

# Islamic banking- A Conceptual Understanding

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**Abstract:** Compared to the Conventional Banking, in terms of size Islamic Banking is a small organization. But their rapid growth in the global banking industry is at a very rapid pace in the last few decades. This paper tries to explore Islamic Banking also known as Islamic finance or Shariah-compliant finance. Early investigations center around the productivity, creation innovation and general execution attributes of Islamic banks contrasted with regular banks, while later work inspects benefit sharing and misfortune conduct, rivalry, hazard. also, various aspects, for example, independent company loaning and monetary consideration. Beside the fundamental exemptions, the observational writing does not propose huge contrasts among Islamic and traditional banks as far as productivity, rivalry, and hazard qualities (albeit little Islamic banks are safer than their customary partners).

**Keywords:** Islamic Banking, Conventional Banking, Shariah Laws.

## I. INTRODUCTION

Two basic and very important aspects of Islamic banking are the distribution of profit and loss, and the exclusion of the collection and payment of interest by money lenders and investors. Islamic banks make a profit through equity participation, which requires a borrower to give the bank a share in their profits rather than paying interest. Many conventional banks have the facility that provides Islamic banking services to their customers.

There are about 520 banks and 1700 mutual funds all over the world that follow Islamic finance according to Muslim Shariah. Between 2012 and 2019, Islamic financial assets increased from \$1.7 trillion to \$2.8 trillion and are expected to grow by \$3.7 trillion by 2024, as per the report furnished by the Islamic Corporation for the Development of Private Sector (ICD) during 2020. This growth is the result of rising economies of Muslim countries.

All countries that fall under the Gulf Corporative council (GCC) which are Saudi Arabia, United Arab Emirates, Sultanate of Oman, Qatar, Kuwait, and Bahrain. Apart from these, countries like Egypt, Jordan, Sudan, Algeria, Tunisia, Syria, and Yemen also follow the same.

The financial framework is the life saver of any advanced economy which helps in the monetary intermediation by activating stores and dispensing of credit. Banking from a innovative perspective is the most common way of tolerating, to loan or venture, of stores of cash from general society, repayable on request or in any case and withdrawable with a money order, draft, request or in any case.

The chief capacity of a Bank is to bring into a typical asset or pool of inactive cash of the overall population, to make advances to other people, to acquire a return as revenue, charge, and profits in making progresses and offering types of assistance to other people. Premium being the cogwheel of the innovative banking, is totally restricted in Islam and thus there can be no financial framework in Islam as Interest. An Islamic bank is a monetary organization which distinguishes itself with the soul of Shariah, as set somewhere around the Holy Qur'an and Sunnah, as respects its goals, standards, practices, and tasks.

## II. RESEARCH METHODOLOGY

This study intends to use secondary sources of data collection, various published sources like articles, books and reports were referred to thoroughly understand the concept of Islamic Banking. This study is a literature and theoretical analysis of previous studies to build up a broad structure for Islamic banking.

The study collected quality data from published articles that majorly concentrated upon the topic and have explained in detail various factors affecting it.

### Background of the Study:

The primary objective of building up Islamic bank all around the world is to advance, encourage and foster the utilization of Islamic standards, law, and custom to the exchange of monetary, banking and related business issues and to advance venture organizations, endeavors and concerns which will themselves be occupied with business

as are satisfactory and steady with Islamic standards, law and customs

The purposes of Islamic finance to put it in points are as follows.

- 1) Religious Objectives, such as collecting and distributing Zakat
- 2) Social Objectives, such as promoting Islamic finance, social aims, such as poverty alleviation and the elimination of social inequities
- 3) Economic Objectives, such as promoting Islamic finance. Economic goals, such as profit maximization and brand promotion projects that are environmentally friendly, save operating costs, and improve product and service quality providing high-quality customer service and competitive financial products

### History

From the most punctual stages in Islamic history, Muslims had the option to build up a framework without interest for activating assets to fund useful exercises and shopper needs. The framework worked successfully during the prime of Islamic human advancement and for a long time from that point. As indicated by Goitein (1971) association and benefit and misfortune (PLS) sharing and non-interest based acquiring and loaning framed the premise of trade and industry in twelfth and thirteenth hundreds of years in the Mediterranean area. Nonetheless, the Protestant Reformation in the Western world gave an impulse to scholarly development (Hillebrand, 2009). This ultimately prompted the adjustment of the focal point of monetary gravity toward the West and Western monetary organizations (particularly banks) became predominant and the Islamic custom stayed torpid.

