

Islamic Banking: Challenges and Opportunities in Jammu and Kashmir

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ABSTRACT

This research paper is an attempt to understand Islamic banking in Jammu and Kashmir, analyzing the causes of financial exclusion of people from conventional banking and evaluating the implications of macro environment on Islamic banking in Jammu and Kashmir using PESTEL Analysis. In this paper, I made an effort to evaluate the polarity between conventional and Islamic banking on the basis of principles, finance, operation and investment (PFOI) by understanding their Respective laws. The Major contrast between the two theories has been the factor of interest. Comparison of Performance of Islamic banking in Malaysia, Saudi Arabia, Qatar, Turkey, Kuwait and UAE is considered. The variables include Asset growth, ROE, ROA, Financial growth, contribution, market share and cost income ratios. Qatar has outperformed in the chosen variables. The results of the research predicts that Islamic banking should be accepted in Jammu and Kashmir by providing a window for only authorized shariah complaint institutions to offer Islamic services and products..

1. Introduction

Islamic banking refers to a method of ethical banking that is based on Islamic Law which prohibits interest based banking and permits only profit sharing based banking. The system is built around the belief that all individuals deserve to lead a life of moral and material well-being. The concept has originated from the holy Quran that prophecies Allah has forbidden interest taking and charging. It is against the use of interest, as interest is believed to lead to exploitation and unproductive income. Islamic Banking derives its principles from the Islamic Law (popularly referred to as Shariah). Islamic Banking, unlike conventional banking permits (halal) only profit sharing based banking and prohibits (haram) interest-based banking. Shariah law considers speculation activities such as alcohol, pork, gambling as illegitimate. Interest or riba is often seen as an instrument which creates a divide between the affluent and the under-privileged. Contrary to the popular belief, Islamic Banking doesn't limit its boundaries to Muslims. Many non-Muslim countries worldwide have also adopted and contributed to the fast growth of Islamic Banking. The Paradise Jammu and Kashmir has three types of bank player's namely cooperative banks, commercial banks and regional rural banks. The Banking in the state has weak technological infrastructure as people are unaware about e-financial inclusion. The strength of regulation and monitoring of the banking is inadequate with massive number of informal and money laundering transactions happening outside the ambit of formal system. The business expansion and technologically innovation of banks is very slow. The banks of the state are lacking behind the benchmark credit deposit ratio of 60 which is a prominent performance measure and vital financial inclusion indicator.. The political instability is further deteriorating the condition by causing blows to their profitability by utilizing funds during political unrest. The economic condition is also unfavorable to the improvement of banking services as there is high levels of poverty and unemployment. There are Bottlenecks to the core of the banking system in Jammu and Kashmir.

2. Review of Literature

A. (HGB, 2017) Impact of Islamic Modes of Finance on Economic Growth through Financial Stability, Journal of business & economic affairs.

The Paper Claims that the objective of Islamic Banking is to bring greater justice and ensure socio-economic development is reached. It is mode to reduce poverty and inequity through risk-sharing instead of debt-financing. It interprets the principles and various instruments of Islamic Banking with whole new perspective. Financial intermediation is believed to be an indicator of economic growth. The entire aim was to correlate how financial intermediation is linked with financial stability.

B. (Chong & Ming-Hua Liu, 2018) Islamic banking: interest-free or interest-based?, Pacific-Basin Finance Journal.

The paper is an introduction to the basics of Islamic Banking, with special emphasis on the profit-and-loss sharing paradigm in Malaysia. They have concluded that Islamic Banking is largely moved by the Islamic resurgence and not because of its pros. Their effort was to see if Islamic Banking system was really different than the traditional system. Reasons for Islamic Banking not being in light as much as its counterparts included the severity of principal-agent problems, moral and ethical issues associated with the theory and also the lack of expertise in the field.

C. (Khaki & Sangmi, 2012) Financial Inclusion in Jammu & Kashmir: A Study on Banker's Initiatives.

The paper Traces back to Post World War II period when India had various challenges like poverty, underdevelopment, illiteracy and malnutrition. In spite of all these, the Government of India decided to focus on inclusive growth. Various reformative measures were taken by Reserve Bank of India to achieve

financial inclusion after considering the recommendations of the Khan commission. It is proven that the state of Jammu and Kashmir lacks financial inclusion as compared to other states. In order to prove this, the credit-deposit ratio and extent of financial exclusion was considered. It also observes the progress and development of financial inclusion in the state of Jammu and Kashmir.

