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ISLAMIC BANKING - FINANCIAL INCLUSION THROUGH ISLAMIC MICRO FIANANCE- A CASE STUDY OF PRAYAGRAG (ALLAHABAD) DISTRICT

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ABSTRACT

Nearly 14.23 (census 2011) of India's population are Muslim. According to Sachar Committee Report Muslim are the most poor and vulnerable section in India's Society. Majority of India's Muslim population don't have bank account and not able to avail the financial service so basically majority of them are Financial Excluded. In this paper we discuss the alternate of conventional banking system i.e. Islamic banking. The basic principle of Islamic banking is based on risk sharing, which is a component of trade rather than risk-transfer which is seen in conventional banking. Islamic banking is found in most parts of the world. Islamic Banking has a huge market potential in India as India is the third largest Muslim populated country in the world. In case of India, Banking regulation Act 1949 needs to be suitably modified to introduce Islamic Banking. The Sachar Committee report highlighted that approximately 50% Muslims are financially excluded. The long held issue of financial inclusion can be taken care of by introducing Islamic Banking. Reserve Bank of India is looking at options to bring the much debated Islamic Banking in India. RBI has initiated correspondence with the center, seeking the possibility of Amending the Banking regulation Act or bringing in new rules to pave way for the establishment of Islamic Banking in the Country. We further discuss Islamic financial product. Islamic Micro Finance and the awareness about Islamic banking with a case study of Allahabad District.

Key Words: Islamic Banking, Islamic Finance, Islamic Micro Finance

INTRODUCTION

It is generally believe that there can be no banking system in Islam as interest is cogwheel of the modern banking, is strictly prohibited interest encourages savings and attracts idle money of the community into the banks without which banking system is inconceivable. The orthodox Islamic finance and its interest free economy leave no room for the establishment of the institutions of riba (interest or usury).

Those who oppose this view assert that Islam is an all embracing universal religion and has already to its credit Bait al-Maal (Treasury of Muslim State), system of banking can be had under the prototype of a state owned Central Bank, performing all its function with the exception only of note issue. A developed system of banking can be had, under Islamic law, in consonance with the spirit of Islam. The interest free economy practiced in the early days of Islam is neither capitalistic nor communist, yet it has good features of both. It can create a healthy society which blossomed in the past and in which there was no accumulation of wealth in a few hands, no hoarding and n profiteering. Based on the principle of 'neither do harm, nor to be harmed it worked well and guaranteed to the poor their sustenance. Every citizen was provided with the means of livelihood, peace and prosperity reigned supreme this was due to the fact that interest was eliminated from the society once for all.

Fundamental Principles of Islamic banking

- Absence of interest based (Riba) transactions.
- Introduction of an Islamic tax (Zakat).
- Sharing of profit and loss (*Mudarabah and Musharakah*)
- Prohibition of investing in unlawful businesses (not permitted by Shariah)

Origin of Islamic banking

Egypt is considered as the initiate the modern Islamic banking in the year 1963 by Ahmad Elnaggar, took the form of a saving bank based on profit-sharing. Islamic banking neither charity institutions nor religious organization, it work similar to the conventional interest based banking but with according to the Shariah law which prohibit acquiring of interest for lending or borrowing of money. The first private commercial Islamic bank was started in Dubai in the mid seventies followed by establishment of private commercial Islamic banking in Sudan and Kuwait in the late seventies. For the first time in the history, government of Pakistan and Iran had actively take part to establish Islamic banking in the Eighties. The Islamic banking had achieved the growth rate of 10 percent with the establishment of Auditing Organization for Islamic financial institutions in the nineties. To oversee the standardization of the Islamic banking, an Islamic financial services board had been established in the year 2002 had also contributed to the growth of Islamic financial institutions across the globe. Recently, large commercial banks take part to offer Islamic finance through an Islamic window has been growing steadily over the year.

