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Facilitating Innovation and Sustainability in the Indian Banking System through Non-Interest Financing

ORIGINAL ARTICLE



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Abstract

Interest-free banking is becoming more common, not just in Muslim-majority countries, but also in the West. If Islamic banking is to thrive in this intensely competitive business, it must be superior and more robust than other traditional banks. As a result, the concept of sustainable banking is seen to be relevant to how it runs. Opportunities abound in Islamic banking, the fastest-growing segment of the financial services business. Transparency, joint ventures, risk sharing, and ethical investing are core foci of Islamic finance, which appeals equally to Muslims and non-Muslims. Islamic banking is now one of the fastest growing capital market and international banking industries. Islamic finance has created a distinct, well-balanced system that adheres to Shariah regulations. Shariah governs all aspects of life in order to ensure a reasonable and equal distribution of wealth, the abolition of all forms of poverty, and the promotion of long-term growth. Islamic banks use two basic concepts for sustainability: institutional and welfare initiatives. The purpose of this article is to demonstrate how interest-free banking is a breakthrough in Indian banking and how it encourages sustainability.

Key Words

Resilience, Sustainability, Innovation, Interest Free and Welfare.

Introduction

Islamic banking is one of the world's fastest growing financial services industries, and it has even invaded western markets (e.g., Luxembourg). Islamic finance is valued USD 2.5 trillion (DinarStandard, 2019) and is expected to be worth more than USD 3 trillion by 2020 (Martnez-Solimán, 2017), with a portion of the proceeds going toward development. According to Dr. Mohamed Damak, Senior Director & Worldwide Head of Islamic Finance at S&P Worldwide Ratings, the global Islamic finance business would rise by 10%-12% between 2021 and 2022.

The following are the primary contrasts between Islamic finance and conventional financing:

- Profit sharing is linked to risk sharing between parties.
- Speculation in transactions is prohibited.

- Interest is prohibited.
- Transactions are either asset-based or asset-backed.

Overall, Islamic finance can be a socially responsible and/or ethical alternative to regular financial products.

The Sustainable Development Goals ('SDGs') were adopted by the international community in 2015 as a universal call to end poverty, protect the environment, and provide prosperity for everyone by 2030. Islamic finance principles, which include inclusion, women's empowerment, accountability, and sustainability, provide a natural link to the SDGs.

Islamic finance may ensure that greater financial resources be used in a more sustainable and fair way to achieve the SDGs. Utilizing zakat and waqf flows might be a first step toward directing these revenues toward the SDGs and underserved humanitarian and development needs.

Objectives

1. To identify how interest free banking is an innovation in Indian banking system.
2. To identify sustainability through interest free financing.

Literature of Review

The foundation of the Islamic banking system is the Islamic ontological and epistemological concepts of social virtue, good governance, environmental protection, and moral conduct of individuals and organisations (Asutay, 2013), (Biancone, 2017). Shariah principles, sometimes referred to as Maqasid al-Shariah, are the tenets of Islamic finance that serve as a guide for the Islamic banking and financial system. (Marimuthu, 2015), (Secinaro, 2017). The foundation of these regulations, according to Saeed et al. (2020) (Saeed, Izzeldin, Hassan, & Pappas, 2020), is comprised of two key ideas that distinguish Islamic banking from conventional banking: profit and loss sharing and the prohibition of interest and other aspects that are banned. Islamic finance is in fact seen in the literature as a complementary system that enhances knowledge of and exposure to the mainstream financial system. (Akhtar, 2008) . As a result, the sector's long-term development and viability depend, in part, on how Islamic finance interacts with and benefits from the established financial system. Comparatively, Islamic finance aligns itself with the complexity and subtleties of Islamic finance products and related risks while adapting to and adhering to international standards and supervision. As a result, the emphasis on sustainability is vital for the development of the business and a promising future. This is because the distinctive traits of Islamic finance can be preserved while maintaining the necessary flexibility and adhering to shariah rules. Sustainability is a process of economic growth, environmental conservation, and social equity, claims Keeble (Keeble, 1988). Sustainability is primarily seen as the process through which businesses manage their obligations and opportunities, as well as the financial, environmental, and social risks associated with doing business. Thus, there are three basic aspects of sustainability: economic, environmental, and social. In South-East Asia, just 26% of Islamic banks disclosed their sustainability practises. (Febrianti, 2017) In addition, other writers (Ellili, 2016)[9] discovered that as compared to conventional banks, the sustainability disclosure of Islamic banks in the United Arab Emirates was significantly low. Additional research looked at 91 Islamic institutions in 13 countries, and it was found that Islamic banks were less concerned with sustainability standards and disclosure. (C., H., & K., 2014)

