

MANAGEMENT OF ISLAMIC FINANCE

Principle, Practice, and
Performance

Edited by M. Kabir Hassan
and Mamunur Rashid

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Mamunur Rashid

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ISLAMIC FINANCE:
PRINCIPLE, PRACTICE,
AND PERFORMANCE**

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INTRODUCTION

M. Kabir Hassan and Mamunur Rashid

1. INTRODUCTION

By 2020, Islamic finance will have completed its first half-century. While the industry is growing at a relatively faster rate than its conventional counterpart, many recent challenges herald a paradigm shift in the system. Islamic banking still covers the lion's share of activities in the Islamic finance industry. The Islamic banking industry has been growing at a double-digit rate for over 10 years now. It has promised its clients adherence to profit-and-loss sharing principles. It has also been found to be resilient to financial risk, as evidenced in the early 1990s and immediately after the global financial crisis of 2007–2008 (Aliyu, Hassan, Mohd Yusof, & Naiimi, 2017; Hassan & Aliyu, 2018). However, Islamic banks are gradually abandoning profit-and-loss sharing principles due to competition, cost, and several institutional factors. Moreover, the Islamic banking landscape has drastically changed in the post-crisis era, moving from a social banking emphasis to a market-centric model.

Recently, allied Islamic financial industries such as the Islamic equity markets, mutual funds, the Islamic bond market (*sukuk*), and Islamic insurance companies, have undergone a significant transformation in terms of regulation, size, and scope. Major stock index providers have opened Islamic indices to cater to the needs of Islamic investors. Despite conflicting results on the superiority of Islamic equities and funds over their conventional counterparts, recent studies have indicated the influence of behavioral biases while making Islamic financial decisions (Boo, Ee, Li, & Rashid, 2017). Moreover, the business model of Islamic equity screening and its implications on corporate selection have significant policy implications at various levels (Rashid, Hassan, Amin, & Samina, 2017a; Rashid, Hassan, Min, & Ullah, 2017b). *Sukuk* are entering a new phase as new *sukuk*-based projects are being introduced globally. Often, countries that lack basic Islamic economic prerequisites will offer *sukuk* to finance longer-term projects. Harmonization of these allied industries with respect to cross-border challenges and intra-institutional risk factors is necessary.

Due to shifts in the global financial and business management landscape as well as the fundamental pro-social atmosphere found in Islamic economics, Islamic social finance institutions are more actively participating in a global setting. Islamic microfinance programs in Bangladesh, *zakat* and *waqf* institutions from the Middle East, Southeast Asian countries, and Pakistan, and other global

Islamic charitable organizations are working toward a collective inclusiveness program (Rashid, Hassan, Amin et al., 2017a; Rashid, Hassan, Min et al., 2017b). The ethical and corporate governance performance of Islamic financial institutions are also being debated in a global business management context (Hassan et al., 2010; Rashid, Abdeljawad, Manisah Ngalim, & Kabir Hassan, 2013; Rashid & Hassan, 2014).

2. THIS ISSUE

This volume sheds light on these broad changes and challenges that the Islamic finance industry has been facing. Eleven chapters are selected from a competitive list of submissions. Choosing a mix of chapters attracting audiences from the sectors of finance, management, and financial services marketing has been challenging. Hence, preference of segmented studies from several subsectors has been prioritized.

Sukuk restructuring has attracted newfound attention in recent days due to several issues conflicting with Islamic Shari'ah, such as, among many, *sukuk* structuring on tangible assets, features similar to conventional bonds, and guarantee by the originator. Offering several cases from these perspectives, Ahmad et al. explore how solving these conflicts can boost the confidence of investors.

Access to finance is a major challenge, even in Islamic finance. Traditional *mudharabah* and *musharakah* contracts often fail to meet this challenge due to several complexities. Dinc and Saiti explore these complexities and search for an equally strong mechanism to finance small businesses using reverse *mudharabah*.

The housing market is gradually improving. As usual, Islamic investors have been expecting the presence of Shari'ah-compliant housing market financing instruments. Varli discusses the implications of the participating mortgage as an Islamic alternative for the housing market.

In order to understand the impact of riskiness in Islamic banks vis-à-vis their conventional counterparts, Hashem and Abdeljawad investigate the systemic risk in Islamic and conventional banks in Bangladesh. They have found an interesting impact of crisis on systematic risk levels for Islamic and conventional banks in this developing country.

Islamic equities offer varied levels of diversification. Yildirim and Masih investigate the possibility of diversification for Islamic equity investors on a global stage. Their study finds that diversification is possible for short-run investors.

While debt is allowed within a precise limit in the Shari'ah-compliant universe, Shah and Abdul-Majid pay a conceptual visit on the corporate threshold for debt, which has strong implications for corporate tax systems in Islamic jurisdictions.

Islamic banking has attracted the attention of Muslim as well as non-Muslim users. Abubakar offers a synthesis of the patronizing factors that enhance the engagement of customers with Islamic banks globally.

In relation to the wider acceptance of Islamic finance, or the wider exclusion of Muslims from conventional financial streams, Hassan et al. present the relationship between social and economic indicators with respect to Islamic finance.

They find that there is a potential for Islamic finance in regions with decent growth of religious practices.

Islamic microcredit is often used to finance microbusiness ideas. In order to ensure financial inclusion, Islamic countries have invested heavily in understanding the use of and satisfaction with microcredit in Islamic jurisdictions. Rashid et al. establish center activity as the most important determinant of satisfaction among Islamic microcredit borrowers in Bangladesh.

Aside from microcredit, a social development role is also expected from other relevant Islamic financial institutions. Shi Min et al. investigate the relevance of development financial institutions from Malaysia that offer Islamic financial services in the presence of a strong Islamic financial (banking) system. Their study sheds light on re-examining the social role of Islamic financial institutions.

Political institutions may also have a strong influence on the development of the Islamic financial system. Grassa and Hassan find a strong positive connection between Islamic finance and political Islam on the growth of Islamic financial activities.

3. FUTURE DIRECTIONS

Based on several recent observations and this issue, many potential areas of interest emerge. Some of these matters may prove to be appropriate research topics in the coming years. Two such issues are the development of the Islamic corporate finance industry and the modeling of (social) business activities from an Islamic perspective. We often take it for granted that Islamic models are all socially adjustable, financially viable, and spiritually doable. In recent years, Islamic finance has been impacted significantly by developments in social responsibility theories, and in an unfortunate turn of events, Islamic finance experts have started accommodating these theories, making adjustments relevant to Islamic finance. Partly due to this, the Islamic finance industry is still largely a “Shari’ah-compliant” industry, not a Shari’ah-based industry. The Islamic finance industry has been mostly a supply-centric industry that has covered a wide range of instruments to finance corporate financial needs in an Islamic way. Perhaps it is now the right time to match these financing initiatives with investment activities. This is where “(social) Shari’ah screening” and a “social identity model” appear especially important. In the upcoming days, Islamic finance experts should engage in more research in these areas.

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