

# INTERNATIONAL JOURNAL OF RESEARCH IN COMMERCE, IT & MANAGEMENT

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## ISLAMIC BANKING IN INDIA: RELIGIOUS AND SOCIO-ECONOMIC PERSPECTIVES AFFECTING MUSLIM INVESTORS OF AHMEDABAD DISTRICT IN GUJARAT

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**NR: INDRODA CIRCLE, GANDHINAGAR**

### ABSTRACT

*Banking institutions have emerged as very necessary for everyone, poor as well as rich. It is needed to deposit and protect the saving however meagre it may be. Such institutions have built a bond with the people with a handful of services. Even every country's financial security is vested in the hands of the central bank of that country. The banking sector has made a trust in the common people by giving out services starting from lending loans for different activities to being as a security locker of money. With around 15% of the Islamic population living in India, there is a large scope of Islamic banking in India too. This system would provide opportunities to the labourers and the working class belonging to the community. This paper introduces briefly to Islamic banking, where an attempt is made by the researchers to explore the feasibility of Shari'ah banking in India. Islamic banking is still in its stage of infancy in India. The existing legal framework does not permit Islamic Banking. Only selective activities like equity investment is possible, while trade finance aspects like taking title to goods is not possible. Researchers have focused on the some of the religious and socio-economic perspectives which affect the investment of Muslims. Primary studies suggests that Gujarati Muslims are not much inclined towards following the principles of Shari'ah while making investment decision. Yet, they have shown interest in Islamic financial products if made available to them.*

### KEYWORDS

Islamic Banking, Muslim Investor, Ahmedabad.

### INTRODUCTION

Islamic banking practice started on a modest scale in 1963 in Mit Ghamr, Egypt, and has shown tremendous progress during the last four decades.<sup>1</sup> A large number of Islamic banks were established during this period in different regions under different economic and social milieu. Today, there are more than 430 Islamic banks and financial institutions spread across 75-plus countries and about 191 conventional banks have Islamic windows. Islamic banking, which is currently concentrated in the Middle East, North Africa, and South-East Asia, is spreading its wings to sub-Saharan Africa, Central Asia, and Western Europe. More than 70 percent of the Islamic banks are in the Middle East, 14 percent in South-East Asia, and 15 percent in sub-Saharan Africa. Assets held by Islamic banks or through Islamic banking windows of conventional banks rose by 28.6 percent to \$822 billion in 2009 from \$639 billion in 2008, according to a survey of Top 500 Islamic Financial Institutions by The Banker in July 2010.

As per the world wide religious aspect Islam occupies second place and second faster growing religious world wide.<sup>2</sup> And as per holy book Quran, Muslims should follow the Islamic principles to fulfill their religious duties. This incurred a new thought, in financial system as ISLAMIC BANKING. The Quran and Hadith are specifying the guidelines for a human being, for society, for an organization, for government. So as Islamic system provides knowledge relating to all fields, banking and financial system is being no exception to that.

General Secretariat of the **Organization of the Islamic Conference (OIC)** defines an Islamic bank as: "A financial institution whose status, rules and procedures expressly state its commitment to the principles of Shari' ah and the banning of the receipt and payment of interest on any of its operations."<sup>3</sup>

Certain businesses are incompatible with Shari'ah Law. Thus, stocks of companies in these businesses are not considered suitable for Islamic investing. Incompatible lines of business include Alcohol, Pork-related products, Conventional financial services (banking, insurance, etc.), Entertainment (hotels, casinos/gambling, cinema, pornography, music, etc.). Moreover, Shari'ah scholars also do not advise investments in tobacco manufacturers or defense and weapons companies.

### OVERVIEW OF THE BANKING SYSTEM

Islamic banks have proved to be a viable and efficient way of financial intermediation in the Middle East. According to a one study conducted by IMF study, the probability for Islamic banking to develop in a given country rises with the share of Muslim population, per capita income, and the country's net export of oil.<sup>4</sup> The distance to the two main Islamic financial centres, Bahrain and Malaysia, does matter for the diffusion of Islamic banks across countries. Islamic banks diffuse faster when a country is closer to one of the above two centres. If the importance of Islamic banks in the economy by assets is measured, in almost all countries having Islamic banks, except Iran, the ratio of credit of conventional banks to GDP is substantially higher than the investment to GDP ratio of Islamic banks, which accounts for less than 20 percent of GDP in most countries.