Origin of Islamic Economic Thoughts

Islamic law provides the Islamic economic thought. The law is that integrate the regulations of Muslim life for all kind of aspects like economically, socially, and religiously. The law is known as Shariah law which is a code for life. Holy Quran and the Sunnah are the priority and supreme sources that were established during the prophet lifetime became bases for Shariah law which contains the Islamic economic principles and detailed economic teachings. Besides, Ijma and Qiyas are the other sources which also provide Islamic economic thoughts.

The Holy Quran

Scriptures of Islam contains in the Holy Quran. Islamic people believe that text of holy Quran is the word of god directly revealed to Prophet Muhammad. It composes of one hundred and forty four chapters, suras in Arabic, were delivered in a period of twenty three years of Muhammad's prophet hood. Main part of the Holy Quran dealing with the beliefs and moral conduct on secondary it deals with the provision of law with only about 500 verses out of 6342 verses. The Holy Quran can be divided into two major groups they are Mecca and Medina verses. The Mecca verses are short and brief, deals with faith and moral education whereas medina verses are long and very detailed deals with legislation (Nasir, 1990).

The Sunnah

The Sunnah of the Prophet is one of the most important sources of Islamic law provide detail and clarity of examples that has been generalized in the Holy Quran verses.

The Ijma

Ijma are regarded as the third significant sources of Islamic law. In short, Muslim scholars of present generation allowed to formulating independent judgment in a legal question based on the holy Quran and Hadith which is not given. Then decision made by the scholar based on the Holy Quran become source of law (Alauya, 1990). However, Ijma is considered only to secular matters not with ritual issues.

The Qiyas

It is the fourth source of Islamic law. Broadly, Qiyas is to make a decision based on judging or comparing something with some other things. Human reasoning knowledge is to applied in the certain things to find the good or bad in that because The holy Quran, Sunnah or Ijma does not mention the good or bad for each and every items. Qiyas allows an individual to apply reasonable thinking of legislation to make judgment which would affect the basic principles of Islam.

BASIC FINANCIAL TERMS/ PRODUCTS OF ISLAMIC BANKING

1) Prohibition of Riba

The Arabic term Riba is a synonym of interest which is used in conventional banking system. Islam considers money only as a medium of exchange and prohibits charging of any interest i.e. money earned out of lending money itself. Islam does not consider money as an asset which can be ethically used to earn a direct return. Interest can lead to exploitation and injustice in the society.

In Islamic Banking, though Riba is prohibited but equity based returns on investment are accepted. Lenders obtain ownership interest in the assets they finance or earn profit share or purely a fee-based remuneration. Lenders also participate in the profit sharing. Islamic banks follow the accounting standards prescribed by Accounting and Auditing organization for Islamic finance Institutions (AAOIFI).

2) Musharakah

It is profit and loss sharing arrangement or a participatory mode in Islamic Banking. It is a partnership or a joint venture in which all the parties involved contribute to finance a venture. Profits are shared by the parties based on a pre-agreed ratios while losses are shared on the basis of equity participation by the parties as Islam says one cannot lose what he did not contribute...Management of the venture can be either by all or by one partner.

3) Mudarabah

It is a contractual partnership for profit/loss sharing in which one person brings the capital (known as rabal-maal) and other the human skill needed to carry on the economic activity (known as mudarib). The profits will shared on pre-agreed ratio; however losses will be borne only by the financier and not by mudarib. The loss shall also be passed on to the depositors.

4) Murabah

It is a contract of sale between the Islamic banks and the clients. Under this contract the banks buy an asset on behalf of the client and then sell it to them for a price plus an agreed profit for the banks. It is also known as mark-up or cost plus pricing. Repayment by the client is made in the form of instalments. Murabah is most commonly financial operation used by the Islamic banks with which they earn their profits and are able to prohibit payments of interest according to Islamic Law.

5) Takaful

It is commonly referred to as Islamic Insurance. Takaful is based on the principle of cooperation and separation between operations of shareholders and the funds. Therefore, the ownership of takaful fund and operations are passed to the policyholders. The policyholders are joint investors with the takaful operator who acts as a manager for policyholders. All policyholders agree to guarantee each other and contribute to a pool of funds (takaful fund) instead of paying premiums. Any claims made would be met out of the fund and surpluses will be distributed among policyholders. Takaful operator would be paid a fee only for managing the fund and covering the costs.

