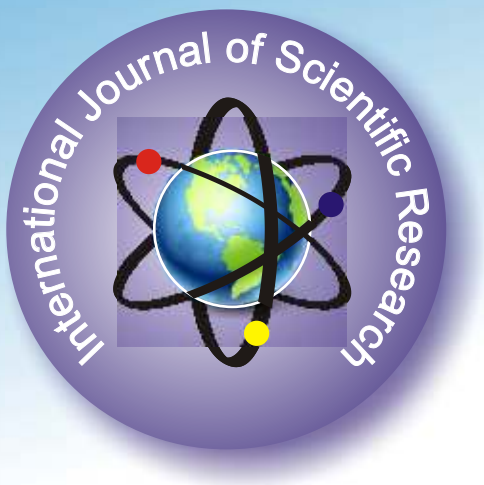
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A Feasibility Study of Islamic Banking System in India Miles to Go

* Dr. Sharif Memon

Abstract

Islamic banking is a worldwide occurrence involving a variety of institutions and instruments. In the precedent few decades, Islamic institutions and instruments have developed in many countries, including the United States. In certain countriesIran, Sudan, and Pakistanall or the majority financial intermediation conforms to Islamic shariah (religious law) as defined by local authorities. In most other countries, including Indonesia, Islamic transactions and institutions make up a small part of the total and must compete with conventional financial institutions. There is even considerable Islamic banking in the United States. If the terms and conditions of Islamic transactions differ too much from those of conventional institutions they become hard to sustain. Thus this paper is an attempt to study the Islamic banking system model and its compatibility to the Indian Banking System.

Keywords : Islamic Banking System, Indian Banking System

Introduction

Modern banking system was introduced into the Muslim countries at a time when they were politically and economically at low ebb, in the late 19th century. The main banks in the home countries of the imperial powers established local branches in the capitals of the subject countries and they catered mainly to the import export requirements of the foreign businesses. The banks were generally confined to the capital cities and the local population remained largely untouched by the banking system. The local trading community avoided the “foreign” banks both for nationalistic as well as religious reasons. However, as time went on it became difficult to engage in trade and other activities without making use of commercial banks. Even then many confined their involvement to transaction activities such as current accounts and money transfers. Borrowing from the banks and depositing their savings with the bank were strictly avoided in order to keep away from dealing in interest which is prohibited by religion.

With the passage of time, however, and other socio-economic forces demanding more involvement in national economic and financial activities, avoiding the interaction with the banks became impossible. Local banks were established on the same lines as the interest-based foreign banks for want of another system and they began to expand within the country bringing the banking system to more local people. As countries became independent the need to engage in banking activities became unavoidable and urgent. Governments, businesses and individuals began to transact business with the banks, with or without liking it. This state of affairs drew the attention and concern of Muslim intellectuals. Thus this paper is an attempt to check the compatibility of Islamic Banking System in the current Indian banking system

Research Methodology

Research Statement:

The problem relates to how the country like India should adopt the ISLAMIC BANKING SYSTEM. The rules pertaining to this banking system are based on Shariah (Islamic law), so considering this laws the banking system is to be liberated , and the main problem of the research is to analyze that how far the people of India accepts, believes, acknowledge and take into consideration this banking system. Thus feasibility and working of Islamic banking system is to be studied.

Research Objectives:

- To check the awareness and understanding of Islamic banks and highlight its salient features.
- To study the progress of Islamic banks which have been successfully implemented in many other countries.
- To know the shariah i.e. Islamic laws relating to finance.

Research Design:

In conducting this study, the exploratory research study (approach) has been used wherein the data has been collected through primary as well as secondary sources and the findings have been developed through data analysis and interpretation.

Sample Size:

The sample population consists of all the potential as well as the existing investor of varied age groups, income groups and professions in Ahmedabad. As it is not possible to collect the relevant information from all the investors due to time constraint, sample of 150 investors from all the age groups, income groups and profession are been included in the research.

Moreover, as the research is based on the survey of the preferences and considerations of the investors while making investment decisions, it includes judgmental sampling technique where inferences are made from the sample about the population to answer the research questions or to meet the research objective.

Analysis & Interpretation

POST GRADUATE RESPONDENTS

How much important are this factors for you while depositing in bank?

	Interest	Safety	Liquidity	Returns
Very important	31	81	38	42
Important	23	19	54	46
Neutral	4	0	8	4
Not important	27	0	0	8
Least important	15	0	0	0
Total	**100**	**100**	**100**	**100**

* Assistant Professor - Marketing Area, GLS Institute of Computer Technology, Ahmedabad, Gujarat

Can profit sharing be substitute for interest?

