NOTES

Principles of Islamic Finance

The principles underlying the Islamic finance system is derived from the Holy Quran and the Sunnah.

The main principles include

- ❖ The prohibition of taking or receiving interest as islam vies money is not an asset that should earn a surplus on and of itself.
- ❖ Financial provider must share the risk with the entrepreneur and not only the profits.
- ❖ Capital must have a social and ethical purpose beyond pure and unfettered return Islam upholds contractual obligation Islam upholds contractual obligation and the disclosure of information as a sacred duty. This feature reduces the risk of asymmetric information and moral hazard
- ❖ Only business activities that do not violate the rules of Islamic law qualify for investment, for example business dealing with gambling, pornography and casinos would be prohibited.

Prohibition of Interest

Profits, symbolize successful entrepreneurship and creation of wealth whereas interest, is a cost that is accrued irrespective of the outcome of business operations and may not create wealth if there are business losses.

The concept of profit-and-loss sharing, as a basis of financial transactions is a progressive one, as it distinguishes good performance from the bad and the mediocre. This concept therefore encourages better resource management.

Islamic Modes of Financing

There are several modes of financing, but the most commonly used ones are Musharaka, Mudaraba and Murabaha. The first two are equity based and the last one is asset based.

The difference between Musharaka arrangements and normal banking is that you can set any kind of profit sharing ratio, but in the case of losses each partner suffers the loss exactly according to the ratio of his or her investment Both Musharaka and Mudaraba work best when the return of Investment can be accurately predicted and is most suitable mode of financing businesses with a longer profit cycle ie agriculture. Murabaha Islamic loans are not seen as loans, but rather a contract of sale between a bank and its client.

MURABAHA

The most preferred method of financing for many Islamic banks due to the simplicity of the model and it has certain advantages of the other equity based modes.

SMEs and MUSHARAKA

Islamic banks offer loans that are based on intangibles such as the business person ' s experience and character. This feature is particularly useful for SME who lack collateral. Viable project denied access to credit by conventional financial institution might prove to be acceptable under the Islamic banking system on a profit and loss sharing basis.

WHY ISLAMIC MICROFINANCE

Microfinance programs are based on group sharing of risk and personal guarantee while maintenance of trust and honesty is tied to the availability of future funds. This model should allow for the inclusion of a Musharaka based model, or in the least, a model of collective guarantee.

SIMILARITIES

Microfinance and Islamic finance have much in common. Islam emphasizes ethical, moral, social, and religious factors to promote equality and fairness for the good of society as a whole. Principles encouraging risk sharing, individual rights and duties, sanctity of contracts are all part of the Islamic code underlying the financial system. In this light, many elements of microfinance are consistent with the broader goals of Islamic finance.

MUSLIM AID

promote the development of an ethical economic system whereby people ' s potentials are unleashed and they work towards the betterment of their economic and social conditions. We run microfinance programmes in several Field offices, notably Bangladesh, Sri Lanka, Pakistan, Somali, Cambodia, Indonesia, Sudan, Iraq and Bosnia; and also non-field offices such as Mexico. The demand for Islamic (interest free) microfinance is tremendously high amongst both Muslim and Non-Muslim clients due to the perceived customer benefits Muslim Aid provides both financial and Non financial services to serve the poor and uplift them from poverty.

‘ JABAL HOSS SYRIA; MURABAHA ’

The project Rural Community Development in Jabal al-Hoss, with its emphasis on microfinance and income & employment generation, is considered as one of the most successful projects in Syria. It has demonstrated on a pilot scale that: Poor people can mobilize their own human and financial resources; As shareholders, they finance and manage their own local financial institutions; As borrowers, they invest short-term loans in a wide range of income- generating activites, gain business experience, and repay their loans; In increasing numbers, women have participated in the sanadiq as owners, managers and users.

Source: SANDUQ: A MICROFINANCE INNOVATION IN JABAL AL-HOSS, SYRIA Published in: NENARACA Newsletter, September 2003, Amman, Jordan

Brandsma, J. and Bujorjee D. (2004) “ Microfinance in the Arab States. Building Inclusive Financial Sectors ” , United Nations Capital Development Fund.

‘FINCA AFGHANISTAN; MURABAHA

The demand for Islamic banking amongst Afghans led FINCA Afghanistan to create Islamic banking products, Its products were created in consultation with local community leaders In 2006, FINCA introduced a new line of Murabaha products, in response to its evaluation of local market demands With just over 40,000 borrowers in Afghanistan, the popularity of Islamic loans has enabled FINCA to become Afghanistan ’ s fastest-growing and second-largest MFI.

Source: FINCA, 2007 ONLINE
http://www.sesrtcic.org/imgs/news/Image/DrMostaqTrainingAndTechnicalCooperati o nForMFGrowthSustainability.ppt#286,1,Slide 1