"Islamic banking and finance: Moral beliefs and business practices at work"

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5.5 Islamic Banking and Finance
Moral Beliefs and Business Practices at Work

The religion of Islam has existed for 1400 years but Islamic economic theory and its financial institutions emerged as an industry only in the 1970s. Islamic financial institutions (IFIs) are designed to help Muslims conduct business internationally while simultaneously upholding traditional Islamic values related to trade finance and currency movement. The basis for their existence is the Islamic moral prohibition on charging interest—interest is a central component of capitalist banking—yet IFIs conduct billions of dollars of business annually in the world economy and the de facto Islamic banking transaction is—/in most cases—virtually identical to a capitalist banking transaction. Business practices in the industry of Islamic banking and finance (IBF: Maurer 2005) have evolved to reinforce some of the major tenets of a moral belief system based on Islamic principles. This chapter will discuss specific practices put into place by the IBF community that are designed to embody tenets of a belief system based on Islam while at the same time generating profits for the institution and its customers. This chapter will contribute to the discussion of best corporate practices by introducing some of those practices and discussing how those practices contribute to the success of the industry.

Religion and Business Practices

Religion is deeply concerned with the relationship between individuals and society on earth and the implications of that relationship on salvation; therefore, it is crucial for humans to understand the place of material survival in the cosmological scheme of life. That concern has been intertwined with questions of what it means to be a person and how to identify with a certain kind of community or communities. Opposition between religion and economy has arisen at times when a religious community is trying to carve out an identity for itself vis-à-vis the broader society. Individuals and societies change throughout history; therefore, spiritual and material well-being must be constantly renegotiated. As such, it makes sense that human beings struggle to find the appropriate balance between material and spiritual matters. These concerns have carried over into contemporary discussions of religion and economy, and have become visible in the form of social movements based on various conceptions of morality. The basic questions and issues are the same as in the past, but the context of globalization (Appadurai 2000, 1986; Sassen 1998; Jameson & Miyoshi 1998; Hannner 1996; Scholte 2000) has expanded the scope of the meaning of identity and community, especially in the context of competing moralities (Shweeder, Minow and Markus 2002; Gupta and Ferguson 1997; Ong 1999).

In the contemporary world, some types of morally driven economic theories—corporate social responsibility, socially responsible investing and, it will be argued throughout this chapter, Islamic finance—are examples of some approaches to economic behavior that are based on moral discourse. Regardless of whether or not religion is specifically invoked in the moral discourse, it is clear that discussions about religion and economy are as relevant today as ever before. Economic cultures are sensitive to cultural and religious understandings of the implications of moral belief systems on business practices.

Most economic development textbooks do not take into consideration the effects of moral or religious beliefs on economic behavior (Kuran 2004). From the Enlightenment until the publication of Weber’s Protestant Ethic, scholars took it for granted that religion and economy were unrelated spheres of life. Whereas an emphasis on the compatibility of religion and economy may have waned for more than a century, some groups in contemporary society are very much embroiled in the same kinds of conversations about morality and business that occupied the minds of medieval moralists. These conversations may not be based specifically on religious morality, but they do call upon an individual’s moral inclinations to curb human greed and to form communities around moral beliefs about economic activity.

Introduction to Islamic Finance

The industry of Islamic banking and finance is growing daily. In 2006, the Islamic Development Bank in Saudi Arabia estimated that Islamic financial institutions manage more than USD$800 billion. There are more than 500 Islamic financial institutions worldwide and the world’s potential market for Islamic finance consists of more than one billion Muslims, in addition to non-Muslims, who are welcome to participate in Islamic finance. Islamic finance has been compared to an environmental fund in that its policies are based on a certain philosophy of life yet its participants also expect to make a profit on investments. Practitioners in the industry define Islamic finance by the ways in which it objects to conventional financial practices in addition to the ban on riba, which is translated from Arabic as interest or usury. Islamic financiers are not allowed to trade in specific goods forbidden under Islamic law, such as pork and alcohol. Islamic finance prohibits taking unnecessary risks or gambling (El Gamal 2000). Islamic financial institutions should adhere to a code of Islamic business ethics and should maintain a Shari’ah Standards Board composed of Islamic scholars to maintain the purity of the institution’s products and conduct (Lewis and Alagoud 2001; Beekum 1997).

