlled form of banking due to dual monitoring as it has board of directors and Sharia Supervision board.
- It give due respect to public interest. Its primary aim is to ensure inclusive growth by providing capital socially desirable projects.

ECONOMIC CONDITION OF INDIAN MUSLIMS

Islam stands as the second largest religion in India, encompassing approximately 14.2% of the population, which translates to about 204 million individuals as of 2019. India, home to nearly 10% of the global Muslim population, ranks third worldwide after Indonesia and Pakistan in terms of Muslim inhabitants. Notably, around 47% of India's Muslim population resides in just three states: Uttar Pradesh, West Bengal, and Bihar. Despite their significant numbers, a considerable portion of the Muslim community faces socioeconomic challenges, with many experiencing a lower standard of living compared to scheduled castes and tribes. The statistics paint a stark picture: only 4.4% of the Muslim population is enrolled in higher education, while less than 5% hold government jobs, and a mere 3.2% are employed in security agencies. This disparity in

access to education and employment opportunities contributes to the overall poor quality of life experienced by many Muslims in India, perpetuating a cycle of social and economic degradation within the community.

Moreover, Muslims in India often encounter barriers to equal participation in public life, including limited representation in government, educational institutions, and political arenas. Economic marginalization further exacerbates their situation, as many Muslims earn less income and are less likely to engage in formal banking and financial activities. This economic disenfranchisement is reflected in the community's educational outcomes, with nearly half of the Muslim population unable to read or write. Historically, Muslims have been renowned craftsmen, but the advent of globalization and mechanization has rendered many of their traditional skills obsolete, leaving them struggling to adapt and maintain their livelihoods.

The persistent socioeconomic challenges faced by India's Muslim community underscore a collective failure on the part of the nation, despite constitutional safeguards and welfare measures implemented over the past 70 years since independence. These measures have not succeeded in effectively empowering the minority community or addressing the systemic inequalities they face. As a result, there remains an urgent need for comprehensive policies and interventions aimed at fostering greater inclusivity, economic opportunity, and social equity for India's Muslim population

REASONS FOR NOT ADAPTING ISLAMIC BANKING IN INDIA

- The establishment of Islamic banks in India necessitates legal reforms and the development of a new regulatory framework. This is because certain provisions within the Banking Regulation Act of 1949, the RBI Act of 1934, the Cooperative Societies Act, and the Negotiable Instruments Act of 1961 may conflict with the fundamental principles of Islamic banking.
- There is a significant lack of awareness regarding the basic concepts and terminology of Islamic banking among the general populace.
- Islamic banks face intense competition from conventional banks.
- There is a prevailing perception that Islamic banking exclusively caters to Muslims.
- Some individuals perceive financial matters and religious principles as distinctly separate entities.

- While interest earned on fixed deposits is subject to Tax Deducted at Source (TDS) as per the Income Tax Act of 1961, profits earned through Islamic banking require a different tax treatment.
- Conventional banks have the option to borrow money from other conventional banks or the Reserve Bank of India (RBI) to meet their financial requirements, whereas Islamic banks are restricted from engaging in interest-based borrowing.
- Certain political groups oppose the establishment of Islamic banks in India.

IV. CONCLUSION

It is imperative for the Indian government to acknowledge the significant potential of Islamic banking and finance and consider its adoption in India. By neglecting this opportunity, India is missing out on the chance to tap into capital from a large section of its population, namely the Muslim community, as well as from other Islamic nations. The history of Islamic thought is extensive and rich, offering diverse perspectives, interpretations, debates, theories, and controversies. Within this vast ocean of Islamic thought lies the potential to address the societal and economic challenges faced by Islamic societies.

Islamic banking presents an avenue for enhancing India's economic growth and can serve as a mechanism to mitigate issues such as inflation and liquidity problems. Given the sizeable population and economic conditions of Indian Muslims, the implementation of Islamic banking could prove to be a prudent decision in addressing economic crises and improving the financial system. Furthermore, Islamic banking offers an alternative banking solution, which can play a pivotal role in restoring equilibrium in society. By providing interest-free solutions, Islamic banking can alleviate the burden of debt on farmers, laborers, and other marginalized groups, thus fostering greater social and economic inclusivity. In essence, embracing Islamic banking not only presents an opportunity for financial innovation and growth but also offers a pathway towards creating a more equitable and resilient society in India

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