

# CRISIL YOUNG THOUGHT LEADER 2008

A Dissertation on

## ISLAMIC BANKING IN INDIA: STATUS, PROSPECTS AND RECOMMENDATIONS

*Submitted on: 25 October, 2008*

By,

G. Pavithra,

MBA, 2<sup>nd</sup> Year,

VGSOM, IIT Kharagpur,

West Bengal

Email: [gpavithra.86@gmail.com](mailto:gpavithra.86@gmail.com)



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## **EXECUTIVE SUMMARY**

This paper examines the Islamic Banking sector on a global and domestic level, in comparison to the performance of conventional banks. With India still in the front line for foreign placements and the Muslim dominated Middle Eastern countries sitting on excess funds looking for suitable investment opportunities, the time is precise to understand this emerging mode of banking and analyze its prospects in India. However, current regulations prevent these entities from setting up base here. The author, after research on existing and past models and present regulatory and market scenario, has suggested a structured introduction of Islamic banking and further seamless integration into mainstream banking in India.

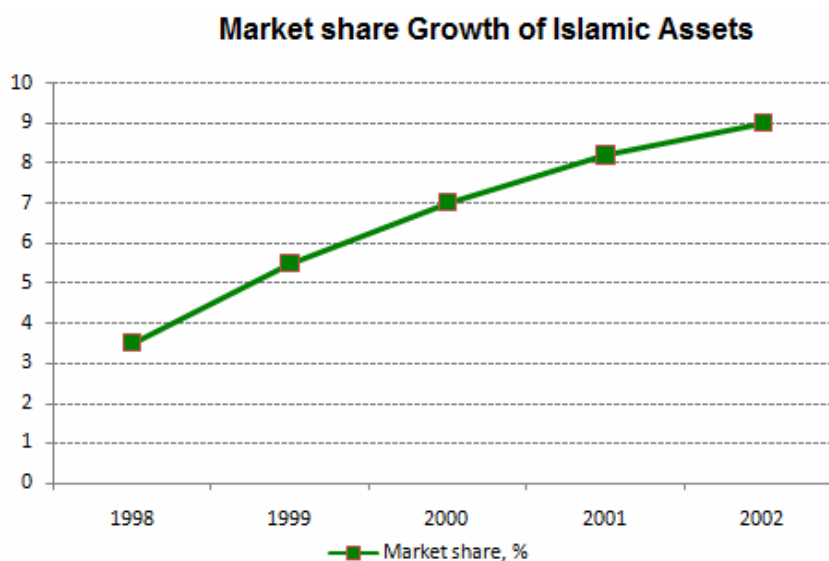
## INTRODUCTION - AN OVERVIEW

A well-developed banking system is a pre-requisite for the smooth and effective functioning of an economy, whilst efficient allocation of the country's assets. The basic task any banking entity is to mobilize savings from the investors' community and channel these savings to high-yielding projects. The fundamental operations of most banks in the world are based on interest charged on loans and interest paid on deposits.

Islamic banking is the age-old mode of banking, based on Islam's Shariah principles, according to which interest (Ribah) in any form is unlawful and the borrower must not bear all the risk/cost of a failure, resulting in a balanced distribution of income and not allowing lender to monopolize the economy. Hence, Islamic banking operates without charging or paying interest. The depositor and bank come to an agreement wherein both parties share the profit or losses at the end of the year. The bank invests in projects after rigorous analysis. The shareholders of the bank would absorb any losses.

Islamic banks have been evolving over the years, coming up with innovative financing and investment products without the involvement of Ribah. They usually engage in profit-and-loss sharing (PLS) with clients, according to Sharia (A glossary of different products offered is mentioned in the Appendix).

What initially started off in the 1970s in the unorganized sector in the Middle East to provide credit for Muslims who could not participate in conventional banking due to religious inhibitions, slowly attracted attention and grew to become a global banking option today. Islamic banking has turned a major alternative mode of banking even in non-Muslim countries, reiterating its global recognition.



Source: S&P Islamic Finance Outlook, 2006 \*Only in Malaysia

## GLOBAL ISLAMIC BANKING INDUSTRY

The global Islamic finance industry (dominated by Islamic banks) comprises of around 250 Islamic finance institutions (IFIs) in 75 countries with assets of over USD800 billion under management. The industry has been reporting a CAGR of 10-15% over the past decade and the trend is expected to continue, with assets growing to over USD1 trillion by 2010, which would account for over half of the savings of the then global Muslim population. This is exclusive of around 250 mutual funds investing funds in adherence to Shariah principles.

**Table 1: Global Islamic Finance - Asset Base**

Segment	billion USD
Islamic Banks (assets)	250
Islamic Banking Windows (assets)	200
Other NBFCs	4
Sukuks	18
Mutual funds	11
Stocks (M-cap)	300
Takaful (Gross Written Premium)	5
Malaysian domestic bonds	17

*Source: HSBC Amanah*

Islamic banks, though were initially concentrated around the Middle East, South East Asia (dominated by Malaysia) and North Africa (MENASEA) regions, have recently started gaining recognition and popularity in the UK, USA, Germany and many other non-Muslim nations. Pakistan (Assets in 2006: USD3 billion), Iran (Assets in 2006: USD 35 billion) and Sudan are the only non-Muslim countries that have adopted this mode of banking on a nation-wide basis. The preferences of religion and creed often associated with Islamic banking are seen to be shed, with non-Muslims forming over 40% and 10-20% of the customer base in Malaysia and the UK, respectively.