Ultimately, all features of Islamic finance are designed to uphold theological concepts of God-consciousness (tawhid) and social justice (adalah) in a business environment.

Framework of an Islamic Economic Theory

The framework of Islamic economic theory was developed in pre-Partition India in the early 20th century by Islamic scholar Mawlana Mawdudi (1903–1979) and expounded upon by one of his students, economist Khurshid Ahmad, who later moved to Pakistan. At the same time, Indian Muslims as a group were relatively disadvantaged economically compared with the majority population of Hindus. The British Raj had provided some economic protections to Muslims, farmers in particular, but at the time it was unclear how or if a Hindu-led government would provide the same protection (Kuran 2004). Mawdudi believed that economic activity and technology were crucial to success in the modern world, and he was dedicated to providing Muslims in pre-Partition India with economic opportunities that allowed them both to function in the modern world and to retain their Muslim identity. He and Ahmad believed that it was possible and desirable for Muslims to embrace systems and institutions of modernity while at the same time adhering to the teachings and practices of Islam (Mawdudi 1980, Ahmad and Ansari 1979). One goal of Mawdudi was to redefine Islamic practices to conform to economic changes. Mawdudi’s ideas were put into practice in the 1970s in the
Arabian Gulf, with the establishment of Dubai Islamic Bank and the Islamic Development Bank in Saudi Arabia.

At first the industry grew slowly. Until very recently Islamic financing was only sporadically available throughout the world, and mostly it was not available at all. Recent developments in the global economic structure due to improved technology and fewer restrictions on capital flows have made world conditions much more amenable to the possibility of IBF making a meaningful contribution to the reformation of business practices to bring them more in line with the Islamic belief system. IBF business practices reflect and reinforce certain key concepts of an Islamic moral economy (Tripp 2006) such as community, partnership and trust. Financial structures and practices provide evidence of adherence to these beliefs.

**Business Practices Under Islamic Law**

The existence of Islamic finance institutions solves a difficult problem for the Muslim desiring to participate in international finance while adhering to Islamic law, or *Sharia*. Islamic law does not allow for individuals or institutions who lend or borrow money to charge or pay interest on that money. Yet in the early twenty-first century global economy, trade finance and other crucial banking transactions are dominated by capitalist financial practices in which return on investment is based upon charging interest.

The Islamic finance industry intends to improve upon global financial institutions by maintaining their positive features and cleaning them of negative features (Mauro 2002a, 2002b; Al Saud 2000). Islamic banks strive, in the words of a prominent Islamic bank's vision statement, to uphold “deep-rooted traditions in the new world” (Dubai Islamic Bank brochure). Islamic finance professionals claim that an Islamic bank is a conventional bank without its immorality. The framework used to determine morality is based on Islamic text and tradition, yet the institutional framework is on the surface at least and to the untrained eye, indistinguishable from the capitalist financial structure.

Islamic law is specific about what constitutes permissible trade behavior. Business practices fall under the set of normative relationships between human beings (*munamalat*) that are ultimately governed by the will of Allah, or God (Waines 1998:65). Therefore, banking, finance and trade are regulated by specific rulings found either in the *Quran* or in *hadith*. Discussions of Islamic finance fall into two categories: moral, ethical and social justice concerns. The first category is the better known and involves the prohibition of specific types of transactions: *riba* and *gharar* (El Gamal 2000) as well as more general trading prohibitions regarding goods forbidden under Islamic law such as pork, alcohol and tobacco. *Riba* broadly refers to any goods or services traded in unequal amounts. Muslims cite a well-known *hadith* to support this concept:

> Gold for gold, silver for silver, salt for salt, dates for dates, barley for barley, and wheat for wheat, hand-to-hand in equal amounts; and any increase is *riba*.
> 
> [El Gamal 2000:147]

The concept of usury may be applied to both monetary and material goods and its prohibition serves a major purpose of keeping relations among businesspeople equitable. This conception of *riba* is, of course, a simplification and its technical properties are widely discussed and debated by Islamic economists (see, for example, Ahmad 1976; for an alternative economic view of *riba*, see El Gamal 2000).

In the area of religious thought Judaism and Christianity, in addition to Islam, have struggled internally throughout history with moral challenges posed by “interest” (Weber 1968).