6) Ijarah

It is a lease agreement between the Islamic bank and its client. The bank would buy an asset as per the client and allow the client to use the asset for a specified lease period and a lease fee. However, the ownership of the asset shall remain with the bank.

7) Qard Hasan

Islamic banks lend loans on the basis of goodwill. No interest or profit is charged on these loans. The borrower is required to pay only the amount she has borrowed. These loans do not charge the borrower the time value for the money and are consistent with the principle of prohibition of interest.

8) Halal activities

Banks prohibit investing in any sinful (haram) activities. It prohibits and abstains from business projects related to gambling, pork products, weapons, defense, alcohol, pornography and any speculative activities according to Shariah Law.

9) Sukuk

It is an Islamic equivalent bond. The investor of sukuk shall get a share of an asset along with the cash flows and the risk. As interest bearing bond structure is not permissible, the investor shall get a proportionate ownership in tangible asset of the project.

10) Wadiah

It is the acceptance of the sum of money for safe keeping which will be repaid. Bank is the keeper and trustee of funds and liable for safe keeping of funds and returning them on the demand of the customer. Banks at its discretion shall reward the customers (*hibah*) as an appreciation for keeping the funds with the banks.

11) Salam

It is equivalent to a forward sale contract in which the payment is made in advance and the goods are delivered at a specified date in the future. This mode of financing is often used in the agricultural sector in which banks advance the money for inputs without charging interest and in return shall get a part of produce which will be sold after its delivery.