Latest available data suggests over 36% of the global IFIs were outside the MENASEA regions and held over 27% of the total asset base. This figure however, is estimated to have grown largely following the recently spurred interest in Shariah based banking modes in Europe and the USA.

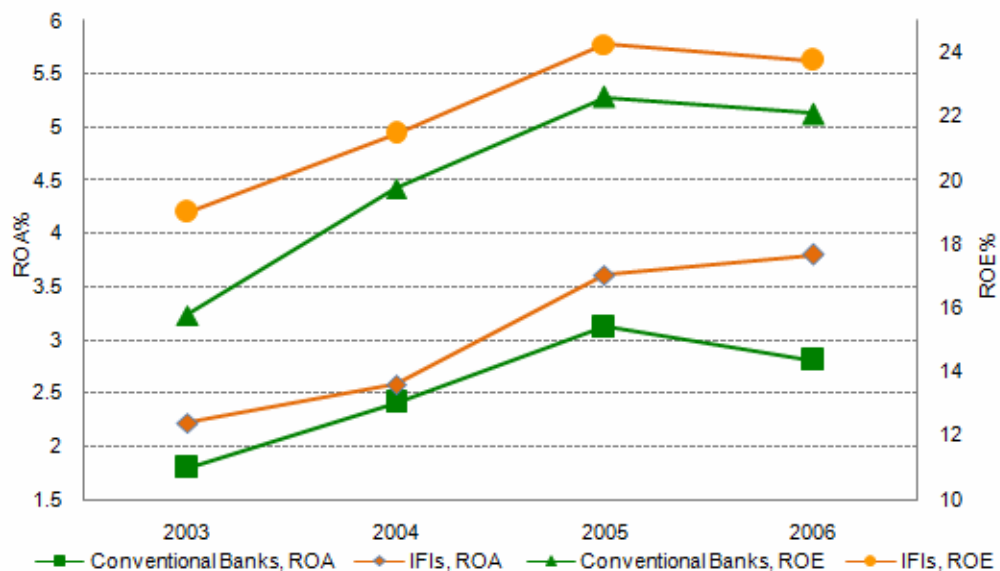
**Table 2: Global Islamic Banks**

Region	% of Total Number of IFIs	% of Total Assets	% of Total Deposits	% of Total Net Profits
South Asia	29	26	23	20
Europe and US	5	1	1	5
Central Asia	1	0	0	0
Australia	0	0	0	0
Africa	20	1	1	2
South East Asia	18	2	2	4
Middle East*	15	56	61	20
GCC countries	12	14	12	49

Source: Directory of international Islamic banks and Financial Institutions, 1997  
 \* Exclusive of GCC Countries

In comparison with conventional banking systems, Islamic banks' assets and deposits have grown at CAGR of 20-22% while those of conventional banks have grown at a rate of 11% for the period 2002-2003. For the same period, the two modes of banks have returned an average of 19% and 16% respectively on equity. Statistics suggest that IFIs have consistently shown higher profitability (in terms of ROE and ROA %) than conventional institutions.

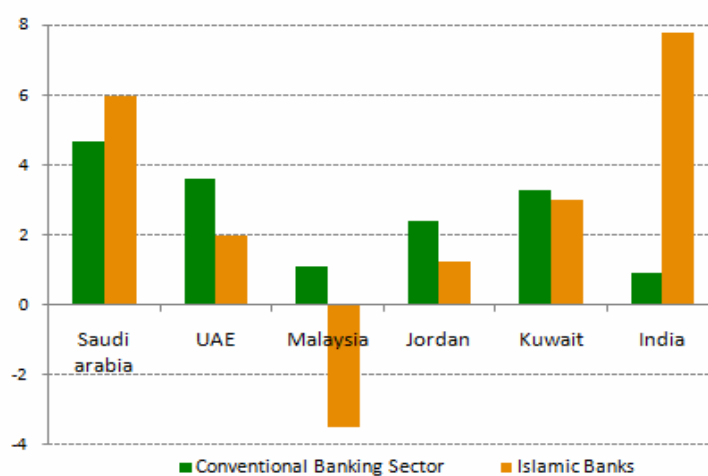
**Chart 1: Profitability of Islamic Banks (vs) Conventional Banks**



Source: Islamic Finance Overview - Grail Research, Institute of Banking studies  
 \* Data available only for GCC and Malaysia

However admittedly, the profitability of Shariah compliant dedicated Islamic banks, in terms of return on assets (ROA) is lower than that of their counterparts in the conventional banking sector (Average ROA of conventional banks against a representative Islamic bank). This can be attributed to lack of high margin innovative financing products in this nascent sector. The scene looks brighter in India however, considering the average ROA of scheduled commercial banks (SCBs) against that of Sheyad Shariat, a NBFC practising Islamic banking in India. (2005 for others, 2008 for India, RBI, banks annual reports)

**Chart 2: Country-wise Profitability of Islamic banks, ROA%**



Besides geographical reach, over the years, the complexities of the products offered by the Islamic banks have widened to attract a larger and more value-seeking customer base. What started with simple commercial banking in the early 1970s has grown adding more products to its kitty and currently offers a broad range of innovative products including commercial banking, *sukuks*, *ijara*, *tawarruq*, *murabaha*, *mudarabah*, *musharaka*, *takaful* and Sharia based mutual funds.