Interest calculation is based on the measurement of time. Foucault (1978) asserts that early Christians viewed time as a gift from God; therefore, it has different value for different people, making the calculation of interest immoral. The original intention of timetables, he asserts, was a religious invention designed to eliminate the dangers of wasting God’s gift of time. The move of instituting schedules served to appropriate the use of time in daily human life. In addition, Landes emphasizes the importance of time to the link between Protestantism and the formation of a capitalist subject (Landes 2000). However, Foucault argues that today time is understood as a material possession to be manipulated and shaped at will. The perception of time as a gift has been negated in capitalist society by the “principle of a theoretically ever-growing use of time” (Foucault 1978:154). Islamic thought designates a similar spiritual orientation to the concept of time (Bamyleh 1999; Waines 1998), which some scholars contend has lost in the modern world (Wilson 1997). Although Islamic practice employs scheduled activities (most notably prayers), Islamic finance intensifies its rejection of the model of interest on the basis of its objectification of time as a material entity (Wilson 1997: see pages 5–7 for a complete discussion). Christianity and Judaism (with similar arguments to those we see in Islamic finance today, see El Gamal 2000) has resolved the moral issue of time in a way that advances capitalist enterprise, where Islam seems to critique capitalism while at the same time advancing it.

Present day IBF institutions avoid the problem of interest by structuring transactions as profit sharing or lease-to-purchase arrangements. Practically speaking, it is challenging for a bank to function without some kind of reference to “interest.” This difficulty was made clear when the author decided to open a checking account at an Islamic bank. *Jahara* means “jewel” in Arabic. *Jahara* is also the name of a bank for women: the stand alone ladies’ branch of an Islamic bank in Dubai, United Arab Emirates (UAE) where the author did fieldwork in 2003. The teller was asked to explain exactly how the annual profit sharing payment on the account worked. Immediately, she responded, “Well, it’s basically like an interest payment.” Although her reference to “interest” may have been stemmed from the fact that the researcher is American, it was nevertheless hard for her to find the words to explain the payment without reference to the better-known concept of interest, in which she was fully conversant. This is a common tactic employed in Islamic finance, and it is not seen to be at odds with the ban on interest.

**Community Financial Transactions**

Community discourse permeates discussions about and within the Islamic finance community. From the outset, the industry was meant to address community concerns. The focus on community stands in contrast to a capitalist understanding of economic activity, which is built on the assumption that the individual is the locus of economic activity, as Adam Smith so elegantly noted in *Wealth of Nations* (1776). Islamic economics subverts the neoclassical economic model by asserting that individuals are (or should be) driven to cooperate for the good of society. This is a very important difference between conventional finance and Islamic finance, and one that is mentioned regularly in conversations with Islamic financiers. Because the Islamic finance industry defines itself with reference to the conventional finance industry, it is valuable to understand how that difference in meaning is instilled into financial practices.

**Classical Financial Structures**

One of the first differences one notices between conventional finance and Islamic finance is the structure of financial transactions. This business practice is not visible unless one delves
into the minutiae of the financial details. Yet, when Islamic financiers are asked what is the most important difference between conventional and Islamic finance, the most common answer is that the transactions are structured differently. In response to the prohibition against charging or paying *riba*, great attention is paid to how well the cash inflows and outflows are conceptualized. In addition to attention to *riba*, transactional structures are meant to reinforce the idea that the provider and recipient of funds share in the risk and return as much as possible. Therefore, the first business practice I will discuss is the practice of structuring the transactions themselves.

There are four classical Islamic financing structures used by the IBF industry intended to avoid *riba* and emphasize the communal nature of business practices. When I began reading about Islamic finance in the early 1990s, these were the *only* transactions available to people who wanted to participate in Islamic finance. Present-day Islamic finance transactions are based on these four basic methods; however, there are now countless ways to structure a transaction that adheres to Islamic law but provides competitive returns in the market. They are based on the notion of partnerships, and highlight the importance of business practices that encourage community members to work together as partners. Although each financing structure specifically addresses the concerns of Islamic finance, each is also compatible with conventional banking practices. Knowledge is acquired together with one’s fellow community member, rather than autonomously through rote learning. Each kind of transaction will be described below.