D. (KHAN & HUSSIN, 2013) Islamic banking in India: Developments, prospects and challenges, International journal of Research in Commerce and Management.

One of the prime changes in the Indian financial system is the deregulation of the banking sector and the inauguration of new banks. The study believes that India should recognise this global trend of Islamic Finance into its economy. The paper focuses on the opportunities, challenges and developments India might face if Islamic Banking was to be introduced. The country is believed to have a real potential for this kind of religious banking. The entire aim of the paper was to draw the attention of Regulators, scholars and activists to encourage and assist them in developing the new banking system. A new solution to the challenges possessed by this banking is by inculcating it in conventional banking system and allowing them to carry on this with their existing infrastructure.

E. (Basha, 2017) The hundred differences between Islamic and conventional banking systems, International Journal of scientific Research and Management.

The paper Acclaims that Islamic Banking has proven itself as a more effective system than traditional banking system. The paper identified Islamic banks to be strong and firm even during global economic crisis, which later became a landmark in the financial world for its destruction. 123 US banks including Lehman Brothers went into bankruptcy during this time. The study attempted to understand the differences between Islamic and interest-based banking systems in practice. It also assessed their respective impacts on economic variables like exports, business cycles, employment, inflation, etc. It concluded saying there exists a whole lot of differences between the two. Traditional banking ignores social, moral and ethical methods because of its ultimate motive of wealth creation whereas; Islamic Banking on the other hand gives them first priority.

3. Research Design

Statement of the problem

Financial inclusion plays a crucial role in the economy of Jammu and Kashmir. The issue is that Jammu and Kashmir is demographically Muslim populated with 68% following Islam as their religion and they refuse to utilize the services provided by conventional banking as the Shariah law firmly prohibits Interest(Riba) and Immoral practices. As a result the beneficiaries of the state have been alienated from financial

inclusion. It's important that these people are connected to formal system of banking to alleviate poverty and kick-start the economy by creating an institution which they believe in. There is pressure from the people of Kashmir but India needs to come up with a window to accommodate the proposal. This prerequisites the need to understand the difference between conventional versus Islamic banking and study of Islamic banking methods adopted in various countries to open the window to Jammu and Kashmir.

Research Objectives

- To explore the reasons for financial exclusion in the state of Jammu and Kashmir.
- To understand the Macro environment using PESTEL Analysis for the introduction of Islamic Banking in Jammu and Kashmir.
- To Compare Islamic banking with conventional banking
- To understand the method of Islamic banking adopted by various countries; Malaysia, Saudi Arabia, Turkey, Kuwait, UAE, Qatar
- To evaluate and conclude on the Islamic banking acceptance.

Hypothesis

- H0: Islamic banking is accepted in Jammu and Kashmir
 H1: Islamic banking is not accepted in Jammu and Kashmir

Methodology:

The type of research included in the study is Qualitative and descriptive study. I read the Islamic banking laws and conventional banking laws to draw comparisons for both theories. Based on past 3 years data on the poverty, unemployment, loan waivers and banker's initiatives I found that these are the reasons for financial exclusion in the state. By studying the macroeconomic determinants, political scenario, technological laws, cultural diversity and environmental policy, outcomes of legal cases I carried out the PESTEL analysis for the state. I studied the regulation and banking act of the respective countries to identify the window for Islamic banking. I analyzed past 4 years data on performance of Islamic banking from their central bank performance reports in those countries to a make comparison. The finding from the performance analysis of countries is used to suggest a framework model for Jammu and Kashmir.

Limitations of the study

- The study focusses only on Jammu and Kashmir
- The study has focused only on Islamic banking in Malaysia, UAE, Saudi Arabia, Kuwait, Turkey, and Qatar.
- The changes in government policies may affect the Islamic banking launch.
- The timeframe of latest population data is Census 2011 which does not give the accurate demographic characteristics of the Jammu and Kashmir population.
- Anti-religious views may restrict the scope of the Islamic banking operations.