## WHY INDIA

The time could have never been more relevant to discuss the battle against the liquidity crunch that has lately been rocking the financial world. Banks have been reporting lack of liquidity in their systems leading to India Inc.'s inhibited access to credit and thus retarding growth and investments. The Reserve Bank of India (RBI) has exhibited a biased dependence on interest rate structures and reserve ratios to tackle the crisis, in the short term. Further, the shaken economies of the West have become largely stringent in their overseas investments and have been pulling out money from the Indian system to finance their domestic needs. The central bank's efforts to ease interest rates to enhance

liquidity in association with the country's large dependence on funds from the West (Europe and the US) which are dwindling lately, is leading to depreciation of the rupee and inflation, thus entangling the economy in a vicious circle. An effort to pause and take notice of an age old yet, ironically nascent mode of banking based on Shariah principles of Islam evidently holds potential to relieve the Indian financial sector, at least partially, of its troubles.

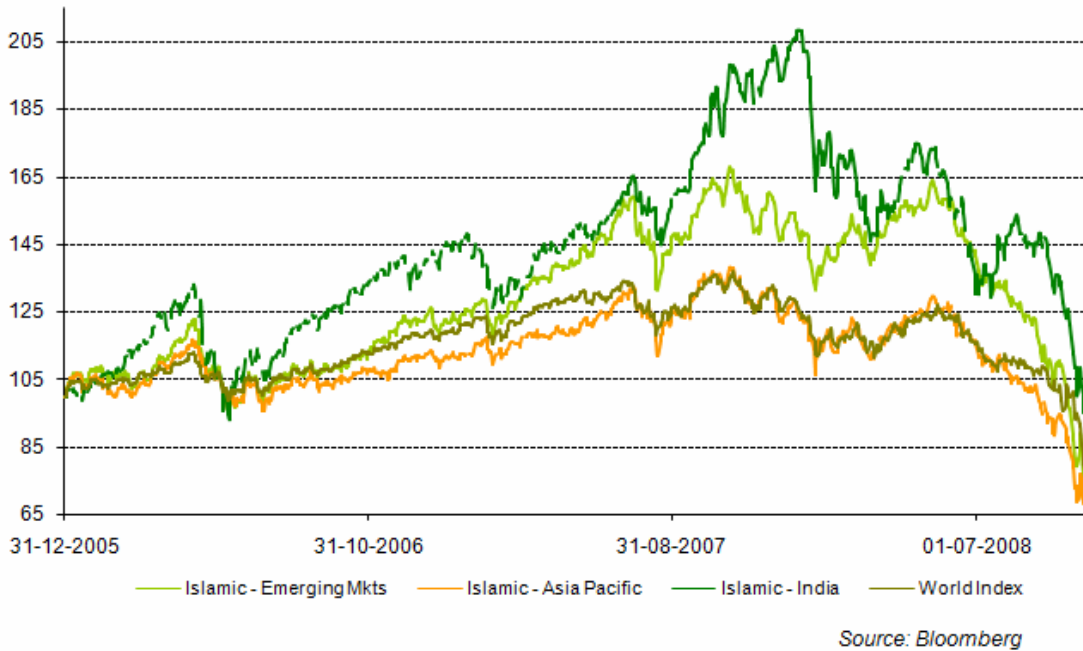
### **Foreign Investments**

Having realised the need to geographically diversify the source of funds, the next best stop is the Middle East, including the GCC countries. The unprecedented growth in these Muslim countries, attributed to the soaring oil prices, has earmarked availability of excess funds among investors looking for high returns from the emerging economies, subject to suitable products and services. Moreover, signs of increased efforts on part of the richer classes of these societies to establish their Islamic identities reiterate the need to attract these funds through Sharia compliant products. This has spurred the interest of global players like Citigroup and UBS, who have swooped in to tap these resources with a range of innovative investment products, thus limiting exposure to the crisis in the West.

With a majority of expatriates in the ME tracing roots back to India, a leader among the high growth-emerging economies, it seems efforts to explore the potential inflow of assets from these regions would spur massive growth. This is the apt entry point for an Indian Islamic bank that would function as intermediary between the interested parties - entering into a profit-loss sharing (PLS) agreement with a potential overseas investor to invest in the fund starved, yet appealing sectors or performing investment banking activities – under-writing a sukuk for a shariah compliant stock looking to raise capital. This would facilitate the flow of money, thus spurring economic growth and providing a solution for the dwindling overseas funds.