The first two structures relate to debt finance. First is a *muraabaha*, or trade finance, which accounts for some 80% of Islamic financing (Wilson 1997). This transaction is very formal, and involves a buyer, a seller, goods for trade and a financier. The seller and buyer wish to exchange goods or services and agree upon a price, all according to lawful means. A financier, in turn, provides the money for the goods at their cost plus a predetermined financing fee. The financier then owns the goods (but does not take possession of them) until the buyer pays for the goods in full (Wilson 1997). This method is a short-term financing technique, and, except for the predetermined fee, looks and operates like a capitalist trade finance.

In other words, say we run a lemonade stand. We need to buy pitchers to serve lemonade to customers and do not have enough cash to purchase those pitchers. We need financing to help us. In order to finance the pitchers on a *muraabaha* basis, a financial institution would purchase the pitchers from the supplier and immediately resell them to our business for a marked up price based on administrative costs and a profit margin. Remember that there is no profit on profit, just the means by which it is acquired.

A second form of debt financing is a lease finance structure. Short-term *ijara* and long-term lease purchase contracts (*ijara wa-igtina*) are functionally equivalent to their capitalist counterparts. Both are normally used to finance machinery or other equipment. As under a *muraabaha* arrangement, in an *ijara* the bank purchases the goods and the buyer pays the bank through a periodic (usually monthly) fee. At the end of the lease term the purchaser may either purchase the item or let the bank dispose of it. The major difference between a capitalist lease and an *ijara* is that, under an *ijara*, the lessor assumes responsibility for owning and maintaining the asset, whereas that responsibility falls to the lessee under the capitalist tradition (Wilson 1997). This stipulation is consistent with the requirement of a seller’s responsibility to take care of merchandise before the sale.

In our hypothetical lemonade stand, another way we can finance the pitchers is via an *ijara*. The financial institution would purchase the pitchers and then lease them to our business. At the end of the lease period, we would either purchase the pitchers outright or return them to the financial institution.

The first Islamic finance structure the author encountered in her professional life was an *ijara*. The company the author worked for in Dubai financed an oil rig, located in Angola. The financial company actually owned the title to the oil rig and received monthly payments as lease payments on that lease. This situation was brought to the author’s attention because the cash flow did not look any different from other loans’ cash flows, yet the funds were separate from the company’s other funds. It was only after looking at the original financing agreement that the author realized the structure was meant to be “Islamic” and the sharing of risk between financial company and lessee were built into the financial plan.

There are two classical forms of equity finance. The first, a *mudarabah*, is a partnership between a provider of capital and a provider of labor. A capital provider may be a bank, individual, or one of many groups of investors (Wilson 1997). Profit and loss sharing are in proportion to the amount of capital invested, and no one except the partners may receive profit (Mistry 1994). Most importantly, liabilities are limited to the amount of capital invested by each investor (Wilson 1997). This type of arrangement is virtually the same as a limited liability company in capitalism, and is compatible with equity financing through a stock exchange.

Another type of partnership is a *musharaka*, under which both parties supply capital (in contrast to a *mudarabah*, in which only one party or group supplies capital). Losses are not limited to the amount of investment, so risk is greater for all parties. The capitalist equivalent would be a venture capital firm providing capital for smaller ventures (Wilson 1997).

### Contemporary Financial Structures

Some contemporary transactions were designed in response to contemporary conventional transactions, but are based specifically on built-in partnership arrangements in keeping with the focus on community and cooperation. The most noticeable difference between classical and contemporary Islamic transactions is the presence of an institution called an Islamic bank. If we look closely at the *muraabaha*, *mudarabaha*, *musharaka* and *ijara* methods of finance, we notice that not one of them requires the existence of an institution. Each form of financing is a partnership arrangement that can easily take place between any entity with available capital and any entity in need of capital. In fact, in the Middle Ages, merchant families themselves financed trade in the Muslim world, not unlike trade finance in Europe at the same time (Udovitch 1970). For example, a neighbor and you could both contribute some money to make a lemonade stand, agree that you will oversee the daily operations of the lemonade stand, and that each person would get a share of the profits according to the relative amounts each of us invested into the project. In this scenario, the neighbor and you have agreed to open a lemonade stand under a *musharaka* agreement. You did not need an institutional intermediary. The transactions discussed below require an intermediary in their financial structure. That intermediary is an IFI or some kind of special purpose investment vehicle. They are more complicated than the classical financial structures.