During the most recent 50 years or thereabouts, in any case, there has been a recovery of interest in fostering an advanced rendition of the notable Islamic monetary framework directly following Muslims' longing to avoid interest and practice monetary exchanges predictable with Shariá standards.

At the point when business banking arose after the modern upset, Muslim researchers communicated reservations with the Western model of monetary intermediation because of its dependence on premium and they required the advancement of elective instruments to play out a monetary intermediation work in Muslim social orders (Iqbal and Molyneux, 2005, Molyneux and Iqbal, 2005).

While credit social orders and cooperatives dealing with a premium free premise existed in a few Muslim nations in any event, during the pilgrim time frame, the similarity to banking establishments began arising in the mid-1960s. A spearheading investigation of trying Islamic standards administering monetary dealings was directed in Mit-Ghamr, Egypt, from 1963-1967. Displayed on the German

saving banks (Sparkassen), the Mit-Gamar drive assembled little reserve funds from the country area through investment accounts. No premium was paid to account holders. In any case, as a motivator they were qualified for little momentary sans interest advances for useful purposes. Account holders were permitted to pull out their stores on request. Likewise, venture accounts based on benefit and misfortune sharing were 4 additionally presented. The assets so assembled were contributed based on PLS with businesspeople.

Drives for the foundation of some of framework organizations supporting the Islamic monetary industry likewise began during the 1990s. At the outset, Islamic financial establishments needed to work inside the institutional system that upheld customary banking and they were at to some degree a relative detriment because the institutional structure was not explicitly outfitted to Islamic requirements. While still in its earliest stages, a start was made towards building an organization of supporting establishments for the Islamic monetary industry.

These days Islamic banking and money shows itself in five ways:

- a) Banks and monetary establishments work in nations where the advancement of an Islamic monetary framework gets dynamic government support.
- b) Islamic banks and monetary organizations work in the private corporate area contending with traditional (Western) establishments.
- c) Islamic banking is drilled by ordinary business banks (through Islamic windows), customary Islamic banks just as non-bank monetary establishments;
4. Global monetary foundations (like the Islamic Development Bank in Jeddah) work on Shariá standards.
- d) Islamic capital market instruments (common assets, Sukuk), and protection (Takaful) are turning out to be more significant, for example, Sukuk issuance mostly supported London's Olympic Village and 'Shard' building.

### III. DISCUSSIONS

#### Banking Concept of Islam

Islamic Society in its genuine sense is a relationship with the end goal of agreeable conjunction. The activities of people in the Islamic culture should execute the code of virtues and direct. Islamic culture is in this manner, considering nobility and shared assistance. "Help ye each other unto honesty and devotion, however, help ye not each other unto sin and offense" is the call of Qur'an.

The main principals and basic rules of Islamic banking and finance are as follows: -

- Transactions in Islamic Banks are administered according to the rules given in the Holy Quran and by the prophetic practice, which is Islamic Shari'a and statute,
- Any types of interest either paid or gathered is restricted (Haram)
- Any interest in initiates like liquor, pork, weapon, Immoral Business, against the fundamentals of Islam is disallowed
- Any transactions that incorporate misrepresentation or betting is precluded
- Sharing loss, profit, and risk as per the agreements of the partner
- A trader should own and process the items to be sold

Since things have changed because of dumbfounding improvement of science and innovation, the Muslims are faced today with the contemporary issues because of the incredible upheaval of science and innovation and hence the monetary standards have taken another heading and requests discount measures to battle these obstacles.

