Prospects Of Islamic Financial Services In India

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ABSTRACT
Islamic Financial Services has been expanding all around the globe and has shown huge potential for developing economies. India, a developing economy, has shown less progress in Islamic Financial Services though there are several opportunities. The article examines the overview of the prospects of Islamic Financial Services in the Indian economy with a focus on regulations and conceptual understanding.

KEYWORDS: Indian Economy, Islamic Financial Services, Regulations.

1. INTRODUCTION

Islamic finance has grown rapidly, demonstrating tremendous creativity and sophistication while providing a diverse range of financial products not confined to reproducing traditional derivatives, fund structures, and instruments for fixed-income investments. Islamic finance is a radical departure from the conventional interest-based, speculative practices approach, relying instead on actual economic transactions like trade, profit-sharing investments, and other accountable business practices. India, the world's second-most populated country after China, is home to one-sixth (17.5%) of all people. It is the second-largest Muslim population after Indonesia, making it a potential market for Islamic banking, accounting for 11% of the world's total Muslim population. India is a developing nation with a low development rate, and the underprivileged, particularly Muslims, are left out financially despite this. They do not profit from the rapidly expanding economy. India continues to be a developing market for Islamic financial goods and services since the Indian populace is not aware of the subtle aspects of Islamic finance [1]. The biggest barriers to the effective adoption of Islamic financing in India include regulatory barriers inside the country's current financial system. Due to the possibility of introducing a true financial system that is both ethical and stable at the same time, Islamic banking is now a subject of global interest and significance.

2. EMERGENCE OF ISLAMIC FINANCE

The contemporary financial system is built on the key principles of depositor capital guarantee and rate of return on deposit certainty. It evolved from and took its cues from European practices, especially those in the UK. In the late 19th century, this finance mechanism was brought into nations experiencing political and economic instability [2]. In order to meet the import and export needs of foreign firms in the capitals of the subject nations, the imperial powers established outposts of their banking institutions [3]. Despite the fact that local trading communities, particularly Muslims in the subject countries, avoided foreign financial institutions for nationalistic as well as religious reasons, local communities found it increasingly difficult to manage their trade and other economic activities without using commercial banks over time [4]. They desired a greater say in governmental economic and financial affairs. Due to this, local banks that were similar to interest-based overseas banks were established. After the Muslim nations gained their independence from the colonial powers, the history of Islamic finance or interest-free financing began [5]. Following independence, when governments, companies, and people started using the established banking system to do business, Muslim intellectuals were more interested in identifying and inventing alternative banking and financial alternatives in order to satisfy Muslims' religious needs. Islamic banking, or interest-free banking, is the name given to the banking and financial system that resulted from this development [2].

Modern Islamic financing's foundational ideas date back to the middle of the 1940s, and models for it first appeared in the middle of the 1950s. Only in the late 1960s did complete and precise proposals for interest-free financing emerge [6]. Due to the political climate at the time, practically all Muslim nations were viewed as an exotic niche in the financial sector and were scarcely conducive to a shift in the overall system of finance.

In 1963, a covert Islamic money experiment was launched in MitGhamr, Egypt [7]. The German Savings Bank, which subsequently changed its name to Naser Bank and was adjusted to meet Islamic beliefs by forbidding it from collecting and paying interest, served as the experiment's model [8]. The second Islamic Conference of Foreign Ministers accepted a declaration titled "Institution of an Islamic Bank, Economics, and Islamic Doctrines" in 1973. The Islamic Development Bank (IDB) was founded as a result of this event in 1974.

3. CURRENT STATUS OF ISLAMIC FINANCE IN INDIA

The Banking Regulation Act of 1949 categorizes financial organizations in India generally into two groups: banks and Non-Banking Financial Intermediaries (NBFI). Banking without interest is not allowed in the country since our traditional banking must be based on interest. The banking laws do, however, permit Islamic finance to function as an NBFI directly under RBI's supervision. NBFIs still have limited capacity and operating flexibility. Additionally, several regulatory changes were made in a short time, which hindered the growth and performance of NBFIs in general and Islamic NBFIs in particular. Since a few years ago, several corporations and asset management firms in the nation have favored the Islamic finance sector. Major business titans in the nation, including Tata and Reliance, to mention a couple, have launched mutual funds that adhere to Shariah.

In order to draw Muslim investors from India and beyond, the Bombay Stock Exchange created an Islamic Index in 2010 in partnership with Taqwaa Advisory and Shariah Investment Solutions. The Index, known as the BSE TASIS Shariah 50 Index, permitted stock market trading by investors without transgressing the guidelines of Islamic finance and investing. As a result of the strategic partnership between the Bombay Stock Exchange (BSE) and Standard and Poor's (S&P) Dow Jones Indices, the S&P BSE 500 Shariah index was the first new Index to be developed. The BSE was created as a consequence of this agreement, which was announced in May 2013. All stocks in the larger S&P BSE 500 index that follow Islamic law are represented by the S&P BSE 500 Shariah index, which was developed for this purpose. The Index serves as a primary gauge of the performance of the Shariah-compliant stocks included in the S&P BSE 500 Index universe. With the introduction of this Index, the BSE TASIS Shariah 50 Index was terminated.