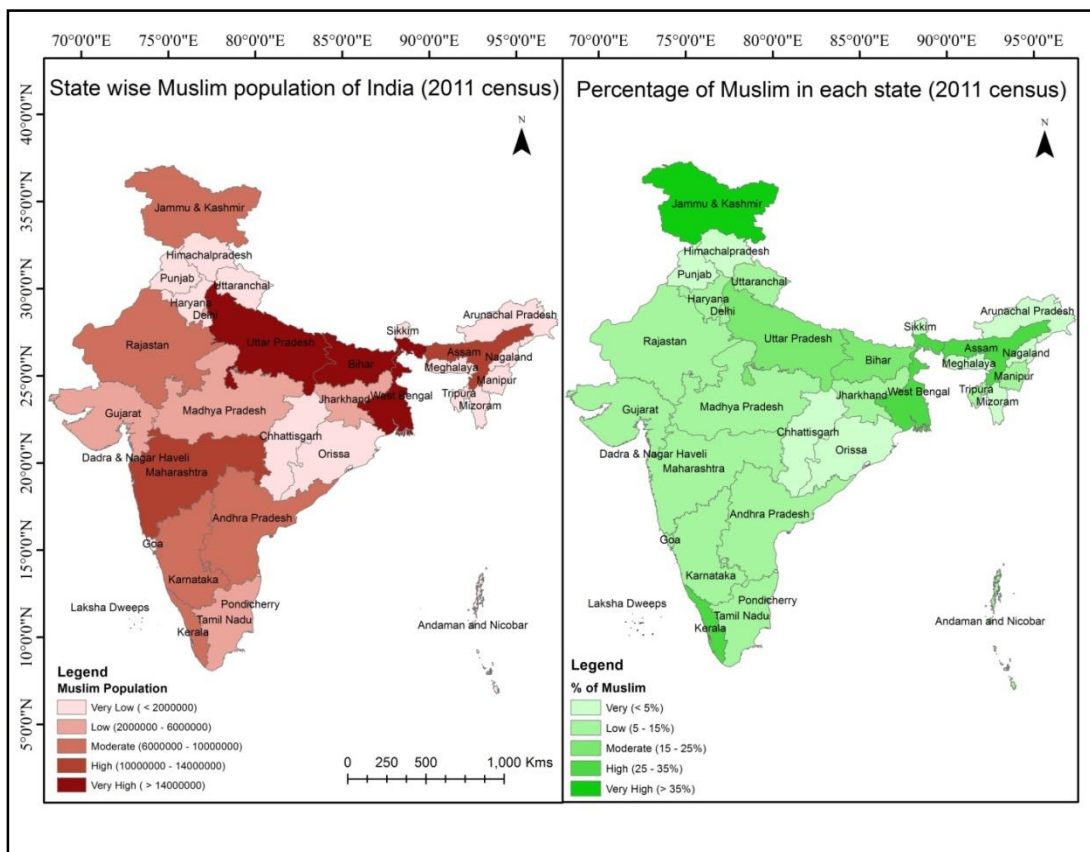
12) Waqf

It refers to a voluntary dedication of one's wealth and property for religious purposes. The waqf property can neither be sold nor inherited or donated to anyone but used for Shariah compliant projects.

Muslim population in India

India is the third largest Muslim population in the world after Indonesia and Pakistan with 14.2 percent of its total population as per 2011 census. Uttar Pradesh has high number of Muslim population with 38,519,225 followed by West Bengal, Bihar and Maharashtra.

Sikkim has low Muslim population followed by Dadar and Nagar haveli and Mizoram. In terms of percentage of Muslim population with total population Lakshadweep has high percentage of Muslim (96.2%) to the total population followed by Jammu and Kashmir (68.3%), Assam (34.2%), West Bengal (27%) and Kerala (26.6%). Uttar Pradesh has only 19.26% of the Muslim population when compared to the total population.



Source: Census 2011, Census of India

Figure 1.2 State wise Muslim population of India

Lowest percentage of Muslim population in the state of Mizoram (1.4%), Sikkim (1.6%) Punjab (1.9%) and Arunachal Pradesh (2.0%) shown in the Figure 1.2. Growth rate of Muslims have been decline steadily with their socio economic progress in the country acknowledged by growth rate come down from 36 percent during 1981-1991, to 29 percent during 1991 – 2001 and to 24 percent during 2001 – 2011. Literacy rate of Muslim in India is 57 percent according to 2011 census which is compared to the national average of 74 percent. Andaman and Nicobar Island has highest Muslim literacy rate of 81.44 percent followed by Lakshadweep (81.13%), Puducherry (80.16%) and Kerala (80.16%). Uttar Pradesh has Muslim literacy rate of 56.26 percent which is lower than the national average of 69.72 percent. Haryana state has very low Muslim literacy rate of 41.76 percent followed by Meghalaya (43.03%), Bihar (44.94%) and Nagaland (46.44%).

Socio-economic status

Muslims lag behind the majority in many socio-economic dimensions in India and Muslims have not benefited much from the different schemes of the Government. Muslims do not have adequate participation as beneficiaries in Government programmes. Muslim women also have less participation in Government Micro finance programmes like the self-help groups (SHGs). There is a need to focus on the inclusion and mainstreaming of Muslim Community in India. (Sachar Committee Recommendations 2005)

After 8 years of Sachar Committee report on the condition of Muslims, a post -Sachar evaluation committee headed by former JNU professor Amitabh Kundu concluded that poverty level among Muslims still remain higher and Government interventions have not been able to match the large number of marginalized Muslims in India.

- According to the findings of National Sample Survey Organization (NSSO), 46 % Muslims in urban areas are self-employed. Only 30.4% of Muslims are from salaried category which is lowest among others.
- Poor financial condition of Muslims was also reflected by NSSO as monthly per capita household expenditure was also lowest among the Muslims. Muslims ranked the bottom in terms of their spending and wealth.
- Several complaints about the exclusion of Muslim concentrated areas from activities of banks were reported to the Sachar Committee. Muslims were financially excluded and committee recommended enhanced access to Muslims in Priority sector advances.
- It was also reported that banking facilities were inversely correlated to proportion of Muslims in a village or locality. Therefore, banks should be provided incentives to open branches in Muslim concentrated sector. Also, the participation of Muslims in micro finance should increase.