The performance of the Dow Jones Islamic indices, though covering the equity markets, is an indication of the rallying interest in this sector. An analysis of these indices shows that the shariah based financial sector has clearly beaten the conventional sectors. Interestingly, the India specific Dow Jones Islamic Index has more than outperformed the other indices, driving home the fact that the concept of interest free financial operations is gaining limelight.

**Chart 3: Dow Jones Islamic Indices**



### **Macro-economic concern**

A section of economists are of the opinion that interest rates are in fact inflationary instruments. Increased rate of interest charged reduces supply thus increasing price levels in the medium term, while interest income increases the money supply of the depositor causing a double effect on inflation. In fact, it leads to a state of stagflation due to reduced investments and retarded growth. Whereas reduced interest rates in turn increase money supply, reducing purchasing power of the rupee and again leading to price inflation. Both ways, interest based banking operations spur inflation, controlling which is the concern of most central banks in the world. However, experiences with interest free Islamic banking, on the other hand, have proven to be anti-inflationary. Equity based financing on the other hand, with the absence of interest income in any form, drives domestic savings and real growth. Also, equity based financing through Islamic banks is set to rapidly increase the exposure of equity markets (micro-equity financing) and hence the liquidity.

Furthermore, Islamic banking operations could enable inclusive growth that the Indian government is relentless trying to achieve. Easier access to credit, little or no collateral requirements could help in penetration of banking facilities to even the lowest strata. Though it is criticized that Islamic banking credit comes at a larger cost, one could still argue that it is better to charge larger costs through profit sharing agreements than to totally deprive one of credit. Also, since the Islamic bank often gains a

managerial control over the financed entity, the government might be expected to incur lesser cost on mobilizing tax revenues from these entities.

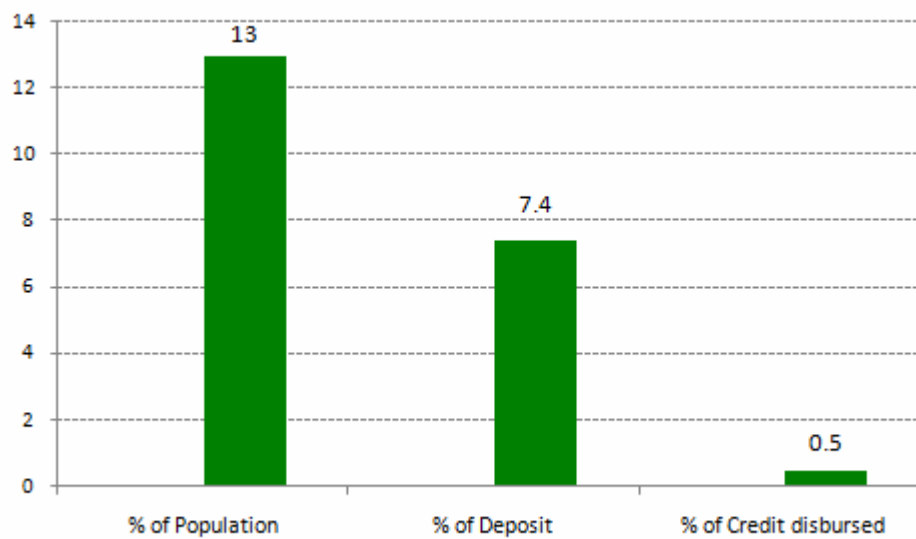
### **Cushioned from subprime crisis**

Notable, Shariah based banks could be shielded from the sub-prime crisis owing to their fundamental operational principles. Shariah does not allow securitization of loans without the borrower's consent and does not approve parking funds in off-balance sheet vehicles, which have spurred the recent crises. Islamic banks are also prohibited from investing in highly leverage companies and are immune to short term volatile changes in asset prices since they trade basically on the growth potential and trends of a business and not asset prices. Also stringent rating practices precede investments and hence these institutions are relatively better cushioned. However, a continued impact of the crisis and fall of asset prices in the medium term could affect sectors like real estate, where Islamic banks generally show maximum interest.

### **Demographic Trends**

India has the third largest Muslim population in the world, which totals to around 138 billion (2001 census). Arguably, most Muslims, bound by their religious faiths, have stayed away from the conventional interest based banking system. For the largest democracy in the world, which holds secularism as one its most important principles, equitable access to bank credit for every section of the society should remain one of the primary concerns. Census data shows that the percentage of households availing banking facilities is much lower in villages where the share of Muslim population is high. The Sachar committee report, which analyzed the condition of Muslims in India, pointed out the lack of access of bank credit to this section of the country. Alarming, Muslims who amount to around 13% of the country's population hold only around 7.4% of the deposits and have received only 0.5% of the credit disbursed by SCBs. Though low income levels are one of the mentioned reasons, strict adherence to religious bindings is an important concern that cannot be overlooked in this context. Also, the study shows that participation of Muslims in banking related jobs is as low as 2.2%, a clear indication that the community has remained uncomfortable with *riba* (interest) based activities.