### *Salam* and *Istina*

The *salam* and *istikma* transactions are both sales contracts used when a commodity is not available for delivery at the same moment financing is needed. A *salam* contract is used for commodity transactions when the financial institution (on behalf of a buyer) advances the purchase price of goods to the commodity owner. The goods are delivered at a later date to the financier, who then delivers them to the buyer. The buyer pays the financier the purchase price upon delivery of the goods.

An *istikma* works in a similar manner, except that it is used principally for manufacturing and
construction finance. The financial institution pays the construction company as work is completed (say, on a building project). The construction company delivers the asset when it is complete. The financier delivers the asset to the customer, who then pays the purchase price to the financier.

The difference between *salam* and *istina* is based on the nature of the goods in question. A *salam* is used to finance goods (commodities) that do not yet exist but are almost assured to exist in the future; e.g., agricultural goods (say, soybeans) that need to be grown during the growing season. The "production process" makes no difference to the transaction: the contract cannot specify how the soybeans are grown, merely that soybeans of a certain quality will be produced. The *istina*, on the other hand, is tied to goods that would not otherwise be produced, like a commercial office building. The *istina* is usually tied to a specific production process, which is essential to the final product and which is included in the price as part of the risk structure of the contract (Vogel and Hayes 1998; Bahrain Monetary Agency 2002).

At first glance, there does not seem to be anything particularly "modern" about either of these transactions. After all, it has always been necessary to finance commodities trades or to provide a farmer with financing based upon the anticipated production of agricultural products. Udovitch (1976) points out that trade finance was always prevalent in Muslim societies, just that merchants would provide financing instead of financial institutions. Vogel and Hayes (1998) draw attention to the modern nature of the *istina* contract: until the Industrial Revolution few goods were exchangeable on a commodity basis as most people produced their own necessary goods. There was little need for manufacturing finance. It was only after the transformation of the nature of goods by the industrial production process that it became necessary to provide long term manufacturing finance (see also Appadurai 1986 for an extended analysis of the history of the commodity and its uses). The *istina* is a response to the changing commercial environment. It must be noted, also, that the *istina* is only valid under the Hanafi legal tradition (Vogel and Hayes 1998). Hanafi was the first legal school to be recognized by Muslims, and is therefore the oldest *madhab*. Hanafi is generally considered to be the *madhab* most amenable to modernization. It is also the school most closely associated with the geographical area of South Asia (India, Pakistan, and Bangladesh) that gave inspiration to Mawdudi.

**Sukuk**

The two most prevalent financing structures in Islamic finance today are the *sukuk* (bond) and *takaful* (insurance). The author does not have any first hand data on either *sukuk* or *takaful* from fieldwork because they were first issued in 2002, when she was in the field. They have since become one of the most popular financing vehicles: therefore, it will be described briefly.

A *sukuk* is a form of bond usually issued by a government, or by a corporation in partnership with a government. It is based on a conventional government bond, and is used for long term financing. A conventional government bond is a method of financing by which a government (local or state/national) sells paper (bonds) to investors in exchange for 1) periodic (usually annual) payments to the investor and 2) repayment of capital at the end of the term. A bond is essentially an IOU from the government to investors. Profit to the investor is based on an interest rate determined by a measure of the stability of the government issuing the bond. The more stable the government—and therefore the better able to repay the funds—the lower the interest rate. Less stable governments must pay a higher interest rate. For example, if a local government wants to build a bridge across the river, it would sell bonds in order to raise cash to pay the contractors. Upon completion of the project, the government would repay the investors from its own capital account.

The cash flow of a *sukuk* looks similar to the cash flow of a conventional bond. The difference, as with most Islamic financial structures, lies with the underlying assumptions and asset structure. Whereas a conventional bond is backed by the goodwill and stability of the government, a *sukuk* is backed by tangible assets. In the example of the bridge financing, the government might pledge the income stream from some government properties or buildings to the *sukuk*. Investor return would be derived from that income. In the event of a government default, investors could theoretically sue the government for the income from its property.

*Sukuk* are "hot" at this time in the Islamic finance market. On the global market, issues of *sukuk* increased from S1.9 billion in 2003 to S6.7 billion in 2004 to more than S10 billion in 2005 (www.zawya.com). The largest single *sukuk* issuance on record to date was just issued by Dubai Islamic Bank on December 10, 2006 in the sum of S3.52 billion (www.zawya.com).

