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ISLAMIC BANKING: A LITERATURE ON THE HISTORY

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Abstract

In the last three decades, and Islamic finance system has greatly expanded. However, people are still not completely aware of how it is different from conventional finance system. Thus, it can be implied that it is widely unrecognized in the western nations and poorly comprehended among people in the Muslim countries (Hassan & Lewis, 2017). Currently, there is an adequate amount of researches relating to the Islamic finance system. Therefore, this study intends to review the literature on Islamic banking.

Keyword: Islamic Banking

1.THE HISTORY OF ISLAMIC FINANCIAL SYSTEM (IFS)

The general terms used for Islamic Financial System were "Islamic Banks" or "Islamic Banking". Presently, the financial institutions and Islamic banking systems, which partially reflect the change that can be seen in the Islamic as well as western markets, are commonly discussed. In reality, financing activities replaced the activities that the conventional banks engage in.

If we consider the situation of banking systems approximately three decades ago, it can be seen that Islamic Banking System (IBS) was hardly in practice. However, now the capital markets and global financial systems greatly rely on it. At present, IBS is considered distinctive and a rapidly growing subsector. The Global Finance website in America conducted a survey in 2013 through which it was demonstrated that there are Takaful (Shariah compliant insurance) organizations in over 22 nations, Shariah compliant investment houses, product trading companies, mutual funds trading companies and leasing companies, in addition to over 599 Shariah compliant financial organizations currently operative in 150 countries that comprise mostly of Muslim and some of the western nations (Global Finance, 2013).

As opposed to this, it was discovered that from 2008-2012; there was 17% growth in the Islamic banking assets (Ernst & Young, 2014). As a matter of fact, 50% of the worldwide GDP will be dependent on the 25 most rapidly growing markets in the world. According to Ernst & Young (2014), 10 of these nations are high in Muslim population with customers amounting to approximately 38m till the end of 2014.

Furthermore, involvement of the biggest Islamic fiscal organizations is accepted to be on a multilateral scale. There are several micro-Islamic monetary forms that are included in the mentioned statistics, such as individual households and macro business firms, financial association and Islamic welfare societies that are dealing with rural units at a homegrown level, and the rural and urban cooperative credit societies. (Presley, 1990; Hassan & Lewis, 2017).

In the last three decades, and Islamic finance system has greatly expanded. However, people are still not completely aware of how it is different from conventional finance system. Thus, it can be implied that it is widely unrecognized in the western nations and poorly comprehended among people in the Muslim countries (Hassan & Lewis, 2017). Currently, there is an adequate amount of researches relating to the Islamic finance system.

However, the topics related to Islamic finance system, such as fiscal centers, multilateral institutions, governmental support regarding finances, project finance, mutual funds, stock market, risk management, marketing, good operational handling, and management liquidity, are still not covered in the documentations. In general, the articles and journals do not include in-depth Islamic financial systems.

In light of the above discussion, this paper considers the Syrian context and aims to analyze the Shariah compliant finance system in a comprehensive manner for a wide range of audience. In order to conduct a thorough research, numerous academic articles and papers have been reviewed by the researcher so as to report on the current status of IFS as well as discuss the debates related to it. Finally, this Study will directly contribute towards the existing material and act as a substantial source of information relating to IFS in Syria.

2.FOUNDATION OF ISLAMIC FINANCIAL SYSTEM

In the last few decades, the world experienced crises regarding the financial systems which weakened the stance on the efficiency argument favouring the interest based conventional banking system (Chapra, 2007). The effect of this crisis has encompassed all the major countries (Stiglitz, 2003; Chapra, 2007).

Thus, as Stiglitz (2003) states, the financial system is not how it should be, and this is not specific to a certain country: it's the same all over the world. Due to this, in order to minimize the severity and frequency of any new financial crisis, or to avoid them completely, there is a need to reform the financial system or improve it significantly. The term 'the new architecture' is used for the reform that is required.

As previously mentioned, the appropriate financial services with regards to Islam are made available to the Muslim community through Islamic banking system or Islamic financial system in general. Additionally, the significant socio-economic objectives of Islam are accomplished through the framework of Shariah compliant finance institutions and the Islamic financial system. This is particularly important because the conventional system does not consider the importance and socio-economic objectives pertinent to Islam (Chapra, 1985; 2016).