ADVANTAGES OF ISLAMIC BANKING

An overview of Muslims in India reveals that though high population of Muslims in India, they are financially excluded and also socially and economically weak and backward. The Islamic community could benefit from the initiative of Islamic banking to a large extent. Moreover, Islamic banking is not just for Muslims alone but is available to non-Islamic community which can have a wider range of choices. Islamic banking can be an alternative to conventional Banking with different financial products but same goal of financial inclusion to be achieved. The various advantages of Islamic banking are-

1) Financial Inclusion

A renewed focus on financial inclusion has led to RBI and Government under Jan Dhan Yojna to bring the unbanked and financially excluded population under the formal banking system. However, for some Muslims, conventional banking system may be unacceptable as it is not in conformity with the Islamic law leaving them financially excluded. Islamic Banking could open new doors for the Muslims enabling the betterment of this community and achievement of the goal of financial inclusion for all.

2) Inclusive growth

The goal of Inclusive growth can be fostered with Islamic banking as easier and cheap credit can be provided to large number of people with little or no collateral which can help to penetrate the banking facilities to lowest strata.

3) Substantial flow of funds

Islamic banking will open avenues for flow of substantial funds in the market. It will help in mobilize large amounts of money from Muslims who participate very little or not at all in conventional banking system.

4) Investment funds from Gulf countries

Islamic banking will also help to channelize huge amount of Islamic investment funds from the Gulf countries that India is currently losing to other countries. It could help to foster dealings with Muslim dominated countries

5) Prohibition of Haraam activities

Islamic banking prohibits investment in activities which are considered 'haraam' under Islam such as gambling, alcohol, weapon, pornography etc and promotes investment in real economic activities that shall lead to social welfare on the whole.

6) Wider financial choices

Wide range of financial products will be available to people as new modes of financing are introduced under Islamic banking. An alternative system of banking could promote competition, innovation, and efficiency.

7) Niche market

Islamic banking is tailor made to meet the requirements of Muslim community which does not participate in conventional banking system due to their religious beliefs. As the demand for niche products is increasing in India, Islamic banking could prove to be beneficial for India.

OBJECTIVES

- To understand the basic features of Islamic Banking
- To understand the concept of Islamic Finance by understanding the various Islamic financial product.
- To know the availability of Islamic Micro Finance in Allahabad district.
- To understand people's perception towards Islamic Micro Finance

LITERATURE REVIEW

Robinson (1995) termed a "paradigm shift" from government and donor-funded subsidized credit to sustainable financial intermediation. A frequently cited example is that of Bank Rakyat Indonesia (BRI), a state owned rural bank in Indonesia, which moved away from providing subsidized credit and converted its micro-banking unit into a commercially sustainable unit offering credit and savings services. The underlying reasoning for this was that the large demand for institutionalized microcredit could not be met by subsidized funding. A sustainable model on the other hand could cater to more number of customers over a longer time period and could be replicated even in situations where there was no subsidized funding available. Within two years of commercial operations, the BRI unit broke even (Robinson, 1995). BRI developed its own unique individual lending model using voluntary savings mobilization as a source of funds and a transparent set of incentives for savers, borrowers and staff.

Morduch, (1999) describes group lending as microcredit's most "celebrated innovation". Group lending is credited with results of high repayment rates (upwards of 98 percent) on microcredit in spite of the loans being collateral free.

Aghion and Morduch, (2005) say that while economies of scale initially motivated Grameen Bank to make use of groups, the bank later realized that requesting borrowers to organize themselves into groups also had the advantage of reducing costs of screening, monitoring and enforcement. Often information on other borrowers can be obtained from group members. For first time users of financial services, the group also offers the comfort of companionship. Moreover, the use of the group model in the Bangladesh context, enabled promotion of social messages through repetition of verbal oaths (called sixteen decisions) regarding matters such as education of girl children and abstention from dowry practices. However, in 2002, the bank did away with joint liability when it introduced changes to its lending methodology called "Graameen II". The objective of Grameen II was to make the model more flexible, primarily to enable restructuring of loans of borrowers who found it hard to repay. After the 1998 flood in Bangladesh, Grameen Bank had provided additional loans to borrowers to rebuild their houses, which resulted in many of them having unsustainable levels of debt⁶¹. Even though the joint

liability mechanism was discontinued, Grameen Bank continued its regimen of group meetings. The group sizes vary from one MFI to the other. In the case of Grameen Bank, each group has five members, while in the case of BancoSol, it has three members. In the case of groups promoted by Foundation for International Community Assistance (FINCA), it has 15-30 members. The optimal size of groups in terms of number of members has been studied both through theoretical models and empirical studies.