In July 2007, the government of the United Kingdom agreed to issue the first ever *sukuk* offered by the government of a non-Muslim country.

**Takaful**

*Takaful* is Islamic insurance. Insurance is a modern concept and therefore is not found in any of the classical Islamic texts. Insurance means that a person or business (the insured) makes periodic payments (insurance premiums) to an insurance provider so that in the event of loss (of inventory, house, car, etc.) the insurance provider will compensate the insured party for that loss. The concept of insurance is controversial; nevertheless, Shari'a scholars have come to recognize the importance of insurance in the international business arena. *Takaful* is one of the fastest growing areas of Islamic finance. I did not interview anyone specifically about *takaful* during my fieldwork because the field is generally considered to be somewhat separate from traditional Islamic finance. It will be described briefly, however, to illustrate how a conventional method of managing risk can have huge implications for the practice of Islamic finance.

What are the problems with insurance? First, the industry is built upon uncertainty about events beyond its control. Insurance deals with an amount of uncertainty (ghanar) because the outcome of a future event is uncertain in the present. In a sense insurance is gambling (majazi), which is forbidden under Islamic law. Because it is highly unlikely that every insured party will incur a loss in the future, insurance companies effectively take a gamble that it will make a profit from insurance premiums even after it pays its insured customers in the event of a loss. This is the second objection to insurance (Lewis and Algaoud 2001). Life insurance presents a particularly difficult challenge to the concept of insurance because of the idea that no one can predict the end of life and that to insure the event shows distrust in God's life plan. A third objection to conventional insurance is that most insurance companies invest their premiums in forbidden *riba* (interest-bearing) investments (Vogel and Hayes 1998). However, this objection can easily be overcome by investing in one of the many Islamic institutions available today.

Conventional insurance operates on a contract basis; i.e., the insured party and the insurance company enter into a contract specifying terms of payment and coverage. The word for Islamic insurance, *takaful*, means "solidarity" and reflects the worldview built into a *takaful* arrangement. In general, a *takaful* agreement is a collective enterprise in which Muslims pool their resources in order to aid each other in the event of a loss (Vogel and Hayes 1998). Members make periodic payments into the fund and the company invests those funds Islamicly. This investment is made on a *mudaraba* basis, with the member acting as the financier and the *takaful* company as the *mudarib* (entrepreneur). This arrangement also helps to
mitigate the element of uncertainty about future payments, as the members would expect periodic payments on their capital investment. This arrangement is also consistent with the concept of *lawhid* (unity), because economic actors are pooling their resources to benefit the group.

**Partnerships in Business Practice**

Just as financial structures reflect an emphasis on partnerships, individuals working in the industry view IBF's business practices as a way to emphasize that same concept. The author interviewed Mohammed, a government Private Investment Office. He states that what makes an IFI distinct from a conventional bank is that the customer expects to be a partner with the IFI. He emphasizes the situation in which the IFI and the customer have more interaction with each other. In addition, they share the financial risk of the transaction.

MOHAMMED: It's more of a partnership... if I am your client, my relationship with you is [based on] taking the same risk. Any opportunity and any investment... if, for instance, you decide to invest in a real estate investment. So, in this case, the bank and the client take on [together] sharing the risk. That's the relationship that I expect from the Islamic bank.

INTERVIEWER: Right, so maybe more interaction.

MOHAMMED: More interaction, more involvement, more of knowing the customer and what I have seen from my own experience, once you get into an Islamic bank you almost get to know everybody.

Partnerships link suppliers and consumers of funds and reinforce the idea of community.

Rania, the general manager of a ladies' branch of a major Islamic bank, states that the partnership aspect of Islamic banking is as important as the actual amount of profit made by the bank or the customer. She believes this is because the bank plays a role in the community of a support system:

And then they also have the flexibility of supporting you, Islamic banking. It supports you through it in terms of partnerships with you, in terms of management, so that gives you another flexibility and choice so that in case the business fails for some reason, you are not completely left on your own, high and dry, in a sense, not knowing what to do. Children aren't driven out of the house because you owe the bank some money or something like that. We try to help you out in all possible ways to prevent that.