**Chart 4: Access of Bank Credit for Indian Muslims**



Source: Sachar Committee Report on Indian Muslims

The abstinence from basic banking facilities has suppressed the economic growth of the community. Interestingly, some reports estimate that these Muslims hold properties worth billions in form *awqaf* and *zakat* due to lack of access to banking facilities that abide by their faiths.

## **INDIA ISLAMIC BANKING SECTOR**

Banking regulations in India maintain that commercial banks can lend credit and accept deposits only on the basis of interest. With Islamic law against this fundamental requirement of *riba*, these shariah based organisations can perform only as IFIs and not as fully fledged Islamic banks. Latest reports estimate that there are over 15 IFIs functioning as Islamic banks, with deposits of over Rs. 750 million. Most or all of these IFIs operate on a regional level with access to a very small section of customer base and a very small range of basic products, thus losing out on economies and scales and scope.

An IFI in India would be registered as a Financial Association of persons, Islamic Financial Societies, Co-operative credit societies or Islamic Finance and Investment companies(IIFCs). All the IFIs in India functioning on a PLS basis and registered under the Companies Act of India are classified as IIFCs. The most common modes of investment of these IIFCs are *ijara*, followed by *ijara-wa-iqtina*, *murabaha* and *musharaka*, in that order. Investments in Islamic funds and Shariah compliant equity are gaining limelight lately. It is estimated more than 50% stocks on the BSE are Shariah compliant. The

sources of these funds are usually share capital, mudarabah deposits, fully convertible debentures and Islamic bonds with variable returns.

IFIs functioned as non-profit organizations prior to 1986. Profit based organization took base from the 1990s when new economic policies heralded privatization and liberalization and provided new opportunities for growth.

### **IFIs OF THE PAST**

One of the biggest deterrents for the success of Islamic banks in India is the poor history these IFIs. Of the many IFIs that started performing banking operations, Sheyad Shariat is the only known operating entity. Most other IFIs have shut shop due to various reasons, dwindling of funds, and lack of morality and loss of trust being the most common ones. Sheyad Shariat operates with a deposit base of Rs 1086 lakhs and CAR of 56%

**Table 3: IFIs practising Banking operations in India, prior to 2004\***

Barkat Investment Group
Al-Amin Islamic Financial & Investment Corporation of India
Al-Barr Finance House Ltd
Syed Shariyat Finance
Assalam Finance & Investment Ltd. 1990
Baitul Islam Finance Ltd

*Source: Non-Bank Financial Institutions: Islamic Alternatives, 2004*

*\* Only Sheyad shariat operates currently*

### **REGULATORY SCENARIO**

Indian banks are governed under the Banking Regulation Act 1949, Reserve Bank of India Act 1934, Negotiating Instruments Act and Co-Operative Society Act. Regulated by RBI, these banks provide cheque facilities and generate deposits through a deposit multiplier, thus adding to the money supply in the system. They have to maintain cash reserves ratio (6.5% currently – no interest) statutory liquidity ratio (25%) which requires investment in government and other securities and bonds that offer market based interest rates, thus over-ruling Shariah's most important principle. Other requirements include capital adequacy, assets classification, provisioning for bad debts and income recognition norms.

## REGULATORY HURDLES

IFIs are licensed under Non Banking Finance Companies Reserve Bank Directives and RBI (Amendment) Act. Unless given the power to issue cheques, these IFIs would continue to perform as NBFCs, missing out on the many advantages and economies of a scheduled commercial bank (SCB).

**Table 4: Regulatory Hurdles for Islamic Banks in India**

Shariah practice	Description	Indian banking regulations
Al Wadiah	Savings bank account	Payment of interest on deposit
Mudarabah	Term deposit/ Investment	Equity exposure giving complete freedom in management disallowed
Mudarabah, Musharakah	Project finance, SME credit	Profit sharing and partnership contracts disallowed
Ijarah	Home finance	Ownership of property (except for private use) disallowed
PLS deposits	Unsecured public deposits	Presevation of capital to be guaranteed

The biggest hurdle for Indian IFIs is lack of recognition as fully fledged banks due to failure to meet regulatory directives of the RBI, primarily the reserve ratios as they are interest based.

**Chart 5: NBFC regulations hindering growth of IFIs**

Deposit period reduced to 12-60 months

Ceiling on brokerage at 2% of deposit

Ceiling on rate of return at 16%

Ceiling on net owned fund (NOF) in real estate at 10% - visible inclination of ME investors in real estate

Floor on liquid assets in SCBs at 15% of NOF

While Musharaka – equity based financing is integral to Islamic banking, this asset is considered highly risky for capital adequacy requirements. The Islamic Financial Services Board (IFSB)