Notwithstanding, in developing a procedure for banking we need to think about all the material realities like the need of credit and so forth, and the way that the Muslims need to manage the non-Muslims inside their own nation and outside. There are five governing principals that are followed by the Islamic banks

1) The absence of interest based (Riba) transactions, 2) The avoidance of economic activities involving oppression (Dhulm), 3) The avoidance of economic activities involving speculation (Gharar), 4) The avoidance of speculative activities (Qimar), 5) The discouragement of the production of goods and services which contradicts the injunctions of Islam (Haram).

The fundamental contrast among ordinary and Islamic banking is that the last option adheres to Shari'a law. For instance, rather than gathering revenue against business movement, Islamic banks give subsidizing fitting through Shari'a-agreeable instruments like Murabaha, Ijara (renting), Musharaka and Istisna. Islamic banks are cash making monetary mediators similar as regular banks, yet to meet the prerequisites of Shari'ah they should cling to four significant standards. A denial on charging riba (premium) is the essential distinction between Islamic banks and ordinary banks, gotten from the thought that charging revenue is a type of abuse and innately conflicting with Islamic upsides of decency; the exacting interpretation of riba is "overabundance.

Islamic banks are likewise denied from theory, as dangerous or unsure undertakings, and from financing haram (criminal operations, for example, organizations associated with the development of cocktails or pork. At

last, Islamic banks are constrained to give a piece of their benefits to help society as zakat, one of the five mainstays of Islam

#### IV. FINDINGS AND DISCUSSIONS

- Justice and Fairness: - The establishment of the Islamic Banking model depends on a benefit sharing rule, by which the danger is shared by the bank and the client. This arrangement of monetary intermediation adds to a more evenhanded conveyance of pay and abundance.
- Banking for All: - Albeit considering Shari'a standards, Islamic Banking isn't confined to Muslims simply and is accessible to non-Muslims also.
- Transparency: - Islamic Banking is tied in with directing business in a reasonable and straightforward way. Directing you through to guarantee full comprehension of dangers and expenses related with the items and administrations is the greatest amount of privilege
- Ethical Dimensions: - The solid moral and moral elements of carrying on with work and choosing business exercises to be financed assume a significant part in advancing socially advantageous speculations and better individual or corporate conduct.
- Discouraging Speculation: - Speculative exchanges are wellsprings of insecurity and naturally is misallocation of capital. Islamic Banks are denied from doing such exercises, rather centering in organization of funding to the genuine economy, to advance financial equity

Islamic banks are lucrative monetary delegates similar as regular banks, however, to meet the prerequisites of Shari'ah they should stick to four significant standards. The Islamic Development Bank, one of the soonest effective Islamic banks and today one of the biggest on the planet, was set up in Jeddah in 1975 and Malaysia additionally arose as an early adopter and trailblazer in the business.

Today just Iran professes to keep a completely Shariah-consistent economy and banking framework. Saudi Arabia, United Arab Emirates, Sultanate of Oman, Kuwait, and Bahrain gloat the main Islamic financial areas on the planet

The exchanges of Islamic business banks are ordinarily ensured by "shariah-consistence sheets" of strict researchers, utilized by the actual banks, or on account of Iran by rules that have been set up by the country's Central Bank. (Regardless of these endeavors, Islamic banks have been scrutinized as being just cosmetically not quite the same as ordinary banks and not genuinely in the soul of Islamic law)

The various modes of financing of the Interest-free Banking are briefly discussed as below: -

- Mudaraba:- The fundamental idea on which prior Islamic Banking capacities depended and prospered was Mudharaba. Mudharaba, as indicated by legal advisers, is a common agreement by which one gives his property to one more to carry on business therewith and the benefit to be divided among them as per the specked terms like one-half, 33% or thereabouts. In Mudharaba, the whole misfortune is constantly ascribed to and deductible from the capital Mudharib and subsequently specialist doesn't have anything to free except for his work
- Murabaha: - Murabaha in previous Islamic undertones alluded to a particular style of straightforward deal and had no significance in the slightest degree with an exchange of funding. Taking into consideration the troubles and dangers pictured in seizing Mudharaba and PLS arrangement of Islamic. Relying upon an enormous scope, as of late, the Murabaha, for all affordable objects was modified from the deal exchange to a technique of financing.
- Riba:- The word Riba in a real sense signifies 'increment' or 'overabundance'. As an overabundance over the chief is Riba, it covers usury and interest both. Hence, it can't be fought that Riba applies to usury or loaning of cash at an excessive rate which is coldblooded, while premium at a low rate is permitted, nor can there be any qualification between the premium for useful purposes and the premium for non-useful purposes. Restriction of Riba is the basic administering guideline of Islamic Financing and this is completely expressed in the Qur'an.
- Ijara:- The Ijara contract isn't an offer of the item, yet rather an offer of the usufruct (the option to utilize the article) for a predefined timeframe. The utilization of usufruct is passable in Islam, as proven by the different sections and Hadith.