Looking to the current scenario, Islamic population is world's second large population. Muslims originates from Saudi Arabia. Generally Muslims are mainly spread over Middle East, North Africa and south East Asia. The ratio of Saudi Arabic Muslim to non Arabic Muslim, by a ratio of 3:1. but the most interesting situation is that the top four nations counting the largest number of Muslims are located outside the middle east namely : Indonesia- 166 million, Pakistan-111 million, Bangladesh- 97 million and India -93 million.

Islamic Banking has different modes of financing and in most of these kinds, the bank involves itself in the trading or business activities of the borrower or will be based on equity participation of the bank, which is very much unlike the conventional banking. In Bai'-Mu'ajjal, the bank resorts to purchase and resale of properties, which is not permissible as per the provisions of Sections 8 and 9 of Banking Regulation Act, 1949.<sup>5</sup>

The need and necessity of interest-free Islamic finance and banking has to be spread among the Muslims, common people, religious scholars, businessmen, bankers, politicians, and other stakeholders is yet unclear among Indian muslims. This level is even less when we talk about Gujarat.

Among Muslims, criticism has been raised against the banking approach itself. Some allege that it is nothing but the changes of nomenclature only. Some other question its capability to meet all the financial requirements of modern day economy. Some go further to say that the whole exercise is futile, with the macro level money creation process remaining the same, what is attempted through so-called innovative products is nothing but a cosmetic touch and even in international arena, Islamic banks have to price their investments on Global standards like London Inter-bank Offered Rate (LIBOR) which are essentially interest-based. These issues are the current topics for debate among Islamic scholars, finance experts and those who campaign for Islamic Finance and Banking.

<sup>1</sup> <http://www.ftkmc.com/newsletter/Vol1-25-sep6-2010.pdf>

<sup>2</sup> [http://en.wikipedia.org/wiki/Major\\_religious\\_groups](http://en.wikipedia.org/wiki/Major_religious_groups) surf on the date 30<sup>th</sup> June at 11.53 am

<sup>3</sup> Hasan, K. (1999), "Islamic Banking in Theory and Practice: The Experience of Bangladesh", *Managerial Finance*, 25(9), 60-113.

<sup>4</sup> Ravindran, M, "Islamic Banking: Scope and Spread" FTKMS, Vol 1, No 25, September 6, 2010, FTKMS (Mumbai), India.

<sup>5</sup> <http://islamicbanking.blogsome.com/2009/12/08/space-and-scope-for-islamic-banking-in-india/>

"Living under constraints, the Islamic banks are mostly relying on the second set of rules; therefore, their activities could not bring a visible change even in the limited circle of their operations. However, if the whole financing system is based on the ideal Islamic principles, it will certainly bring a discernible impact on the economy".

All these bring out to the fore that the concept of Islamic banking should be dealt with as an absolutely different sector with separate norms to address the specific structure and contents of the financial instruments in Islamic banking.

In view of the above, if the banks in India are to be allowed to do Islamic banking, appropriate amendments are required in Banking Regulation Act, 1949 and separate rules and regulations may have to be framed to permit them to do the business in view of the special characteristics of financing they adopt.

Thus, in the current statutory and regulatory framework, it would not be feasible for banks in India to undertake Islamic banking activities in India or for branches of Indian banks abroad to undertake Islamic banking activities there." (Page No. 47, 48 & 48A).

## LITERATURE REVIEW

There have been an increasing numbers of empirical studies of Islamic banking. Khan (1983) initiated the work systematically to explore the dimension of Islamic banking. Islamic banks operating in Sudan, United Arab Emirates, Kuwait, Bahrain, Jordan, and Egypt were the part of his research where it was concluded that Islamic banks of these countries faced little difficulty in devising practices of Shari'ah. He broadly categorized two types of investment accounts: one where the depositor authorized the banks to invest the money in any project and the other where the depositor had a say in the choice of project to be financed. On the asset side, the banks under investigation had been resorting to mudaraba, musharaka and murabaha modes.

The study also revealed a strong preference for quick returns, which is understandable in view of the fact that these newly established institutions were anxious to report positive results even in the early years of operation.