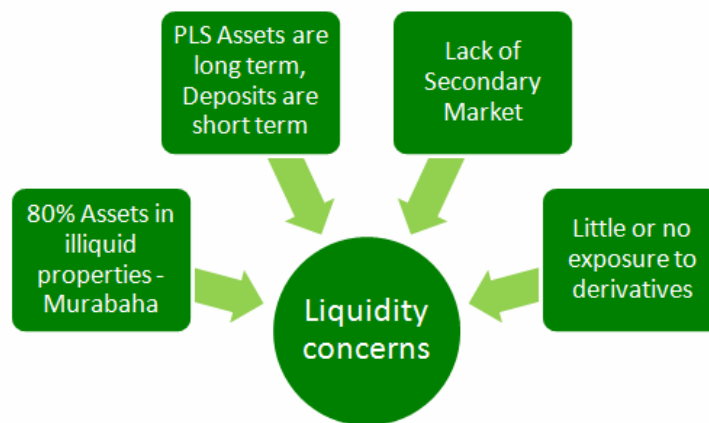
maintains standards for capital adequacy for Islamic banks, which like Basel II, can be adopted by regulators with/without changes.

The BR act even disallows Indian banks' overseas subsidiaries from launching products/ services against its rulings. The basic income of Islamic banks is profit based and hence an earned income, unlike interest, which is passive income and hence subject to different tax procedures. These findings drive home the reality that existing regulations, unless amended, almost nullify the chance for IFIs to perform as banks. However, structured response from the RBI to strategically open up Islamic banking, would mobilize the inflow of petro-dollars and our investments in petroleum resources alike.

### **ISSUES WITH SHARIAH BASED BANKING**

With possible introduction into the Indian banking system, the IFIs would be exposed to excessive risk, considering that with current interest-based regulations, the RBI cannot be the 'lender of last resort' and interbank operations will be hampered, making emergency funding in crisis times difficult. Delinquency poses larger risks as late Murabaha payments cannot be penalised under Shariah.

**Chart 5: Liquidity - Major concern with Islamic Banking**



Criticisms suggest the cost of credit from IFIs often end up higher than in conventional banks. With no rigid accounting standards in place, IFIs in the organized banking sector might face problems in both domestic and cross-border transactions; Lack of expertise and experience in management of these banks make project valuation and product offerings difficult. Ironically, the most important problem is lack of consensus on principles that are Islamic and non-Islamic, leading to frequent oppositional hiccups.

## RECOMMENDATIONS

As mentioned, the unsuitable existing regulations have made the scene dim for Shariah based banking in India. However, timely recognition of the immense growth potential of this sector and strategic initiatives to accommodate these innovations in the Indian banking sector are deemed to impact the economy positively. Based on research and guided by successful examples, the author has suggested a structure of introduction and strategies for integration of Islamic banking into mainstream banking.

**Chart 6: Phased structure of Introduction of Islamic Banks in India**



### **Experiments with Existing Models**

The few entities already practising Shariah based operations on a small scale are expected to be relatively more experienced and possess better expertise in the sector. The performance and potential of these IFIs can be tested by experimental modification of NBFC regulations to provide a larger operating platform and drive growth. These existing, experienced, relatively unknown entities will be close representatives of the performance of an organised system that can be put in place, subject to experimental results

### **Islamic Window**

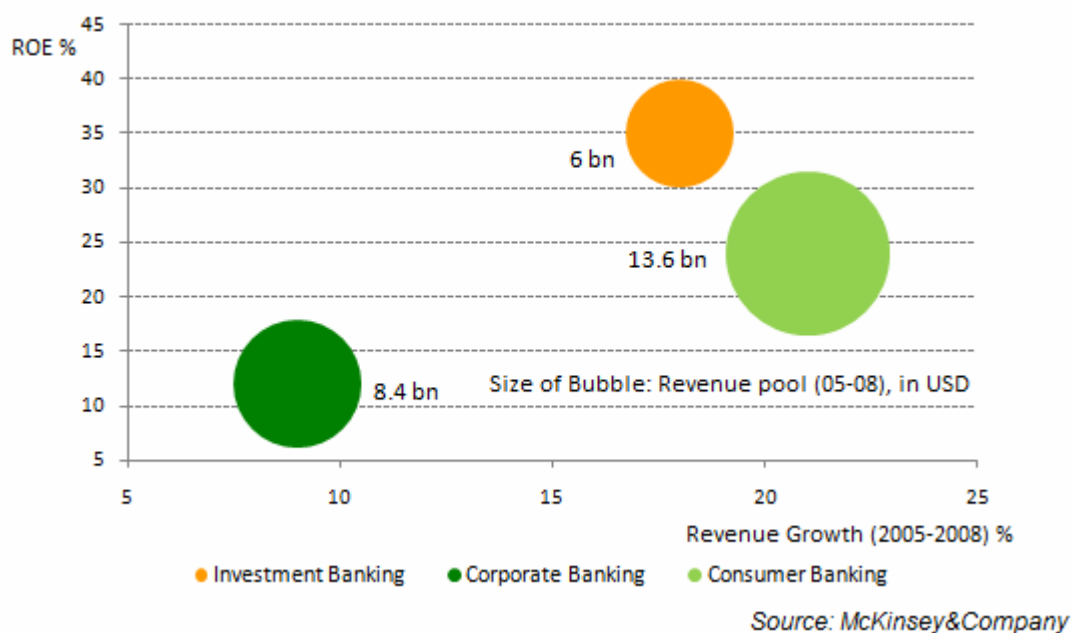
Slowly gaining expertise in the operational and regulatory activities, the RBI could license a few global players, already practising Islamic banking overseas, to open up customised ‘Islamic Windows’ within the country. These would perform as private banking windows, catering to select high networth individuals. The licensing that would be slow and phased out would recognise the expertise already gained by players like HSBC, Citigroup and other global players.