The most significant aspects of Islamic financial system are profit-sharing on fair basis, investing savings for economic development, Price mobilization, price stability, the distribution of wealth and income on equitable basis, economy's high growth rate, economic welfare, and socio-economic justice.

In order to make the future goal clear, it is important to introduce the religious dimensions. This should be done in a way which leads to fiscal deals that are religiously legitimate and more valuable than the financial process. The list of items of "Islamization" provides the basis for IFS, however this framework lacks financial resources to improve social well-being, and a clear viewpoint for the interest-free system which Islamic economic development supports (Choudhury, 2016).The Islamic socio-economic systems that lack the comprehension of Islamic Financial System's transformation in a participatory and equitable structure shares these previously discussed perspectives (Choudhury and Hoque, 2014; Choudhury, 2016).

However, the present advancement of Islamic social theory relies on the basic Islamic principles. It is also in accordance with Quranic teachings, particularly "Tawhid" oneness of Allah, and "Sunnah"; the sayings of Prophet Muhammad. The mobilization of resources, social security, and individual rights protection reflect the appropriateness of IFS's framework (Choudhury, 2006, Choudhury & Hoque 2004).

Interest, whether in terms of giving or receiving, is prohibited in Islam and this principle provides lays foundation for the Islamic banking system. According to Choudhury (2016), this is the primary factor that distinguishes conventional banking system from the Islamic banking system. In reality, the Sunnah; habits and teachings of Prophet Muhammad (PBUH), and Quran are the primary sources of Islamic laws, teachings, and principles.

As a matter of fact, the Islamic ethics of property rights or justice are against interest because the Quran and Sunnah regard it as an act of injustice and corruption. In Islam, the term "riba" is used for interest. In light of the teachings of Quran, the institution of riba has no place in the IFS. (Iqbal & Mirakhor, 2011).

"الَّذِينَ يَأْكُلُونَ الرِّبَا لَا يَقُومُونَ إِلَّا كَمَا يَقُومُ الَّذِي يَتَخَبَّطُهُ الشَّيْطَانُ مِنَ الْمَسِّ ۚ ذَٰلِكَ بِأَنَّهُمْ قَالُوا إِنَّمَا الْبَيْعُ مِثْلُ الرِّبَا ۗ وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا ۚ فَمَن جَاءَهُ مَوْعِظَةٌ مِّن رَّبِّهِ فَانتَهَىٰ فَلَهُ مَا سَلَفَ وَأَمْرُهُ إِلَى اللَّهِ ۖ وَمَنْ عَادَ فَأُولَٰئِكَ أَصْحَابُ النَّارِ ۖ هُمْ فِيهَا خَالِدُونَ"

سورة البقرة الاية 276

Those who eat Riba (usury) will not stand (on the Day of Resurrection)
except like the standing of a person beaten by Shaitan (Satan) leading him
to insanity". That is because they say: "Trading is only like Riba (usury),
"whereas Allah has permitted trading and forbidden Riba (usury). So
whosoever receives an admonition from his Lord and stops eating Riba
(usury) shall not be punished for the past; his case is for Allah (to judge);

*but whoever returns [to Riba (usury)], such are the dwellers of the Fire -
they will abide therein".Al-Baqra Verse No:275*

For this purpose, in order to clarify why Islam forbids interest, several scholars put forth economical justifications. The logical arguments to defend the injunctions of Quran against interest do not need to be put forth, as stated by Anwar Iqbal Qureshi (1946; 1991) and Farooq (2012). However, the arguments that focus on the definition of riba rather than riba itself, may be presented.

Prior to discussing the varying definitions of riba discussed by modernists and traditionalists, it must be established that there are two separate sides to riba, firstly riba in which trade is involved, and secondly riba that includes loan (Algaoud and Lewis, 2007). However, even if the wide-scaled charter suggested by Choudhury (2016) is overlooked, the prohibition of interest is only one of the many aspects that the Islamic critique depends on.

In addition to usury "riba", there are many other things, such as "Gharar" (irrational uncertainty) and "Maysir" (game of speculation and chance) that are also prohibited in Islam. Through these two factors, it is ensured that the "halal" (permitted) method is being used to deal with the financial activities, consequently impacting the society's well-being in a positive way by also fulfilling the requirement of paying Zakat (almsgiving) according to the Islamic principles (Hassan, & Lewis, 2007).