Apart from these there are also some small case studies of Islamic banks operating in Bangladesh (Huq 1986), Malaysia (Halim 1988b), Pakistan (Khan 1986), and Sudan (Salama 1988b). These studies reveal interesting similarities and differences. The current accounts in all cases are operated on the principles of alwadhiah. Savings deposits, too, are accepted on the basis of alwadhiah, but 'gifts' to depositors are given entirely at the discretion of the Islamic banks on the minimum balance, so that the depositors also share in profits. These case studies also show that the profit-sharing ratios and the modes of payment vary from place to place and from time to time. Thus, for example, profits are provisionally declared on a monthly basis in Malaysia, on a quarterly basis in Egypt, on a half-yearly basis in Bangladesh and Pakistan, and on an annual basis in Sudan. A striking common feature of all these banks is that even their investment deposits are mostly short-term, reflecting the depositors' preference for assets in as liquid a form as possible. Even in Malaysia, where investment deposits have accounted for a much larger proportion of the total, the bulk of them were made for a period of less than two years. By contrast, in Sudan most of the deposits have consisted of current and savings deposits, apparently because of the ceiling imposed by the Sudanese monetary authorities on investment deposits which in turn was influenced by limited investment opportunities in the domestic economy.

Research conducted on Islamic banking to examine customer satisfaction & perception among Jordanian people was referred for this study. The analysis revealed a certain degree of satisfaction of many of the Islamic banks' facilities and products. The respondents expressed their dissatisfaction with some of the Islamic banks' services. Although the respondents indicated that they are aware of a number of specific Islamic financial products like Murabaha, Musharaka and Mudaraba, they show that they do not deal with them. This study indicates that it is important for Islamic banks to put cultural differences at the front when adopting SQ and suggests a new model to measure SQ called CARTER, which is based on 34 items.

A study found that religion did not play significant role to select an Islamic bank but profit motivated criteria was an important factor to choose a bank opening new branches is also not a significant factor. However, other major findings are that peer group influence plays an important role in selecting Islamic banks as depository institution. The study explored that the demographic factors such as religion & knowledge are playing a significant role to select a bank. Researchers found that customers do not have so much knowledge about the Islamic banking products such as Mudaraba, Musharaka, Murabaha etc., but they buy these products for the reason of religion. Study also revealed that bank's name and reputation also strongly effect on selecting a bank. In this study, they explored that reputation and image factor are evidenced as one of the important criteria in the banking selection decision.

## CONCEPTUAL FRAMEWORK OF THE STUDY

This study tries to identify the consumer perception about the Islamic banking among Gujarati Muslim community. Based on the discussion in literature review, it was identified that quality social and religious perspective and availability of services are the main factors affecting the investors' decisions. Therefore, based on these factors theoretical framework of this study has been developed

## REASON TO SELECT GUJARAT STATE

Gujarat economic growth rate is about 12% in the year 2009-10. In Gujarat, People mainly follow Hinduism and about 89.1% of the population is formed by the Hindus. Besides Hindus, Gujarat is also home to a considerable number of Muslims and Jains. Muslims constitute about 9.1% of the population, while Jains form nearly 1.0%. Sikhs are quite small in number and just constitute 0.1% of the population. This confirms the reason for cultural diversity of Gujarat.<sup>6</sup> The following table depicts the number of Muslims in different districts of Gujarat State.

POPULATION OF MUSLIM COMMUNITY IN GUJARAT STATE:<sup>7</sup>

No.	State wise Districts	Total Population	Muslim Population	Muslim%	Urban Population	Muslims in urban areas	Muslims %
1	Ahmadabad	5,816,519	662,799	11.40	4,663,533	606,628	13.01
2	Surat	4,995,174	447,951	8.97	2,995,817	349,915	11.68
3	Vadodara	3,641,802	317,194	8.71	1,646,222	195,411	11.87
4	Jamnagar	1,904,278	270,223	14.19	836,256	183,602	21.96
5	Rajkot	3,169,881	292,676	9.23	1,625,862	177,916	10.94
6	Junagadh	2,448,173	274,481	11.21	711,528	155,892	21.91
7	Bhavnagar	2,469,630	172,740	6.99	935,038	132,802	14.20
8	Anand *	1,856,872	199,263	10.73	507,971	96,575	19.01
9	Bharuch	1,370,656	293,459	21.41	352,560	90,536	25.68
10	Kachchh	1,583,225	329,254	20.80	474,892	87,217	18.37
11	Panch Mahals	2,025,277	120,676	5.96	253,362	86,838	34.27
12	Kheda	2,024,216	218,660	10.80	406,450	84,574	20.81
13	Sabar Kantha	2,082,531	117,806	5.66	225,129	53,237	23.65
14	Surendranagar	1,515,148	97,846	6.46	402,448	49,830	12.38
15	Amreli	1,393,918	83,077	5.96	312,958	47,483	15.17
16	Banas Kantha	2,504,244	170,142	6.79	275,501	45,053	16.35
17	Valsad	1,410,553	66,440	4.71	381,161	44,802	11.75
18	Dohad	1,636,433	52,632	3.22	156,323	42,016	26.88
	<b>Total Population</b>	<b>40,801,544</b>	<b>4,068,247</b>		<b>16,625,527</b>	<b>2,443,509</b>	