These banks could follow a defensive strategy and try to harness their existing Muslim customer base, in the first place. This however, would be preceded by setting up a nation-wide consulting body that would help the RBI with regulatory frameworks, following the examples of international regulators (IFSB) until they gain the required regulatory knowledge and skill in the sector.

### Shariah Subsidiary

These steps, when expanded slowly to larger scale commercial banking and more licences, would start showing positive results and impacting the consumer base. This would be an ideal point of entry for dedicated entities banking the shariah way, with a larger customer base. This includes JVs with existing banks overseas. However, proof of efficiency is important before diversification and expansion. This can be achieved by initially restricting licences to consumer banking that has historically shown largest revenue growth and a higher ROE.

**Chart 7: Profitability and Revenue Growth of Islamic Banking Segments**



Though this would restrict growth, it would help the bank gain a stronghold in operations and earn trust of the customer base. A pre-condition to a subsidiary would be assurance and proof of complete segregation of the Islamic and conventional operations, thus relieving investors of apprehensions of possible mingling of funds. Regulatory expertise is expected to strengthen in this stage, followed by country specific modifications in international rulings and nation-wide operating and accounting standards that conform to international standards.

### **Full fledged Islamic Banking licence**

The introduction of fully fledged Islamic banks into the system follows ample proof of historical performance of the subsidiaries. This however, would require larger changes in existing laws by RBI to accommodate Shariah principles that conflict with existing rulings. This, the author believes, is a long term activity. This would be accompanied by proactive transition from Islamic client base to value seekers and increasing scope of operations through innovative instruments.