4. Analysis of Financial exclusion in Jammu and Kashmir

- a. **Islam as Popular Religion:** 68% of the population profusely follow Islam as their religion and shun interest banking as Quran strictly prohibits interest.
- b. **Illiteracy Level:** The proportion of rural illiteracy is high in the state. As a result people lack inclusiveness about banking and are remote from the formal system.
- c. **Paranoia of the Customer:** The customers lack confidence about the safety of their money in the banks due to accountability and transparency concerns.
- d. **Attitude of Banks:** Follow up by banks on customers to update their know your customers details and to make transactions transparent has not gone down well's people displayed dismay as they don't want to be tracked by any form. This is jeopardizing the banker-customer relationship and shooing away the existing customers.
- e. **Availability and Ease Of Use:** The number of set up and functioning banks are minimal. This limited the outreach as customers couldn't take full advantage of the services due to restricted access.
- f. **Processing Speed and Time:** Banks slogged in terms of the efficiency and pace at which they provided services to customers. This waived off the perks of banking as customers could neither avail the service on time nor benefit from it as there was more waiting time.
- g. **Informal Channel:** The size of transactions through informal network in the market is increasing. People prefer to exchange and channel transactions outside the purview of formal system of banking which resulted in high financial exclusion.
- h. **Security Concerns:** Rising financial security concerns in the state failed to garner the trust of customers.
- i. **Poverty and Unemployment:** Large population belt in the state doesn't have steady stream of income and are unemployed. They are leading despair life due to the political insurgency and economic conditions. As a result they have no savings to maintain and operate the account.
- j. **Financial Literacy:** Most people felt the process of banking as complicated as they don't understand the terms and conditions because they are illiterate and are therefore reluctant to use the services. They lack training and awareness to use the internet banking.

5. Pestel Analysis of Jammu and Kashmir for Islamic Banking

- **Political Factors**

The paradise has been on the edge of power struggle between Pakistan and India for years now. The continual power play of both parties to get upper hand has resulted in insurgency by militants and has completely deteriorated the economic growth and conditions of the state. This makes the government less stable and democratic.

The fact that the government is unstable makes the process of implementing legislation, decision making and Judiciary slow. As a result any decision to change takes a long span of time. There is no strong face of leadership to shape the economy. The state has been put under the governor's watch after the BJP broke out of the alliance with the state because of uprising terror. This dictates the level of political instability persistent in the state.

There are no traces of cordial relations with its neighbouring countries. In fact it has strained relationship with India to seek any financial and economic support. There is democracy only for the name sake but the harsh reality it is few rule where the decisions are taken without giving due to consideration to their voices.

- **Economic Factors**

The economic spectacle is not very favourable as the face of poverty is evident in the roots of the soil. The economy is facing hardship because of growing unemployment as jobs are a scare thing and stagnation of growth and opportunities in the vital industries and core sectors. The state had failed to do rejuvenate multiple times. A fiscal deficit has also been on rise at an alarming rate according to RBI. The deficit grew massively by 356 % from 2014-2018. The interest payment obligation due to debt has also been on a rise due to increasing borrowings. The state hardly got any foreign direct investments over these years. The equity and bond markets are illiquid with minimal investors trading which shocking compared to the amount of premium is paid for underwriting. The coupon rate is also higher as the government is unstable. The retail inflation is highest which makes the prices of food to shoot up as a result the cost of living is expensive and the aggregate demand has steeped downwards due to lack of capital expenditure and formulation.

- **Social Factors**

The state has 68% following Islam as their religion. It's unanimously Muslim populated. People's right to live is taken for granted and they live under constant threat of safety because of rift between militants and populace. They are communal killings of Hindus in the name of religion. The people have a feeling of seclusion from India and associate them as distinctive and demand for freedom. The Sexortion ban is the first of kind in the whole country. The lives of women needs to be improved as the ratio is lacking behind national average which presents a huge gap and the literacy rate of men is also higher compared to women. The society is patriarchal towards women and has been undermining them for years.

- **Technological Factors**

The state is lacking behind digital connectivity in rapid developing country. Businesses are losing big because of the stoppage of internet. It doesn't have required infrastructure to support electronic banking

facilities, e-business and e-payments. The present system is deficient to encourage financial inclusion. The rapid evolution in technologies in industry sectors is unhealthy owing to political and infrastructural reasons. Though people are provided with financial inclusion programs. They are having trouble using it as they are not trained and educated to use the services. People are clueless about the services available online and security information. The No frills accounts and many such schemes provided the government could not be benefitted by the rural sections as they are financially illiterate. The cost is also huge to carry out the process of e-financial services.

The state doesn't provide decent mobile services or facility. This explains the level of backwardness of the population in technology progress.