According to **Mathews, Tlemsani and Siddiqui** (2004), the Islamic economic principles of sharing risks and rewards, as well as joint involvement in the wealth creation through equity financing by investors and entrepreneurs, have the potential to induce creativity and productivity in an economy. In addition, PLS contracts promote fairness and subsequently create value for each of the contracting parties involved. **Siddique(1968)** A pioneer attempt of providing a fairly detailed outline of Islamic banking was made in Urdu by Siddique in 1968. His Islamic banking model was based on Mudaraba and shirka (a partnership of musharakah as it is usually called). His model was essentially based on two tier mudaraba financier entrepreneur relationship. He classified the operations of an Islamic bank into three categories; services based on fees, commission or other fixed charges; financing on the basis of mudaraba and partnership and services provided free of charge. According to him interest free banks could be viable alternatives to interest based conventional banking.

RESEARCH PROCESS

An exploratory research has been conducted based on survey method. Descriptive and analytical methodology has been applied, for the primary and secondary data are collected and utilize for the study.

Data Sample Frame

The targets respondents for this study are the Muslim minorities at three division of Prayagraj (Allahabad). Initially 1050 questionnaire was distributed, out of which 935 responses were received. On scrutiny of the sample, incomplete and dual entry questionnaire were removed and for the analysis, 810 questionnaire were considered suitable for analysis and discussion.

ACCESSIBILITY OF FINANCIAL INSTITUTION

Regarding the number of Islamic microfinance institution in their locality, more 53 percent of the respondents said that there is one IMF in their locality, more than 45 percent of the respondents said they have more than one IMF in their locality shown in the Table 1. It inferred that respondents have accessibility of IMF in their locality.

Table 1 Number of Islamic microfinance institution

Number of Islamic microfinance institution	Frequency	Percent
None in my Area	6	0.7
One	433	53.5
More Than One	371	45.8
Total	810	100.0

More than 98 percent of the samples says that they are facing difficulties in getting loan from Islamic microfinance institution followed by 1.1 percent says there is no difficulty in getting loan from IMF shown in the Table 2. Even though the available of IMF in their locality there is difficult in getting loan from the IMF.

Table 2 Difficult of getting loan from IMF

Difficult of getting loan from Islamic micro finance Institution	Frequency	Percent
No	9	1.1
Yes	801	98.9
Total	810	100.0

Despite of getting loan from IMF is difficult more than 22 percent of the samples getting loan from IMF is once in six month, 9.8 percent of the respondents getting loan from IMF is once in a month, 55 percent of the respondents gets loan once in a year from IMF. 12 percent of the respondents said they getting loan more than a year from the IMF shown in the Table 3.

Table 3 Frequency of getting loan from IMF

Frequency of Getting loan	Frequency	Percent
Once in a month	79	9.8
Once In six Month	185	22.8
Once in a Year	448	55.3
More than a Year	98	12.1
Total	810	100.0

In this paper we find that the 53.3 percent of respondents finds the presence of IMF in their locality. More than 98 percent of the respondent finds it's difficult in getting loan from IMF and 55 percent of the respondents gets loan once in a year.

CONCLUSION

Developed countries such as Germany, UK, USA, France and Singapore have embraced in Islamic Banking. Major Multinational Banks including HSBC, Standard Chartered, Lloyds TSB bank, Citi Group offer products in accordance with Islamic banking principle. Islamic Banking is operational in more than 95 countries of the world. In this paper we have seen that there is lot of potential for Islamic Banking in India. Through Islamic banking we will reached our goal of financial inclusion easily.

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