### (Negative Factors) Derogatory Factors

#### A crucial Aspect of Business

These fall into two classes: benefit and misfortune sharing (PLS) financing, or non-benefit and misfortune sharing (non-PLS) financing. This first kind of financing, addressed by the mudaraba and musharaka structures, requires either an organization or direct value partaking in an undertaking by all gatherings

PLS financing is viewed as ideal by Islamic lawful researchers and is in a general sense not the same as regular obligation-based financing models. Non-PLS agreements ought to be established on really central assets, yet needn't bother with advantages and incidents to be divided between accomplices.

The main liabilities on an ordinary business bank's asset report are normally client stores, long term obligation, and credits from other monetary foundations. (Since the Islamic

interbank market is generally lacking and Islamic banks are precluded from giving customary premium bearing obligation protections like securities and business paper, the present Islamic banks structure their asset reports fairly in an unexpected way).

Islamic Banking or Interest-Free Banking isn't some outsider idea, it is very well practicable and intelligent as to be acknowledged as an option in contrast to the Conventional Interest based means of banking. It notwithstanding, needs a genuine idea from every one of the corners to incorporate it; Willingness on piece of Consumers, Intensive Efforts by Banks and appropriate and positive standards (and legalities) by the controllers.

Numerous Islamic organizations are situated in the Gulf Cooperation Council (GCC) nations, and as their economies are chiefly determined by energy costs, it would be intriguing to explore how much such factors impact bank execution and hazard? More extensive inquiries should zero in on connecting monetary and social incorporation in the Islamic world and perceive how this is identified with ideas of neediness, uniformity, and financial turn of events.

### V. CONCLUSION

From the following research paper, we have understood that Islamic banks are established to increase the Islamic standards, customs, laws and to advance venture organizations with Islamic financial standards. It has been growing at a very rapid pace in the last few decades because of the rising economics in the Muslim countries, therefore it's important to study about it. It is followed according to the Muslim Shariah principles. It is followed by all the countries that falls under Gulf Corporative Council (GCC). The main objective of this financial model is to promote Islamic finance. A key finding from this line of research is that Islamic banks are essentially equally capable and (particularly for humble banks) have less default/leverage risk than conventional banks. Islamic banks tend to focus on independent borrowers from higher quality companies with a lower probability of default. Also we have understood that the future of Islamic banking looks brighter than that of traditional banks. We can see that Islamic banks have not suffered as much from the global financial crisis as traditional banks. One of the main selling points of Islamic banks, at least in theory, is that unlike traditional banks, they focus on project feasibility and business profitability rather than collateral size. Outstanding projects that may be rejected by traditional banks due to lack of collateral are funded by Islamic banks on a profit-sharing basis. In this very sense, Islamic banks can play a catalytic role in stimulating economic development. Of course, in many developing countries, development banks are supposed to take on this function. Islamic banks are expected to be more proactive than traditional banks. But in practice, Islamic banks focus on short-term trade finance with the lowest risk.

This could become an argument for more Islamic banks in some countries as it forces banks to become more innovative and competitive. Another solution is to allow traditional banks to provide equity financing or to operate Islamic 'windows' or 'windows'. The argument that we need specialized Islamic financial institutions such as Mudaraba Bank, Murabaha Bank and Musharaka Bank competing with each other to provide the best possible service is perhaps not too outrageous.

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