The prohibition of interest in Islam gives rise to the question that how the conventional interest rate system can be replaced and adjusted according to the framework of Islamic finance (Choudhury, 2006). If it is considered that receiving or paying interest is prohibited, then how the system will work and what will be its modified or substitute methods?

As a matter of fact, the PLS (Profit and Loss Sharing) order or other financing means related to PLS are not used in the conventional fiscal transaction method of interest. (Gafoor, 1995). It is also important that the origin of PLS is recent (Hassan and Lewis, 2007):

In the recent years, various studies have been conducted related to PLS framework in terms of initial references on banking's reorganization. The common factor highlighted in all these studies is the fact that interest is the root of all evil and there is a need for commercial banks that use Mudarabha profit and loss sharing concept.

The pre-agreed interest rates on loans should not be allowed, according to the "Shariah"; the Islamic law. Approximately 1400 years ago, the Islamic principles envisioned that interest should be prohibited. The fixed pre-agreed rate on loans are not preferred in the Islamic philosophy, instead it emphasizes on agreed ratios of profit sharing (Uzair, 1978). According to Shahid & Siddiqui (2001), the fair profit and loss sharing of financial activities should be implemented. Nevertheless, for a single objective, there is a need to organize the partnerships and forms of businesses within the context of Islamic Shariah law.

The participation and different terms of the two parties involved in the PLS should be made clear. Thus, according to Choudhury (2006), for the resource allocation purposes, PLS can be used instead of usury or interest. A few of the transactions, among the numerous transactions in IFS, are considered the most significant; such as "mark-up" methods, Mudaraba (trustee finance), and Musharaka (equity participation). The two of these transactions, i.e. Mudaraba and Musharaka, are the first ones to be introduced in the Islamic financial framework. In the following section, the Islamic financial system is discussed in terms of its history, definition, advantages and disadvantages, aims, and its preference over the conventional financial framework.

3.DEFINING ISLAMIC BANKING

The nature of Islamic Banking System has been defined and thoroughly explained through numerous set definitions. These definitions may vary, however the core meaning and function of IBS is the same. To be particular, the Shariah and its practices provide the basis for the banking activities in the context of Islamic banking, and this aspect is included in all the standard definitions. In addition, they also include how the Islamic economics' development can be used for the practical application of Islamic Banking System (Khan, 2014).

The Quran and Muslim legislation based on Quran strictly prohibits dealing with riba under any circumstances. Due to this, the conventional banks or businesses using interest to finance their activities cannot be used by the Muslims. Thus, according to Zurbruegg (2007), in order to address this issue, the IFS

(Islamic Financial Institutions) have developed an alternative and improved way to provide financial services to the Muslim community. The instruments used in this system are in accordance with the Shariah laws and are totally non-interest based (halal), as reported by Zurbruegg, (2007).

4.THE HISTORY OF IBS (ISLAMIC BANKING SYSTEM)

The city of Medina gave birth to Islamic banking system thousands of years ago and the financial matters were researched upon in the time of the Prophet Muhammad (PBUH). According to numerous Islamic researchers, Prophet Muhammad (PBUH) led the life of simplicity and did not keep any money in the house (Alhlapa, 2013). The Muslim and non-Muslim countries all over the world consider IFS as a competitive and viable financial system. Throughout the years, the Islamic financial system has significantly and continually spread across different sectors of financial markets in the world and successfully provided wide-ranging financial products and services.

In the mid-1970s, these products and services were operating on a smaller level as it was just the start of the new vision of IBS. However, in the last few decades, it has greatly evolved, spread, and advanced. As a matter of fact, for the last three decades it has been recording growth rates of double-digits on an annual basis, consequently making it one of the rapidly growing industries in the world (Molyneux, 2005; Macmillan, 2006; Al-Omar and Iqbal, 2011). The complete Islamic financial system and the Shariah law principles are currently being followed in 38 nations by over 23 fiscal organizations handling $250b globally, according to Islamic financial institutions and the general bank council. However, CIBAFI reports that the figure of approximately $200,000,000,00b is not included in the statistics mentioned above, this figure comes from the dual system Islamic banking and conventional operations working sideways with the dual system of conventional banks (Oseni, 2013).