• **Environmental Factors**

The state doesn't take the environmental issues seriously. The growing water pollution and land fillings suggest that. The state is naturally gifted with resources but is undermine its resources utilization and can be put to improve infrastructure and economy alleviation. Increasing deforestation of forest land and resources to seek strategic advantage for power play is threatening the environment for both people and animals.

• **LEGAL FACTORS**

The Government can use public safety act to jail anyone who is causing disturbance to the public order. It can also challenge an individual entry to an era.

COMPARISON OF UNIQUENESS AND COMMONNESS(1.1)		
PRINCIPLES AND ASSUMPTIONS	CONVENTIONAL BANKING	ISLAMIC BANKING
INTEREST	The interest is the key to conventional banking. Its their vital source of income. There is no banking without interest. . As a result fixed deposits and savings account are important to interest.	The interest factor is erased. Holy Quran forbids interest taking and charging. As a result savings and fixed deposits are removed. Banks enter into agreements to share profit.
SPECULATION	No restriction on people to carry out any business provided its under the ambit of regulation and legal.	There are restrictions and the nature of business must be compliant with shariah law. It must be ethical and legal.
REGULATION AND LAWS	The central bank and government enacts the laws. The banking Act determines the rules. They are highly regulated and governed	The Allah is the creator and his wordings take precedence above law and government. The shariah council governs and approves Islamic products.
OBJECTIVE	To provide economic support and means to the people	To improve social well-being of the people.
MORALS AND ETHICS	They are not very high on ethical and moral grounds. They are more concerned about profit maximization	The shariah law encourages to share the risk and profit –loss as per agreement. They borne risk as a result the profit depends on the earnings and can be subject to even sharing losses. Splits the risk between both the parties.
OPERATIONS	CONVENTIONAL BANKING	ISLAMIC BANKING
DEPOSITOR	Banks don't disclose what they will do with funds and nature of investments. the depositor is guaranteed of the money. The deposits are bank liability	They disclose where the money will be parked. No deposits are not guaranteed but only deposits based on their contracts are guaranteed. Deposits is not completely debt and are partly equity.
FUNCTIONS	Borrowing and lending.The time value is considered. The contracts are backed by both collateral and financial assets.	Investing as a participant. time value is not considered. The contracts with people are backed by real assets only
ACCOUNTING AND AUDITING	They audit and account as per GAAP And international standards. They follow accounting policies set by the international institutions.	They are compliant to Accounting and Auditing Organization for Islamic Financial Institutions. They follow the guidelines set by the institution.
RETURN	The rate of interest is fixed and predetermined including earnings	They are not predetermined. It depends on the agreement between parties.
FINANCING	CONVENTIONAL BANKING	ISLAMIC BANKING
BASIS OF PROJECT FINANCING	The credit worthiness of the borrower comes in to the picture and takes priority. The project sustainability and success is secondary. different loans can be given.	The project sustainability and success is primary than credit worthiness. There is one loan given to people in any respect.
LEASING	The bank is the owner but the risk is passed on to the end customer . the bank can wholly claim rent and as customer bears the risk he has to pay for the loss of	Bank is the owner and cannot pass the risk to anyone. The leasing puts bank position in jeopardy as it cannot claim rent and instalments if the asset underwent loss or

	asset till the end of the lease term. The rent consists of interest payments.	repairs.
OVERDRAFT	In long term, cash is offered. In short term cash is given by charging interest and daily expenses are reimbursed.	In long term asset is provided. In short term the asset is sold to customer at a mark-up. The expenses and profits are reimbursed in a timely manner
INVESTMENTS	CONVENTIONAL BANKING	ISLAMIC BANKING
STATUTORY RESERVES	They have to mandatorily maintain Cash reserve ratio and statutory liquidity ratio as per central bank guidelines.	They have no such requirements.
SHARES, BONDS AND MONEY MARKETS	They can buy company shares provided they give sound earning and predetermined interest. Banks can participate in money markets and earn income. They can also raise bonds to borrow	They can buy company shares provided the business and its operations should be ethical and interest free. Investment and issue of bonds is disallowed with due consideration to interest .They can participate in money markets provided its interest free and complies with shariah principles.