Additionally, Dhuizii (Dhuizii, August, 2018) looked at the sustainability and disclosure procedures of 14 Islamic banks from 14 different nations. Literature has also demonstrated that the primary problems facing Islamic banks in seven Muslim countries are not related to their sustainability strategies or disclosure (A. & S., 2010). Institutional and welfare techniques are the two main models that Islamic banks apply in their banking operations in order to be sustainable. Mansour et al. (W., K., & e, 2015) assert that the institutional approach boosts the wealth of the bank's stakeholders. By enhancing people's well-being, the well-being method attempts to accomplish Maqasid Al-Sharia. It is therefore feasible to state that sustainability is connected to and essential to the idea of Islamic banking. The Sustainable Development Goals were established by the UN to draw attention to sustainability on a worldwide scale (SDGs) (J. Bebbington e J. Unerman, 2018). The 17 initiatives to advance sustainable development offer a great chance to cover a wide range of sustainable development research topics. Furthermore, the necessity of doing high-quality research on sustainability, which will yield useful findings for managers and policymakers, has increased as a result of the United Nations and its member nations' commitment to attaining the SDGs by 2030. (W. Leal Filho et al., , 2018,) In accordance with Salam Gateway's research (Gateway, -2020-2021), the Islamic financial system has expanded significantly during the previous 40 years. It is presently regarded as one of the financial system's segments with the fastest growth rates. A slight economic rebound in major Islamic finance markets and greater Islamic bond issuance are predicted to propel the $2.2 trillion global Islamic finance sector's 10%–12% growth over the 2021–2022 period. Iran, Saudi Arabia, Malaysia, the United Arab Emirates, Kuwait, and Qatar are the leaders in the Islamic banking sector, accounting for around 85% of all Islamic banking assets worldwide, according to research by Jan et al. (A., M., P., J., R., & N., 2021). The second-largest Islamic banking countries worldwide include Turkey, Indonesia, Bangladesh, and Pakistan. The countries having the least share of the worldwide Islamic banking business include Brunei, Egypt, Oman, Bahrain, and Sudan. From an Islamic viewpoint, Jan et al study's (Jan, Marimuthu, M, & Mat, 2019) on the relationship between sustainability practises and financial performance in Malaysia from 2008 to 2017 found that Islamic banks' financial performance was strongly positively correlated with sustainability practises.

Methodology

The current study is a concise examination of secondary data acquired from previous research work, journals, Government publications, research papers, and other media-accessible and internet content.

Interest Free Banking is an Innovation in Indian Banking System

The growth of Islamic banking has a lot to offer the Indian community. Islamic banking can serve as an alternative for traditional banking by providing a variety of financial products while still promoting financial inclusion. Islamic banking is not just open to Muslims. It is open to non-Islamic populations, which may have more alternatives.

Among the many advantages of Islamic banking are:

- **Financial Inclusion:** The Government and RBI introduced the Jan Dhan Yojna with a focus on financial inclusion in order to bring the unbanked and financially excluded population into the formal banking system. The old banking system may be unsatisfying to some Muslims since it breaches Islamic Sharia. As a result, they were kept out of the regular financial system. Islamic banking has the ability to open up new channels for community progress and the realisation of the universal goal of financial inclusion for Muslims.
- **Inclusive Growth:** Inclusionary growth may be supported by Islamic banking since more individuals may obtain loans more simply and inexpensively with little to no collateral, allowing banking services to reach even the most disadvantaged populations.
- **Substantial Flow of Funds:** Significant infusion of funds Islamic banking will provide up chances for major financial flows in the business. It will help raise substantial quantities of money from Muslims who participate in the regular banking system either seldom or not at all.
- **Investment from Gulf:** Investment capital from Gulf countries Islamic banking will also help reroute a significant chunk of the Islamic investment funds from the Gulf States that India is now losing to other countries. Dealings with Muslim-controlled countries may gain from it.
- **Wider Financial Choices:** When new financing possibilities are made available through Islamic banking, people will have access to a wide range of financial items. A different financial system may foster competition, creativity, and efficiency.