<sup>6</sup> www.bharatonline.com/gujarat/culture/religion.html

<sup>7</sup> Census of India Report 2001.



Amongst these districts, the following districts in Gujarat has the highest numbers of people from Muslim community.

Rank	Name of District	Total Population	Muslim Population	Muslim %	Urban Population	Urban Muslim Population	Urban Muslims %
I	Bharuch	1,370,656	293,459	21.41	352,560	90,536	25.68
II	Kachahh	1,583,225	329,254	20.80	474,892	87,217	18.37
III	Jamnagar	1,904,278	270,223	14.19	836,256	183,602	21.96
IV	<b>Ahmedabad</b>	<b>5,816,519</b>	<b>662,799</b>	<b>11.40</b>	<b>4,663,533</b>	<b>606,628</b>	<b>13.01</b>
V	Junagadh	2,448,173	274,481	11.21	711,528	155,892	21.91

Researchers decided to carry out their study in Ahmedabad district based on convenience and for adequate sampling.

## OBJECTIVES OF THE STUDY

- To examine the awareness level of Muslims residing in Gujarat related to religious values and principles of Shariah's.
- To examine strong religious values of Shariah's principles and its actual reflection on financial decisions made by Muslims

## UNIVERSE

The universe for sample survey is Ahmedabad district of Gujarat state.

## RESEARCH DESIGN

The study was an exploratory type. This design's main purpose is to know awareness level of the respondent relating to Shariah's and how to deal with it in routine life while taking financial decision.

## RESEARCH INSTRUMENT

Survey was done via structured questionnaire consisting of both open ended and close ended questions. A five point rating scale has been used at many places so as to get the ratings of satisfaction / dissatisfaction about a particular question.

## SAMPLING UNIT

A respondent residing in Ahmedabad district of Gujarat irrespective of age, economic status, Educational background etc.

## SAMPLE SIZE

Non probability convenient sampling method was used. Here a sample size of 100 respondents was interviewed.

## SECONDARY SOURCES

Researcher collected secondary information from the internet, magazines, articles etc

## DATA PREPARATION AND ANALYSIS

Data preparation includes editing, coding, transcription and verification. This had been done and data were feed with the help of SPSS software. Data analysis parts include deriving information related to the component of the marketing research problem and thus provide input to the financial managers in decision problem.

### PROFILE OF THE RESPONDENTS

#### A) AGE

AGE	Percentage
20-30 years	5.0
31-40 years	10.0
41-50 years	34.0
51-60 years	42.0
more than 60	9.0
Total	100.0

#### B) EDUCATIONAL QUALIFICATIONS

As the education level is lies between H.S.C and gradation, Muslims are inclined more towards business rather than occupying themselves in services. Along with that higher education is also missing among members of this community.

Educational Qualifications	Percentage
Upto SSC	16.0
HSC	37.0
Graduate	39.0
Post Graduate	8.0
Total	100.0

#### C) OCCUPATION

Occupation	Percentage
business	43.0
job/ service	37.0
profession	12.0
agr.	8.0
Total	100.0