6. Results and Discussion

A. The PESTEL Analysis reveals that Jammu and Kashmir has serious problems be it any macro

ANALYSIS OF PERFORMACE OF ISLAMIC BANKING IN MSQTUK REGIONS(1.2)						
CRITERIA	MALAYSIA	SAUDI ARABIA	QATAR	TURKEY	UAE	KUWAIT
ASSET GROWTH	The Islamic banking recorded growth of 4%. the contribution of to the total banking assets is \$137b	The Islamic banking recorded growth of 18%. The contribution to the total banking assets is \$291b	The Islamic banking recorded growth of 20%. The contribution to the total banking assets has been \$72b	The Islamic banking recorded Growth of (-1%). The contribution to the total banking assets is \$45b.	The Islamic banking has recorded growth of 18%. The contribution to the total banking assets \$132b	The Islamic banking recorded growth of 13%. The contribution to the total banking assets is \$89b
CONTRIBUTION TO GLOBAL ISLAMIC ASSETS	The country has contributed 17%	The country makes largest contribution 36%.	The country has contributed overall 9%	The country has contributed about 5%	The country has contributed about 16%	The country has contributed 11% .
MARKET SHARE	global market share is 21.3% and national market share is 15.5%	global market share is 33% and national market share is 51.2%	global market share is 8.1 % and national market share is 25.8%	global market share is 5.1% and national market share is 5.5%	global market share is 15.4% and national market share is 21.6%	global market share is 10.1% and national market share is 45.2%
COST TO INCOME RATIO	40%	40%	27%	54%	41%	49%
FINANCIAL GROWTH	The Islamic banking recorded growth of 10%. The contribution to the total financial assets is \$92b.	The Islamic banking recorded growth of 15%. The contribution to the total financial assets is \$246b.	The Islamic banking recorded growth of 25%. The contribution to the total financial assets is \$48b	The Islamic banking noted growth of 7%. The contribution to the total financial assets is \$33b	The Islamic banking noted growth of 16%. The contribution to the total financial assets is \$116b.	The Islamic banking noted growth of 12%. The contribution to the total financial assets is \$70b.
ROA	1.2%	1.9%	2.1%	0.2%	1.7%	1.2%
ROE	12%	15%	14%	2%	12%	11%

Determinant poverty, retail inflation and Unemployment. The economy is in despair and needs fundamental restructuring in terms of establishing secure government and banking to make things fall into the place. Islam banking instigation might uplift the social wellbeing of the people considering the seriousness of backwardness in the state.

B. The comparison of conventional and Islamic banking in table (1.1) unveils that the biggest disagreement is on

the principle of interest. Interest is a big deal in the Indian banking system as it is the face of income for banks. In a country where everything works on the concept of interest the term interest free might have huge implications on both supply and demand side.

- Demand side – interest is the biggest influence for people to invest their money rather than keeping it idle. If it wasn't for interest People would rather park their money at home because of no incentive.

- Supply side – The whole ecosystem will be affected as there will be oversupply and bond markets will downplay. The interest margin is what banks use to function and administrate their expenses. The aggregate demand for the industry will be impacted.

C. The findings from analysis of performance in the table (1.2) reveal the following


CRITERIA	COUNTRY PERFORMANCE.
ASSET GROWTH	Qatar is better in terms of growth rate in the assets.
CONTRIBUTION	Saudi Arabia makes good contribution to the Islamic assets
Market share	Saudi Arabia is dominant in the Islamic markets because of its huge contribution to the industry
Cost to income ratio	Qatar is performing has low percentage which signifies the its operating efficiently
Financial growth	Qatar is doing better in terms of earnings and Cash-flows
ROA	Qatar is able to put good use of its assets.
ROE	Both Saudi Arabia and Qatar seems to be doing better job at generating profit with less leverage.

7. Conclusion

We see that Qatar has performed remarkably and by far gives the best outcomes across all variables. Saudi Arabia was really close to performing better than Qatar as it holds dominant position in the Islamic banking industry and contributes heavily to the Islamic assets globally. The method of Islamic banking in Qatar may be emulated in Jammu and Kashmir where only Shariah compliant institutions can provide Islamic services as the Islamic and conventional banking laws contradict highly on the fundamentals of interest charging and giving.

This requires institutionalizing Shariah advisory council and passing necessary Islamic banking acts to support the development and bring governance as Standalone Islamic banking cannot be set in motion as the economic operations will be affected without interest and requires changing the existing banking rules which is a debacle politically. I accept my hypothesis 1(Null hypothesis) that Islamic banking should be accepted in Jammu and Kashmir as it might bring change in shaping the welfare of the people and provide better opportunities. So a window needs to be Opened to recognize Shariah compliant institutions in the State backed by necessary financial education and transparency in the system to foster inclusion and prosperity.

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