	% of respondents
Strongly disagree	15
Disagree	15
Neither agree nor disagree	15
Agree	31
Strongly agree	24
Total	100

Which preference will you consider while investing in a bank?

	Fixed income	Profit and loss sharing (variable income)	Only profit sharing (variable income)	In line with inflation
Always	58	11	62	54
Occasionally	23	50	11	23
Rarely	11	31	4	12
Never	8	8	23	11
Total	100	100	100	100

Graduate respondents

How much important are this factors for you while depositing in bank?

	Interest	Safety	Liquidity	Returns
Very important	9	55	21	36
Important	24	42	61	55
Neutral	15	3	12	6
Not important	49	0	6	3
Least important	3	0	0	0
Total	100	100	100	100

Can profit sharing be substitute for interest?

	% of respondents
Strongly disagree	6
Disagree	15
Neither agree nor disagree	18
Agree	40
Strongly agree	21
Total	100

Which preference will you consider while investing in a bank?

	Fixed income	Profit and loss sharing (variable income)	Only profit sharing (variable income)	In l ine with inflation
Always	49	12	21	36
Occasionally	33	27	40	43
Rarely	15	49	30	15
Never	3	12	9	6
Total	100	100	100	100

Under graduate respondents

How much important are this factors for you while depositing in bank?

	Interest	Safety	Liquidity	Returns
Very important	6	56	50	50
Important	19	38	38	44
Neutral	31	6	12	0
Not important	44	0	0	0
Least important	0	0	0	6
Total	100	100	100	100

Can profit sharing be substitute for interest?

	% of respondents
Strongly disagree	13
Disagree	37
Neither agree nor disagree	13
Agree	31
Strongly agree	6
Total	100

Which preference will you consider while investing in a bank?

	Fixed income	Profit and loss sharing (variable income)	Only profit sharing (variable income)	In line with inflation
Always	25	13	6	19
Occasionally	31	6	38	50
Rarely	25	69	44	31
Never	19	12	12	0
Total	100	100	100	100

Do you have ever heard of islamic banking system?

	% of respondents
Yes	76
No	24
Total	100

If yes, than from where have you heard?

Source	% of respondents
Newspaper or magazine	23
T.v or internet	21
Heard from someone	44
Others	12
Total	100

According to you what should be the components of islamic banking system?

Components	% of respondents
No interest	39
Share of profit & loss	35
Both of the above	20
Only share in profit & not loss	4
Others	2
Total	100

Will you prefer to invest in a bank which shares profit and not loss?

	% of respondents
Yes	78
No	21
Can't say	1
Total	100

Would you like to put in your money in a bank whose lendings are backed by a project(which reduces possibility of loss)?

	% of respondents
Yes	95
No	4
Can't say	1
Total	100

Hypothesis testing

How much important are this factors for you while depositing in bank? (only for interest)

Hypothesis

Ho = investor consider interest as an important factor.

H1 = investor don't consider interest as an important factor.

Method used = cross tabulation/chi-square

	Interest	Safety	Liquidity	Returns	Totals
Very important	24	96	50	62	232
Important	34	50	84	74	240
Neutral	22	4	12	6	44
Not important	60	0	4	6	70
Least important	10	0	0	2	12
Total	150	150	150	150	600

Fo	Fe(rtxct)/gt	Fo-fe	$(fo-fe)^2$	$\{(fo-fe)^2\}/fe$
24	58	-34	1156	19.93
34	60	-26	676	11.26
22	11	11	121	11
60	17.5	42.5	1806	103.21
10	3	7	49	16.33
96	58	38	1444	24.90
50	60	-10	100	1.66
4	11	-7	49	4.45
0	17.5	-17.5	306.25	17.5
0	3	-3	9	3
50	58	-8	64	1.10
84	60	24	576	9.6
12	11	1	1	.09
4	17.5	-13.5	182.25	10.41
0	3	-3	9	3
62	58	4	16	0.275
74	60	14	196	3.27
6	11	-5	25	2.27
6	17.5	-11.5	132.25	7.58
2	3	-1	1	0.33
			Total	251.17

X2 calculate=3.09

Significance level	X^2 table value		X^2 calculated
Alpha=0.05	5.991	>	251.17
Alpha=0.10	4.605	>	251.17
Degree of freedom (r-1x c-1)=2			

Where r= no of row

c=column

fo=observed frequency

fe= expected frequency

gt=grand total

Here null hypothesis is accepted because x2 calculated is below the above region and so alternative hypothesis is rejected. Here null hypothesis propose that investors consider interest as an important factor while investing into bank.