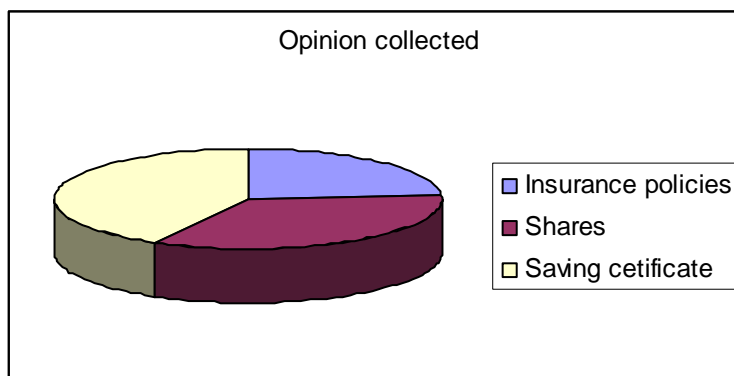
#### D) MONTHLY FAMILY INCOME

Monthly Income	Percentage
Rs. 5000	11.0
Rs. 5001- Rs.10000	47.0
Rs.10001- Rs15000	35.0
more than Rs. 15000	7.0
Total	100.0

## MAJOR FINDINGS AND INTERPRETATIONS

### 1) INVESTMENT OPTION USED BY MUSLIM COMMUNITY OF AHMEDABAD DISTRICT

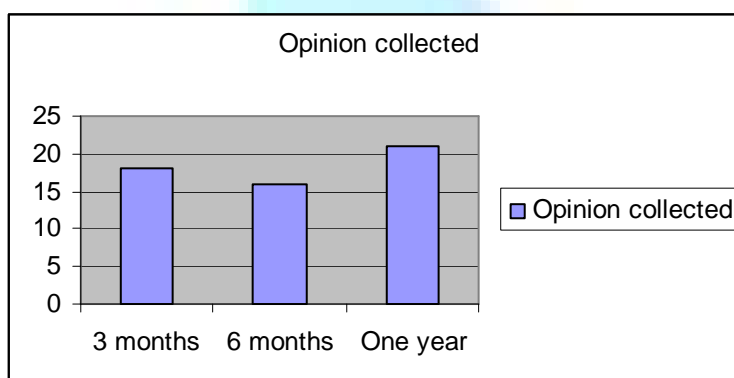
The respondents were not seen to strongly following the principles of Shari'ah while making investment.



The above figure indicates that Muslims invest their amount in the insurance policies, share market and National Savings Certificates.

### 2) FREQUENCY BETWEEN TWO MAJOR INVESTMENTS

Time duration	Frequency
3 months	18
6 months	16
One year	21



The above date indicates that the respondents invested on yearly basis. This is more of tax-saving investment inclined to insurance and mutual funds.

### 3) OPINIONS REGARDING INVESTMENT IN STOCK MARKET

Company's main business will be halal, if it does not indulge in any haram business, like financial dealing based on interest, gambling, liquor, pork / entertainment, media, casino and conventional and any other impermissible activity.

If a share of company bought at face value of Rs10 (for e.g.), a person can't sell this share in more than the par value unless the companies have some fixed assets like raw material, machinery, land. If a company has no fixed assets then buyer can sell only at its face value price and can't sell at above par value extra money will be pure interest.

Normally every company takes some interest bearing loan from banks or other institutions and some time when they have excess money they lend money on interest. In both cases there is a group of Islamic scholars who do not permit to buy or sell the stocks of such companies. Other Ulema and scholars of Sub Continent and also some other Islamic Scholars do permit it with following conditions.

The debt should not exceed 33% of total average of market cap of the company in full financial year. Dow Jones Islamic index which is decided by famous Islamic scholars follows the same principle.

So when we combine these conditions then the outcome is that Muslim can purchase the stocks of company whose debt is not more then 33% of Market Cap and for that he may take objection to make company free from debt.

Company's impure income should not exceed more then 10% of the total Gross Income. Its aggregate of account receivables should remain below 45% of total assets. That impure income which is less then 10% after checking balance sheet of company should make charity to poor Muslims without intention of (Sawab) reward.<sup>8</sup>

After checking the above discussed principles Muslim can buy and sell the selected stocks which we call as Shari'ah complaint stocks and above conditions are the best bench marks for every Muslim to follow the same.

Researcher objective was to find out how strongly did the muslim investors believed that it is against Islamic principles to invest in Stock market (Haram). Here, one-sample T-test was adopted to test the hypothesis.

**H0:** Respondents agreement ratings do not equally state that it is *Haram* to invest in Stock Market

**H1:** Respondents agreement rating equally state that it is *Haram* to invest in Stock Market

#### ONE-SAMPLE STATISTICS

	N	Mean	Std. Deviation	Std. Error Mean
stock	100	2.94	1.205	.120

The mean observed in this test is 2.94 while the standard deviation is 1.205.

