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CONTENTS

- I CONTROLLING SOCIAL INTELLIGENCE: PARTIAL CORRELATION BETWEEN EMOTIONAL INTELLIGENCE OF ENTREPRENEURS AND SUSTAINABILITY OF VENTURES IN MANUFACTURING SECTOR . . .
By: Ms. Prachi Tiwari, Dr. Shefali Tiwari, Dr. Manisha Singhai 1-14
- II "EDUCATIONAL RESPONSE TO THE COVID-19 LOCKDOWN: EXPERIENCES AND CHALLENGES OF E-LEARNING IN INDIAN HIGHER EDUCATION"
By: Caroline Wahlang 15-30
- III ANALYSING THE STATUS OF WATER RESOURCES & THEIR CONSERVATION: KEY STRATEGIES FOR SUSTAINABLE DEVELOPMENT IN MAHOBA DISTRICT OF UTTAR PRADESH (INDIA)
By: Dr. Yadav D.S. 31-41
- IV INTEREST FREE BANKING IN INDIA: NEED, CHALLENGES AND ITS POSSIBILITIES
By: Mariya Bintah Siraj, Prof. Ehtesham Ahmad 42-48
- V A REVIEW ON MACHINE LEARNING BASED AUTOMATED BLOOD LEUKEMIA DETECTION
By: Harsh Paliwal, Dr. Jayesh Gangrade 49-63
- VI ENVIRONMENTAL JUSTICE AND NATIONAL GREEN TRIBUNAL: A HOPE TOWARDS SUSTAINABLE FUTURE
By: Aprajita Singh 64-76

INTEREST FREE BANKING IN INDIA: NEED, CHALLENGES AND ITS POSSIBILITIES*

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Abstract

The aim of this paper is to know the reasons of adaptation and hurdles of adaptation of Islamic banking in India. This paper describes the possibilities of Islamic banking in India by considering the fact that India is home to nearly 204 million Muslims, which is world's third largest Muslim population. With the help of available resources on internet and other resources the past literatures have been reviewed to know the trend and growth of Islamic banking all over the world but not in India. Islamic banking means a financial system which is based on the Islamic law (or sharia) and guided by Islamic ethics. The purpose of article is to portray a quick roundup of scenario of Islamic banking and highlights its potential and need in India and in the accompanied challenges.

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

Paper Type: Review Paper

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1. Introduction

There are 195 countries in the world and out of these countries more than 75 of them around 40% of the countries in the world have already adopted Islamic banking. Unquestionably there must be a reason that both developed and developing countries are practicing it. Thus, the question arises that India being the third largest Muslim populated country is still not adapting the interest free banking. India, the seventh largest country by area, second largest in population and the most populous democracy in the world. Moreover, it is popularly known for its unity in diversity, difference of culture, language, religion, beliefs, and occupation. Hence, in this democratic set up both Islamic banking and conventional banking system can co-exist wherein people can democratically decide which system they want to choose according to their requirement. Muslims can invest in harmony according to Islamic principles and rest may have a substitute of conventional banking which involves interest. Islamic banking is a banking system that run on the basis of doctrine of Islamic law (shariah) and governed by Islamic economics (Kamarulzaman & 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 tends to be an integral part of global mainstream in banking system (Gilani, 2015; Rammal and Zurbruegg, 2006). Most of Indian Muslims either invest in non-interest bearing investment or donate the interest as charity. There is an open opportunity for Islamic bank to attract fund that convention bank are not able to. Normally Indians practice participatory banking by establishing corporative bank, non-banking financial institute and micro credit facilities the same can facilitate to introduce Islamic banking.

Initiation of Islamic banking in India can possibly lead to the financial inclusion not just from different sections of society but it will also attract foreign investors mainly from gulf cooperative council countries which possibly are the great help in fulfilling the dream of becoming a financial hub. Islamic banking can also help India to solve insufficiency problem between labour and capital ratio, which can be a revolutionary step in the field of agriculture and other unorganised sectors. Islamic banking may also motivate entrepreneurship by providing finance in the basis of sharing of profit and loss (no interest).

Objective of the Study

- To explore the reason why most of developed and developing countries are interested in adapting Islamic banking.
- To explore the quality of life of Muslims.
- To explore the reason why Islamic banking is not yet adapted by India.

2. 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 improves income distribution in the country and tends 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). Captivating the example of Bahrain Islamic Bank (BIB), a 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 group they have been the satisfied customer for more than six years of Islamic banking and they continued (Saad A Metawa, Mohammed Almoosawi 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 Ahmad, and Tariqullah Khan 1998). A serious empirical study brought a conclusion that Islamic bank have shown fairly well progress in the period of 1990 to 98 when it was compared with the 'control group' of conventional bank (Munawar Iqbal 2001). Besides they have witnessed global crisis suffered in 1998 to 1999 but it recovered soon and performed really well after the downfall period and 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 revealed that if the Islamic bank is able to give the expected return so they continue to keep their money in Islamic bank. The result was 62.1 per cent of Muslims agreed and 66.5 per cent of non-Muslims disagreed. This research concluded that Muslims will support either it able to share sufficient profit or not (Philip Gerrard, J Barton Cunningham 1997). Islamic banks are 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 practice 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 amplified 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).