Which preference will you consider while investing in a bank? (only for fixed income)

Ho = null hypothesis =investor consider fixed income while investing

h1 = alternative hypothesis = investor do not consider fixed income while investing

Method used = cross tabulation/chi-square

	Fixed income	Profit and loss sharing (variable income)	Only profit sharing (variable income)	In line with inflation	Total
Always	70	18	48	58	194
Occasionally	44	46	44	56	190
Rarely	24	70	36	26	156
Never	12	16	22	10	60
Total	150	150	150	150	600

Fo	Fe(rtxct)/gt	Fo-fe	$(fo-fe)^2$	$\{(fo-fe)^2\}/fe$
70	48.5	21.5	462.25	9.53
44	47.5	-3.5	12.25	0.25
24	39	-15	225	5.77
12	15	-3	9	0.6
18	48.5	-30.5	930.25	19.18
46	47.5	-1.5	2.25	0.05
70	39	31	961	24.64
16	15	1	1	0.67
48	48.5	-0.5	0.25	0.01
44	47.5	-3.5	12.25	0.26
36	39	-3	9	0.23
22	15	7	49	3.27
58	48.5	9.5	90.25	1.86
56	47.5	8.5	72.25	1.52
26	39	-13	169	4.33
10	15	-5	25	1.67
			Total	73.84

X2 calculate=3.09

Significance level	X^2 table value		X^2 Calculated
Alpha=0.05	5.991	>	73.84
Alpha=0.10	4.605	>	73.84
Degree of freedom (r-1x c-1)=2			

Where r= no of row

C=column

Fo=observed frequency

Fe= Expected frequency

Gt=grand total

Here null hypothesis is accepted because X2 calculated is below the above region and so alternative hypothesis is rejected. Here null hypothesis propose that investors consider fixed income while investing into bank.

FINDINGS & CONCLUSIONS

Through the survey of the investors it has been found that the as Islamic banking system is not present in India, investor have very less awareness about the concept. It has been observed that the investors below 30 years of age are in a much better position to take on higher risk to meet their banking requirement (ready to share Profit & Loss), whereas with the increase in the age the risk taking ability of the investors also decreases, thus the investor in the category will to invest in fixed income or only profit sharing for banking purpose. Similarly for the investors between the age group of 45 and 55 the proportion of their debt investments outpaces their equity counterparts and hence the higher debt allocation. On reaching the age group of above 55 years, the investor faces the most challenging phase of investment age. The main consideration of the investor is fixed income after retirement. Moreover, most of the investors wanted their investment in the banking products should grow with inflation.

Out of the total samples, it has been seen that salaried people do not consider interest as important where as students and housewife consider it to be very important. All the other criteria such as safety, liquidity and returns are considered important by all the investors of different occupation.

It has been observed that out of the Post-Graduates 81 percent consider safety to be at very important where as 54 percent of the investor consider liquidity to be important as well as 46 percent of the investor consider returns to be at the important position as compared to this only 31 percent of the investor consider interest to be very important. Out of the Graduates 61 percent consider liquidity to be important where as 55 percent of the investor consider safety to be very important as well as 55 percent of the investor consider returns to be at the important position as compared to this 49 percent of the investor consider interest as not at all important. In Under-Graduates 56 percent consider safety to be at very important where as 50 percent of the investor consider liquidity and returns to be very important as compared to this 44 percent of the investor consider interest as not at all important. From the above we can interpret that safety, liquidity and returns are consider to be important or very important.

It was also found that 31 percent of Post-Graduates, 40 percent of Graduates and 31 percent of Under-Graduate agreed that profit can be substitute for interest. Moreover 62 percent of Post-Graduates always invest in only profit sharing avenue while 40 percent of Graduates and 44 percent of Under-Graduate do so occasionally and rarely respectively, while most of the investor do not wish to invest in an avenue which shares profit and loss equally. Similarly, most of the investor always wanted to invest in an avenue which provides fixed income. 54 percent of Post-Graduates always like that their income should grow with inflation, while Graduates and Undergraduate would occasionally invest as per the nature of the investment so that their investment grows with inflation.

Almost 76 percent of the investor where aware about the term Islamic banking system, out of them 44 percent has heard from someone where as 44 percent of the invertors have heard form media, some of them have also heard form religious heads. Most of the respondent stated that no interest and profit and loss sharing were components of Islamic banking system. Even it is clear that if in a banking system, only profits are shared & loss not and the money is being invested in the project backed avenues majority of the respondents would invest in such avenues.

Thus from the above findings it can been concluded, if an banking system is being implemented in India which provides good return as only profit are shared and not loss, also safety of funds being assured as project backing is their most of the invert would like you invest, and will be ready to forgive interest as good returns in terms of profit is being assured and will agree upon variable income in against of fixed income as the funds can grow with inflation

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