<sup>8</sup> "Is Investment, (buying and selling shares) in stock market is Halal as per Sharia Principles?" available on < <http://www.islamicequity.co.in/Default.aspx?LeftId=8> > accessed on November 1,2010

**ONE-SAMPLE TEST**

Test Value = 4.85						
	t	df	Sig. (2-tailed)	Mean Difference	95% Confidence Interval of the Difference	
					Lower	Upper
stock	-15.857	99	.000	-1.910	-2.15	-1.67

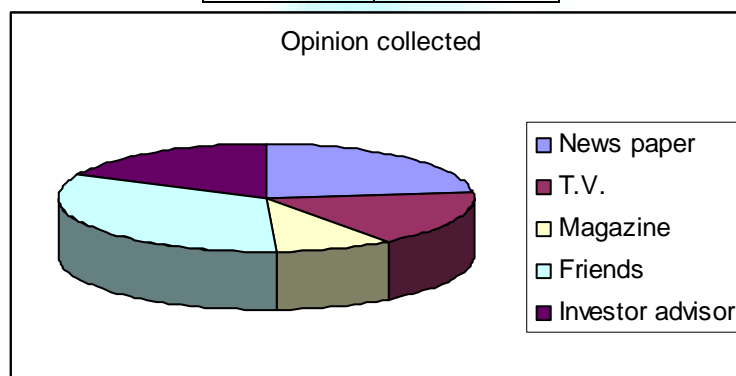
From the one sample t statistics the mean of the observed sample is 2.94 and the expected mean set by the researchers was 4.85. From the result the significance value is less than 0.5 which indicates that there is a significant difference between the test value and the observed mean. Also the confidence interval for the mean difference does not contain zero this also indicates that the difference is significant. Hence,  $H_0$  cannot be accepted.

Thought this signifies that Muslims are not in favour of stock market, many respondents agreed they still invested for better returns.

This means that thought they want to follow Islamic principles lack of availability of Islamic financial products, they still have to invest in non-Shari'ah investment options.

**4) FACTORS/ MEDIA AFFECTING INVESTMENT**

Factor affecting	Opinion collected
News paper	13
T.V.	9
Magazine	5
Friends	18
Investor advisor	10



In the above graph it shows that to invest in particular scheme people consider their friends opinion at the most along with their investor advisor suggestion. In this some people take independent decision by reading newspaper also.

General tendency of the people, to hold investment for more than a year. Very less people believe to hold their investment only for one year in their life.

Moreover, majority of the respondents opined that they believe in holding their investment for a long term (five years and more).

**OTHER FINDINGS**

1. Researcher found that almost all respondents were aware about Halal and Haram norms in investment.
2. Researcher wanted to know whether Muslim residing in Ahmedabad strictly follow Shari'ah in their day to day life. A majority of them stated that they try their best to follow these principles depending on the situations (82%)

**INVESTMENT IN ISLAMIC FINANCIAL PRODUCTS IF MADE AVAILABLE**

The respondents has shown their interest in Islamic financial products if they are made available to them

Investment decision	Percentage
Invest immediately	36
Think before investment	48
Will consult the company	16

**CONCLUDING REMARKS FROM THE STUDY**

The study reveals that the conventional financial products currently offered to Muslims in the India are incompatible with Islamic principles; hence, there is a recognized demand for other better options within this niche community.

While carrying out the survey in Ahmedabad district it was observed that Muslims are currently forced to opt out of the conventional financial system or compromise their beliefs. Muslims aspire to invest in accordance with Islamic principles but investment products and services in India are invariably incompatible with Shari'ah principles.

Of course Shari'ah compliant equities are available in India but there is no much awareness about such indices.

In India, Investment in equities through the various Stock Exchanges is still in its infancy stage among Muslims. Even though the Indian Muslims are aware of the investment opportunities in Equities through the Stock Exchanges, most of them prefer to stay away from it as they visualize that either it is risky and unsafe to invest in the Stock or they think it against Islam. Thus it a necessity to educate them about the Indian Equities Market.

Hence there is a great potential in India itself. Even if a small percentage of this population can be persuaded to invest in the equities, the amount of money that can be brought into the system could be enormous. The Securities Exchange Board of India (SEBI) is gearing up the Indian Capital Market towards Globalization through international standards and norms being implemented by it. Today the Indian Markets are comparable to any leading markets of the World.

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