In August 2013, the RBI approved Cheraman Financial Services, a Kerala-based non-banking financial organization that runs in accordance with Shariah having a stake owned by the Kerala State Government. This was a very important and uplifting step for the country's Islamic banking and finance advancement. The Islamic Corporation for Development (ICD), a division of the Islamic Development Bank (IDB), just announced, located in Saudi Arabia, is anticipated to open its first Indian branch in Ahmedabad, and Islamic financing in India gained a boost. This branch's operations would be per Shariah as a non-banking financial institution. This was determined in April 2016 when the Indian Prime Minister visited Saudi Arabia and signed agreements with the IDB and the EXIM Bank of India. According to media rumors, Mr. Zafar Sareshwala, who had accompanied the Prime Minister on tour, would be in charge of the ICD's activities in India.

4. OBSTACLES IN THE WAY OF ISLAMIC BANKING IN INDIA

A few Islamic financial organizations have formed in recent decades, offering a limited range of goods and services. However, none succeeded, and for Indian Muslims, a full-fledged Islamic bank still exists only in their dreams. Few challenges prevent any Islamic financial organization from becoming successful.

4.1. LEGAL HURDLE

All banks in India are required to follow the interest-based operating philosophy as per the Banking Regulation Act of 1949. As a result, it is illegal to establish an Islamic bank, which is effectively a no-interest bank. Banks are also required by law to retain a significant portion of their deposits in interest-bearing government and public sector securities under the Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR). The emergence of non-banking financial institutions that followed Shariah law was hindered by the numerous revisions and the limits placed on these NBFCs.

4.2. UNEQUAL TREATMENT OF DEBT AND EQUITY

Dividends are taxed in India under the current tax laws, although interest is not. An Islamic financial institution operates by profit and loss sharing; hence the capital is equity-based. This makes Islamic financial companies far worse off than other traditional financial enterprises.

4.3. LACK OF ISLAMIC INSURANCE

Since there is no provision for deposit insurance and credit guarantees, unlike traditional commercial banks and cooperative societies, which have these facilities, Islamic banking and financial enterprises have a sense of insecurity and lack confidence. Other severe issues facing Islamic financial enterprises include the lack of Islamic insurance programs, the absence of interest-free instruments, the underdeveloped Islamic primary market, and the absence of secondary markets for Islamic goods.

4.4. LACK OF TRANSPARENCY

Transparency in profit sharing, financial reporting, and adherence to government and Shariah regulations are necessary to foster and re-establish investor confidence. Islamic financial institutions, however, have not been able to live up to these expectations. The worry that borrowers may underreport their earnings is constant. Additionally, there are no severe penalties for defaulters, which still leads to another concern about its abuse.

4.5. LACK OF CREDIT RATING AGENCIES FOR ISLAMIC FINANCIAL INSTITUTIONS

Several credit rating companies for conventional financial institutions, but none exist to grade Islamic financial institutions. Investors become less confident as a result.

4.6. LACK OF QUALIFIED SHARIAH EXPERTS

The difficulties faced by investors in determining if a company is genuinely following Shariah law are greatly exacerbated by the absence of trained Shariah specialists. Indian Islamic SWOT analysis is a crucial tool for understanding and identifying the strengths and opportunities that are already present and developing a strategy to fully capitalize on them, while the identification of weaknesses and threats helps to recognize the dangers and take preventative measures before they negatively impact the business or the industry.

5. CONCLUSION

For emerging economies, it is important to explore new avenues of finance in order to promote innovation in the economy. Islamic Finance provides that opportunity for developing countries. India has had an improvement in its financial structure with a recent push in terms of digitalization. However, the great potential of Islamic financial services is yet to be explored in India. To reap the benefits of Islamic Financial Services in India, a level playing field with clarity in regulations is required. The study identifies that there is significant scope for Islamic Financial Services in the Indian Capital market. However, separate credit rating agencies are required for Islamic Financial Institutions. In addition, the present legal framework in India does not provide a level playing field for Islamic Financial Institutions. The problem can be solved with new regulations as per the current requirements.

6. DIRECTIONS FOR FUTURE RESEARCH

Future research should focus on specific Islamic financial products that may have high acceptability in the Islamic Capital Market. Small and potential investors can be enquired about their perception of Islamic Financial Products. Research in light of current macroeconomic policies should also be undertaken to enhance the policy impact of Islamic Financial Services.

CONFLICT OF INTEREST

None.

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