From the customer's perspective, an emphasis on partnership is a positive aspect of Islamic finance. The author talked to a customer about the partnership concept: Manoj is a very successful owner of multiple businesses in Dubai, including marble and tile factories. He has been living in Dubai for over thirty years so he had watched the growth of Islamic finance from the ground up. He is Hindu, from India, but strongly emphasizes that anyone can participate in Islamic banking as he does. Part of what has made him so successful is the fact that he finds the best deal in the market, and he says that, often, Islamic finance provides the best financial deal. In addition to that, he feels that Islamic banks look more at the merits of the project and the customer rather than the interest rate, as the international banks do. The Islamic bank's profit is tied more to the project than the world interest rate. He feels very comfortable with this method of financing and stated that he would rather have a partnership relation with his bank.

Hamad was the director of the Islamic Banking division of the Dubai International Financial Center (DIFC) during the time of my fieldwork. He is a UAE national who was educated (undergraduate and graduate) at a prestigious, socially liberal university in the United States. He is very philosophical about the state of Islamic finance in the Gulf region. The discussion had digressed from the formal questions and we were talking about what he sees as strengths and weaknesses of the industry. In addition to what he perceives as a lack of innovation in IBF, he sees the "entanglement of religious behavior" in business to be a weakness of the industry. He sees IBF focus too much on paperwork where it should be taking the principles of Islam and applying them on a more fundamental level.

HAMAD: I think we have to get rid of this model if we want to have a truly international Islamic finance. We have to separate it. I mean, if you create a truly new industry that does things in a certain way that will be more than just paperwork. So the contractual terms change—this is what you do in Islamic finance—so the contractual term changes and reposition what you are to commercial finance from lenders to investors to partnership (italics added). This is what they do. Islam rejected the usury concept, and consider[ing] that most financing is usurious, then the contractual terms only change where the financial institution turns into more of a partner (italics added).

Hamad's critique of the industry is that it needs more innovation to truly uphold the principles of Islamic finance.

In addition to the emphasis on community building business practices, IBF institutions strive to contribute to the welfare of the Muslim community. For example, Masood of East-West Bank Corporation (EWBC)—an international, conventional bank with an Islamic division—views his involvement in IBF as a way to promote the Muslim community's welfare:

Well I always as a Muslim had a passion for this Muslim community welfare as such... and I always had a realization that you can't have a strong economy unless you have a strong banking system. And when you have a strong, you have a strong banking system you need strong indigenous banks. And I was involved in Islamic banking in supporting Islamic financial institutions in either managing their money or doing transactions for them as a banker.

It appears that the discourse of "IBF as community service provider" is a theme in the offices of EWBC: the idea that banking is providing a needed service for the Muslim community is echoed by Masood's colleague, Peter:

I mean there are things that you once used to share with the community—for example the building of your house—the whole village comes together. You help me, tomorrow, you want to build your house—I'll help you. Now we are living in a different more specialized society and everybody does its own job so we pool our resources in financial institutions, so instead of me going home to house to ask for help to build my house, I borrow money, build my house and then I will repay my share to that society so there is a social function—very important.

Peter also recognizes a very important fact in the world today: that institutions have taken over some community functions. If institutions and aid agencies are now providing assistance to the community, then it follows naturally that those institutions should share some of the core values of the community they intend to help.
The Financial Community and Trust

Being part of a community also means being able to trust other members of that community. The author spoke with Hesham, who was born in Pakistan but left when he was a small child. He has lived in the Middle East and in the United States, and now runs a conventional financial management company in the US that also structures Islamic transactions. At the time of the interview, he was relatively new to the field of Islamic finance and was going through the process of introducing an Islamic hedge fund. He had some observations about the function of the Islamic finance industry as a bridge between cultures.

It's been interesting to create that particular product actually ... the world view of Islam has changed in my opinion because Islam is truly global today. American Muslims will be very different from European Muslims will be very different from Asian Muslims or Middle Eastern Muslims and so on and so forth because they're American, European, Middle Eastern, Asian and they have their own perspectives in that sense. I never really thought of it as a—as a truly global (religion)—I never really saw it as that.

Hesham became aware of the diversity within Islam only after beginning to work in an Islamic finance space. In conjunction with that diversity, the unity of being part of a Muslim community allows its members to build trust among themselves. It is important for the purposes of looking at the self, though, to understand that Islamic finance does provide a mediating influence in how Islamic practitioners see the role of the industry in their lives. Many IBF practitioners see themselves as part of a community, a role that transcends participation in a mere profession.