The structure of Islamic banking system and Islamic financial system is established on the basis of other salient features, in addition to the prohibition of riba. These particular characteristics also contribute towards the uniqueness of IFS. However, it is established that Islamic Shariah's injunctions and rules strictly emphasize on the prohibition of interest and other similar features. This prohibition establishes a broader and all inclusive system and way of life on the grounds Islamic ideology. The practicing of IFS is a new concept and it was not common a few decades ago. The banks, throughout the world, did not acknowledge the interest free banking system. Nevertheless, the Islamic world history included the concept of unlawful interest even centuries ago. The biggest challenge that the Islamic finance industry faces is to manage liquidity (Banker Website, 2010). According to the banker website (2010), there has been a great number of researches in the last few years aiming to address the issue of insufficient availability of instruments to Shariah compliant institutions for the management of liquidity in an effective manner.

In order to enable the lending of excess funds between Islamic banks, the Pakistani government introduced the interbank offer rate in accordance with the Shariah, and Islamic interbank money market (Interbank Wakalah & Interbank Musharakah) in 2010. A memorandum of participation was signed by IFSB in October 2010 for the establishment of IILMC (International Islamic Liquidity Management Corporation) so that the complex liquidity management can be facilitated in the institutions working in the foreign countries. Irrespective of this, a weak asset growth of 8.85% can be seen in 2010. Nevertheless, according to the Banker Website (2010), this percentage is acceptable if it is compared with the worldwide banking industry. The goal of Islamic finance in the year 2010 was to deal with the financing challenges related to SME's as well as increase the diversity of product portfolio of the Shariah compliant. The product portfolios will required to be repositioned if the brands ethical banking and Shariah compliant has to be built. The repositioning will be according to the segments of target market inclusive of both Non-Muslim as well as Muslim customers. The Islamic financial institutions and the conventional banks both can greatly benefit from the global financial crisis, such as the future performance of the bank depends on the perception of the investor today (TheBankerwebsite, 2015).

5.THE OBJECTIVES OF ISLAMIC BANKING SYSTEM

In order to fully comprehend Islamic Banking System, its objectives as well as philosophy must be understood. In fact, it depends on the basis of Islamic law, the Shariah law compliant orients its structure. Thus, the percepts and philosophy of Islamic philosophy must be followed by IBS and guided by the business structure of Sharia Law. The IFS of any kind depends on two philosophies or reasons, as stated by Haron (1996; 2004):

- ***Firstly***, *"while drafting the policies and goals, the IFS will use policy-makers from the banks or Islamic Banking System's philosophies by the management.*
- ***Secondly***, *"The philosophies indicate if the Islamic percepts and Shariah law principles are being complied with."*

Essentially, the Islamic law must be followed by the objectives of the Islamic banking systems that they have included in their economic system. It has been strongly highlighted by various researchers and economists that Islamic Banking System is a smaller part of the wide-scale economic system of Islam that struggles for a neutral, fair and just society in complete compliance with the Shariah objectives (Presley, 1990; Khan, 1991; Khurshid Ahmed, 2000; Shahid & Siddiqui, 2001; Naqvi, 2003, Soros, 2005; Chapra, 2001, 2008b, 2009).

Consequently, in order to promote social harmony and ensure that all the involved parties are being benefited from the market transactions; these prohibitions of excessive risk, gambling, and usury (lending money) play an important role and protect the interests of the parties involved (Ahmad, Rahim, & Rahman, 2012; Chapra, 2007, 2009; Naqvi, 2003; Shahid & Siddiqui, 2001). The Quran is the primary source of these prohibition and clearly states that:

O ye believes, do not eat up your property among yourselves unjustly
except it be a trade compromise, and do not kill yourselves, Allah is Merciful to

" يَا أَيُّهَا الَّذِينَ آمَنُوا لَا تَأْكُلُوا أَمْوَالَكُمْ بَيْنَكُمْ بِالْبَاطِلِ إِلَّا أَنْ تَكُونَ تِجَارَةً عَنْ تَرَاضٍ مِنْكُمْ ۚ وَلَا تَقْتُلُوا أَنْفُسَكُمْ ۚ إِنَّ اللَّهَ كَانَ بِكُمْ رَحِيمًا "
النساء (29)

you"Alnisaa verse "29"
Do not eat up your property among yourselves unjustly and you make it to
the referees to eat a team of people's money guilt and you know"

"وَلَا تَأْكُلُوا أَمْوَالَكُمْ بَيْنَكُمْ بِالْبَاطِلِ وَتُدْلُوا بِهَا إِلَى الْحُكَّامِ لِتَأْكُلُوا فَرِيقًا مِنْ أَمْوَالِ النَّاسِ بِالْإِثْمِ وَأَنْتُمْ تَعْلَمُونَ"
البقره (188)

Albaqra verse "188"

In addition to this, the emphasis of Shariah law is on a framework that is morally good and since Islamic Banking System is its derivative, it distinguishes itself by enforcing public obligation and ethical norms towards the community (Warde, 2000, Ahmed, 2000; Finance *et al.,* 2008;).