Research Methodology

The present study is a brief study extracted from the secondary data which is collected from previous research work, journals, government publication, research paper and data offered by media and internet.

3. Reason Why Countries Adapting Interest free Banking.

More than 75 countries in the world have already adapted Islamic banking. The rapid performance an average growth rate of 15% of assets Islamic banking and finance during last few decades gave opportunity to all growth and development sinkers to adapt. Many developed or developing countries have already adapted as an alternative system like Germany, UK, Europe, USA, France, Singapore, Jordan, Indonesia, Egypt, Bangladesh, Singapore, Bahrain, Pakistan, Nigeria, and Malaysia. Including HSBC Amanah, standard chartered saadiq, Lloyds TSB bank, citigroup and major international banks

offer facilities which came under Islamic banking principles. On the basis of slogan "NO FAVOR, BUT NO DISCRIMINATION" western nations like UK promote Islamic finance introduced by former prime minister who predicted that London will be a future gateway and his prediction turned to be true. Whenever other banks face closure the Islamic bank comes into picture as a reason behind its expansion.

- The assets of Islamic banking have increased at an average rate of 15% in last decade.
- The principles followed by Islamic banking are derived from holy Quran and 'Hadeeth' which have been narrated by Prophet Mohammad.
- Islamic bank closely monitors their investment and insures 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 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 gives due respect to public interest. Its primary aim is to ensure inclusive growth by providing capital socially desirable projects.

4. Economic Condition of Indian Muslims

Islam is the second largest religion in India with approx 14.2% of population about 204 million (2019) Muslims. India is a home to almost 10% of world Muslim population which is third largest in the world after Indonesia and Pakistan. Almost 47% of the population is found in three states Uttar Pradesh, West Bengal and Bihar. Considering their population major proportion dealing worse off standard of living than scheduled caste and scheduled tribes. Only 4.4% of Muslim population is enrolled in higher education and less than 5% held a government job and only 3.2% in countries security agencies. The quality of life is worst a prime reason behind social and economic degradation of this community. Muslims always noticed having low share in public (or any formal) like job, school, university place and seats in politics. As compared to other sections or group of society Muslims earn less and hardly take part in any sort of bank and other finance activity, spent very few years in school that results in lower literacy rate (nearly half of the population 46% cannot read and write). Muslims were traditional craftsmen in the course of globalisation and mechanization most of craft skills have been taken away and Muslim craftsmen left obsolete and lost their traditional livelihood. It is a collective failure as a nation even after 73 years of independence constitutional safeguard and several welfare measures are not able to empower minority.

Interest free banking in India for whom

- ✓ For all those people who are interested and searching for a financial system that is ethical.

- ✓ For the Muslims who practice Islam in all aspects of life including trade, commerce and investment.
- ✓ For all those entrepreneurs of developing countries that are search of fund for their small investment projects.
- ✓ For all those who does not find conventional financial system convenient. (Because it involves riba that is prohibited in Islam)

5. Reasons for Not Adapting Interest free Banking in India

- The establishment of Islamic bank in India will cost a change in legal reforms and need a new regulatory structure. Because banking regulation act 1949, RBI act 1934 and corporative societies act and negotiable instruments act 1961 may section of these are against the basic tenets of Islamic banking.
- Lack of awareness about basic concept and terms of Islamic banking.
- Cut thrown competition among conventional bank.
- The perception that Islamic banking is only for Muslims.
- The perception of keeping financial matters and religion are two different aspects.
- The interest on fixed deposits earned is subjected to TDS as per income tax act 1961, but the profit earned in Islamic banking needs a different treatment.
- Conventional banks can borrow money from other conventional bank or from RBI to meet its requirement but Islamic bank cannot because it involves interest.
- Oppose by some political groups.

6. Conclusion

It's high time that Indian government need to recognize significant opportunities of Islamic banking and finance to be adapted in India because it losing a chance of garnering capital from large section of society (Muslims population) as well as from other Islamic nations. The history of Islamic view is an ocean, which has produced many perceptions, interpretations, debates, theories and controversies. Islamic thought are very wide and able to solve the problems of Islamic societies. Islamic banking can increase India's economic growth and may work as a system to avoid the countries inflation and liquidity problems. Considering the population and economic condition of Indian Muslims, Islamic banking may prove a smart decision to overcome and solve economic crises and improve financial system by giving people of India an alternative banking solution. Apart from alternative banking system it can restore equilibrium in society by providing interest free solutions to debt-ridden farmers, labours and other marginalized groups.

7. Scope of Study

This article has certain limitation because it is based on secondary data that is extracted from previous research paper and internet source so it opens the way for future research. Firstly, not just Muslims economic condition but non-Muslims economic condition should also be considered. Secondly, future study can focus on better way of implementation of Islamic banking in India as this paper recognise the need and demand of Islamic banking in India the future research may focus on the supply side. Thirdly, the research on Islamic banking in India should be practical not just based on previous paper

but some practical survey by using random sample method to the real need in India. Islamic banking is one of the most studied topics yet it has so much to reveal and explore as it is still an alien topic.

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