Rania, who was introduced earlier in the chapter, also confirms this feeling of trust, and feels it especially in the Islamic banking environment:

I feel that it's a very fair system. The only thing is that there are no hidden charges; they are very fair with the customers. I mean I worked in foreign banks and when I compare it I know. And people in general have a feeling of more trust and faith and caring. I've seen the compassion in here which I have not seen in foreign banks.

Just as Mandaville (2004) suggests in his analysis of the history of the Muslim community, many Islamic financiers recall in their imagination the early days of Islam when thinking about Islamic finance. Tony is an accountant who has worked with Islamic finance in the accounting practice run by his father and himself.

TONY: Islamic banking probably has more because that was probably set as a precedent by the prophet himself because a lot of people entrusted assets to him.

INTERVIEWER: Right.

TONY: Because he's honest, honorable and he would look after those assets—so Islamic financial institutions—probably that is the most important principle that they should adopt—that whatever's entrusted to you, you have to look after in the best possible manner.

Association with this golden era of Islam (Maurer 2005) allows Tony to see IBF as being inculcated with a high level of trust.

Yasir, of Ethical Investing Corporation, raises the issue of trust not only from within the IBF community itself, but as a way to promote interaction with the conventional banking community:

YASIR: We actually try to tell them [conventional bankers] that “what we do is very, very similar to what you do” but we have a sort of filtering that we have to superimpose over what it is that they do. So we always try and make them feel, especially because there is a little bit of aura and, you know you don’t trust what you don’t know, we want to avoid confusion. A lot of Islamic institutions that I've come across tend like to create a mystique around the whole you know Islamic industry, to make it inaccessible to their Western counterparts. They feel threatened so they say “no no there's no way you guys can do it”; “you need the Shari'a [Board] and it's impossible to talk to them and it's impossible to reach them and you have understand this and that.” It's actually not so, it's an accessible market. We've seen that demonstrated by Western institutions that have already set up shop and we take an opposite view. I mean we tell people literally “I do exactly what you do however I have to do it within these guidelines.” You have to do it within your guidelines but amazing similarities.

Yasir sees trust as an important component of the “bridge” function of IBF.

Shari'a Standards Board

Another way of strengthening community through the structuring of transactions is to require Shari'a board approval for every transaction, or type of transaction. A Shari'a Standards Board (SSB) is composed of Islamic scholars, who are fluent in both Islamic commercial law and international financial principles. The SSB's purpose is to ensure that Islamic law is being followed accurately in the business practices and financial arrangements of the IFI. A separate financial standards board evaluates the efficacy of financial transactions, just as it does in a conventional institution, and the two boards often work together.

Islamic scholars must publicly declare that a transaction adheres to Islamic law before a company can go ahead with that transaction. A company's SSB does this by issuing a fatwa (religious declaration). A transaction does not adhere to Islamic law if it is not accompanied by a fatwa, as Khurram explains: “the fatwa is kind of more expected by the retail clients... the retail market wants to see a fatwa.” The issuance of a fatwa makes the transaction Islamic in a way that is recognizable to members of the community, and members trust that transaction will meet their moral criteria for business practices.

Conclusion

The industry of Islamic banking and finance structures its business practices and financial transactions according to a belief system that counts community, partnerships and trust as its highest priorities. Islamic financiers reinforce business practices and financial structures that emphasize the mutual benefits of sharing both profits and losses with fellow humans, rather than a system that focuses attention on profit only. IBF practitioners align themselves morally with corporate social responsibility and socially responsible investing movements in the way they expect to receive profit on investments while at the same time improving upon moral imperatives, such as building community and fostering healthy business practices. IFIs take the additional step of monitoring their own activities through a Shari'a Standards Board charged with upholding and monitoring the moral efficacy of the company's activities. Through its financial structures, business practices and corporate
governance, Islamic finance provides an example of how business practices can be aligned with moral beliefs.

Notes

* This case was prepared by Karen Hunt Ahmed, Assistant Professor of Finance at DePaul University. Used with permission by author.
1 The first takaful (Islamic insurance) company was launched in the UAE in October of 2002 (Khalej Times newspaper article, October 12, 2002).
2 Vogel and Hayes (1998) point out that this should not be a concern because insurance protects the living from "adverse material consequences" (p. 151) of death and does not make any prediction about death itself.

References