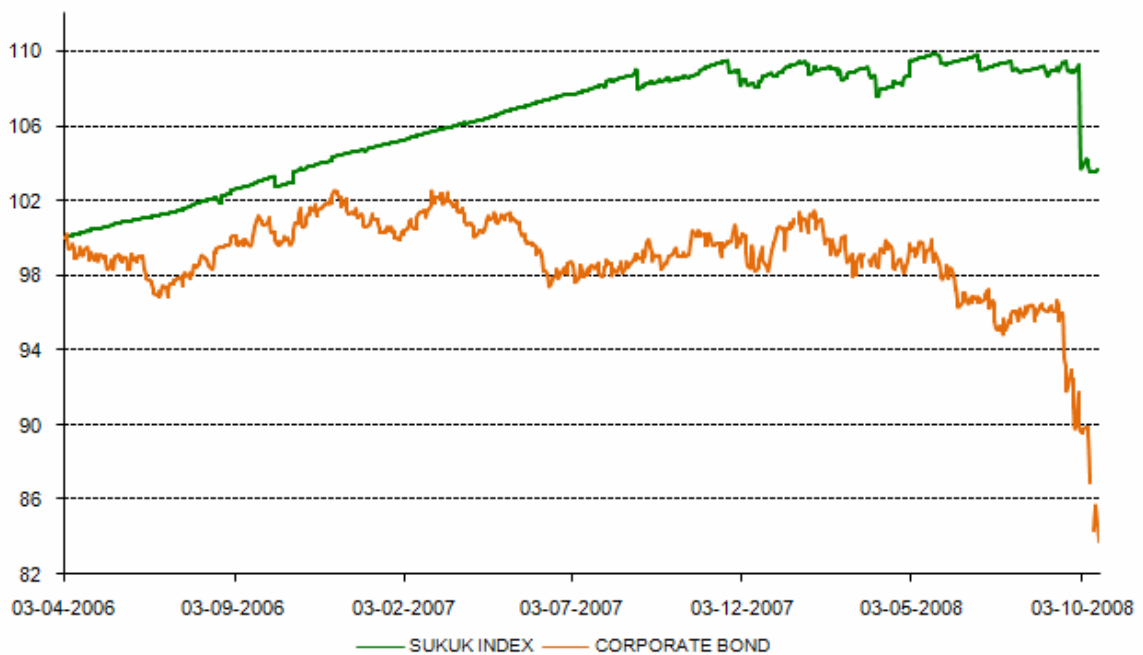
### STRATEGIES AND INNOVATIONS

Strategies	Description	Notes
Level playing field	No differentiation from conventional banks	Example from FSA's UK Strategy - "No obstacles, no favors"
Training Institutions, Awareness campaigns	Relatively new sector, Management and operational expertise needed	IFIs could pool funds for training programs
Risk Fund Reserve	Cover from excessive risk	Alternative to other reserve requirements that are Shariah in compliant; Periodic dividends from Risk Fund
Secular image, remove apprehensions of religious heralding	Nomenclature: Participatory (equity-based) banking, PLS Banking	Communal resistance very likely
Loan Loss Database	Lessons from peers, N.American loan loss database	Most banks have not completed full operational cycles - small sample size
Charity Investment	Interest based Emergency funds	Government/RBI sponsored emergency funds are Ribah based
Commodity Investment	Gold follows LIBOR movement	Contracts with banks to hedge their interest rate risks
Product	Description	Notes
Mark-Down Pricing	Incentive for Early payment	Counters delinquency. Time-value based, Shariah concerns
Banker's Acceptance	Based on Commissions/ Service charge	Market makers, sales force integral
Securitisation on assets into portfolios	To reduce risk, as sell as short term investments	Market's negative sentiment on securitisation detrimental
Funds to match yield profile of Inter bank returns	Liquidity opportunity from Interbank operation lost in shariah	
Bancassurance	Takaful - Shariah based insurance provision	Supporting Islamic infrastructure to increase visibility in target market
Wholesale banking	(Corporate banking + Investment banking)	Liquidity for Small banking units

## SUKUKS - IMMENSE POTENTIAL FOR ISLAMIC BANKS

Sukuks are Shariah based asset-backed bonds; Holders are entitled to a share of revenues realised from the asset. The global Sukuk market is estimated at USD50 billion (2006). Sukuks are a long-term way for Islamic banks to manage risk through a portfolio of maturity and yield profiles. The active secondary sukuk markets, which have shown spectacular results since inception in 2004, would help the liquidity situation of IFIs.

**Chart 8: Dow Jones Islamic Indices**



Source: Bloomberg

Sukuks have become popular among domestic and overseas investors, alike. These instruments have so far been active mostly in the ME, though attracting interest in the US and Europe lately. Presence of investors from areas other than ME suggests Islamic principles attract investment for reasons other than religious faith too. This attitude is vindicated by the performance comparison of sukuks versus conventional bonds

Notably, sukuks could be a suitable alternative for government lending and SLR requirements for Islamic banks - Sovereign sukuks can attract Islamic banks' investments in government bonds. For instance, Saxony-Anhalt, Germany issued a successful €100 million sukuk in 2004. Following Malaysian, Bahrain and Sudanese examples, the government could issue these Islamic papers or RBI can design innovative sukuks to attract Islamic bankers

## **CONCLUSION**

Most global banks, having realised the opportunities aplenty in this sector, are looking to expand their roots into geographies with high Muslim population. With cut-throat competition rising fast in the other Muslim dominated regions, India with the world's third largest Muslim population is an ideal destination for these Shariah experts. Sufficient and timely recognition of this mode of banking and setting up a suitable regulatory framework to introduce Islamic banking into mainstream banking is integral to tap these resources. However, it should be realised that this would be just another alternative mode of banking that would strengthen market efficiencies with innovations and competition and would never be a substitute/replacement for conventional banking operations.

## **APPENDIX – GLOSSARY OF TERMS**

**Riba** - The premium that is paid by a borrower to the lender over and above the principal amount, as a condition for the loan.

**Sukuk** - Similar to conventional bonds with the difference that these financial papers are asset-backed. Sukuk holders are entitled to a share in the revenues generated and in the proceeds of the realisation of the Sukuk assets.

**Takaful** - A collection sharing of risks by a group of individuals - insurance based on mutual cooperation, responsibility, protection and assistance between groups of participants.

**Waqf** - Assets that are purchased or held for socially beneficial purposes.

**Almudarib-udarib** – Mobilising of financial funds on the basis of profit sharing and extend the same to the users on the same basis

**Amana** - Given by one party to another party to keep for some reason such as safe custody.

**Bai' Mu'ajjal** - An agreement where the Islamic institution sells a good on the basis of a deferred payment in instalments or a lump sum, at a marked-up price.

**Fiqh** - Islamic jurisprudence, based mainly on interpretations of the Qur'an and Sunna. It covers the religious, political, economic and social aspects of life.

**Gharar** - Exposure to excessive or unnecessary risks in an exchange transaction as a result of uncertainty or ignorance regarding an essential element of the transaction, such as price, quality or quantity.

**Ijara** - An agreement where the Islamic institution leases a particular asset for a specified amount and period of time, with the option for the lessee to purchase the asset at the end of the period at a predetermined price.

**Istisna'** - A contract for the purchase of a good that is to be produced, whereby the price is paid in instalments based on the progress of production.

Mudaraba - A contract whereby the Islamic institution contributes the necessary capital to finance a project, while the entrepreneur contributes his/her labour, time and expertise. Profits are shared between the institution and the entrepreneur at a predetermined ratio.

Murabaha - A sales agreement whereby the Islamic institution purchases goods (at spot) at the request of the customer, and sells them immediately to the customer at an agreed marked-up price on a deferred basis. The buyer makes deferred payments to the seller equal to the cost of the goods in addition to the agreed upon profit margin.

Musharaka - An equity partnership whereby all partners participate in the investment and management of the project. Profits are shared according to a predetermined rate, while losses are shared according to equity contributions.

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