Thus, Islamic Banking System is more about the framework that considers the factors that contribute towards accomplishing socio-economic objectives in order to create an democratic and fair society, rather than a system that only prohibits dealing with interest (riba), matches and ensures that the Islamic law and its legal requirements are being complied with (Shahid & Siddiqui, 2001; Hassan. & Lewis, 2007; Dusuki, 2008; Amin & Isa, 2008; Rashid, 2009; Gayatri, Hume, & Mort, 2011; El- galfy & Khiyar, 2012).

According to El-galfy & Khiyar (2012), to accomplish betterment for the entire society, a lasting balance between spending and earning is brought about by the Shariah compliant banks as a way of conducting a business.

The provision of a direct expression should be provided by the Islamic finance organizations and institutions as it is their duty, In addition, it must be in accordance with the statement put forth by the Islamic bank's international association, which is as follows:

"The Islamic finance system involves a social implication which is necessarily connected with the Islamic order itself, and represents a special characteristic that distinguishes Islamic banks from other banks based on other philosophies. In exercising all its banking or development activities, the Islamic bank takes into prime consideration the social implications that may be brought about any decision or action taken by the bank. Profitability, despite its importance and priority is not therefore the sole criterion or the prime element in evaluating the performance of Islamic banks, since they have to match both between the material and the social objectives that would serve the interests of the community as a whole and help achieve their role in the sphere of social mutual guarantee. Social goals are understood to form an inseparable element of the Islamic banking system that cannot be dispensed with or neglected." (p. 27)

According to the above statement, it becomes clear that the social commitments and responsibilities are greatly regarded by the Islamic Banking System. It has a primary objective which is the prohibition of riba, however on a wider scale it also stresses upon the socio-economic well-being of the society. The conventional banking system is totally different as compared to Islamic Banking System or Islamic Financial System, in general. This is primarily because of the fact that the Shariah based principles guide the framework of IFS, and on the other hand, the goal of conventional banks is to maximize profitability, i.e. they follow the capitalist ideology.

The Islamic law's primary objective is to be fair and just and work towards the betterment of the humanity, and this is accomplished through the principles of Islam. The Islamic principles, in all their entirety, have one common purpose, to work for the well-being of the people. It caters to all the aspects of health care, such as spiritual satisfaction and physical health for this temporary world as well as the permanent one (hereafter). Thus, the Muslims do not consider financial maximization or money as their primary goal, instead, they equally regard ethics, morality, justice, conscience, and spiritual wellbeing. These factors are quite significant for the Muslims and they believe in implementing them irrespective of good or bad circumstances (Hassan, & Lewis, 2017).

As a result, the social obligation as well as the factor of profit is incorporated in the Islamic financial system, as opposed to the conventional fiscal institutions and banks that entirely focus on maximizing the profit (Ahmed, 2000). Therefore, the Shariah laws and objectives are followed when the everyday struggles are dealt with according to the Islamic teachings. However, according to Zainal (2015) and Ackermann & Jacobs (2018), the banks or the Islamic Finance System in general, must not be considered as the charitable institutions or welfare organizations that also worry for the financial activities in the society.

In a similar manner, the social responsibility is the most significant factor of the Islamic Finance System and it must not be neglected or deemphasized through the tightening of financial maximization policies or other money related policies by the management of IBS; such an act is unacceptable at all levels (Haron, 2004). In reality, the balance between social objectives and profits is hard to maintain, and the Shariah law does struggle with it. The shareholders who invest their funds should be provided with adequate returns by the Islamic financial institutions, otherwise it will be unfair to them.

Furthermore, taking excessive earnings from the customers or charging them unnecessarily is prohibited for Shariah compliant financial organizations by the financial institutions compliant. Similarly, neglecting or undermining the responsibilities towards the shareholders is also considered wrong (Chapra, 2001; Dusuki, 2008).

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