- **Niche Market:** Islamic banking is particularly created to meet the demands of the Muslim community, who, due to religious views, does not use the standard financial system. Given the increased need for specialised goods in India, Islamic banking may be helpful.
- **Socially responsible investing:** SRI has been a more popular investment strategy in the last 20 years. An investment is considered socially responsible due to the nature of the company's activities. In addition to financial benefits, it is expected to have good social and environmental consequences. The three major pillars that underpin the examination of an investment's sustainability and ethical effect are the environment, social justice, and corporate governance. To put it simply, SRI is an investment strategy that prioritises both monetary gain and social good. Many SRI investors avoid companies that they feel have a negative influence on society, such as those that produce fossil fuels, fast food, alcohol, cigarettes, gambling, weapons, and pornographic content.

Prohibition of sin goods and services

Islamic banking restricts investment in things like gambling, alcohol, firearms, pornography, and other activities that are considered "haraam" in the Islamic religion, and instead encourages investment in things like legitimate economic activity that would enhance community welfare overall.

In Islamic finance, there is a prohibition on investing in sin goods and services, which are considered harmful to society and/or morally objectionable. Sin goods and services include products such as tobacco, alcohol, gambling, and pornography. The prohibition on investing in sin goods and services is based on the principle of "maqasid al-shariah," which means the objectives of Islamic law. One of the main objectives of Islamic law is to protect human life, health, and well-being, and sin goods and services are seen as a threat to these objectives.

The prohibition on investing in sin goods and services has several implications for the Islamic finance industry. First, it means that Islamic financial institutions cannot invest in companies that produce or sell sin goods and services. This restriction can limit the investment opportunities available to Islamic financial institutions, particularly in industries such as alcohol and tobacco, which generate significant profits.

Second, the prohibition on investing in sin goods and services can have a positive impact on society by promoting ethical and socially responsible investing. By avoiding investments in companies that produce or sell sin goods and services, Islamic financial institutions can encourage the development of industries that promote social and environmental well-being, such as renewable energy and healthcare.

Third, the prohibition on investing in sin goods and services can help to promote financial stability by avoiding investments in industries that are subject to significant legal and reputational risks. For example, investing in companies that produce or sell tobacco can expose investors to significant legal liabilities and reputational damage, particularly as awareness of the health risks associated with smoking increases.

Sustainable Development through Interest Free Financing

Sustainable development is a global priority that aims to meet the needs of the present without compromising the ability of future generations to meet their own needs. Interest-free financing, also known as Islamic finance, can play a critical role in promoting sustainable development by encouraging long-term planning, fostering financial inclusion, and supporting socially responsible investments.

One of the key advantages of interest-free financing is its focus on profit-and-loss sharing arrangements, which encourage long-term planning and discourage risky investments. This can help to promote sustainable development by encouraging investments in projects that have a positive social and environmental impact over the long term, rather than short-term profit maximization.

In addition, interest-free financing can also promote financial inclusion, particularly in developing countries where large segments of the population lack access to traditional banking services. By using profit-and-loss sharing arrangements, banks can offer affordable and accessible financial products and services to underserved communities, including small businesses, farmers, and low-income households. This can help to promote sustainable development by providing these communities with the capital they need to grow and improve their economic outcomes.

Interest-free financing can also support socially responsible investments, such as renewable energy projects, that have a positive impact on the environment and society. In India, for example, interest-free financing could provide a way for investors to support the development of renewable energy projects without relying on conventional loans that carry high interest rates. This could help to accelerate the growth of the renewable energy sector, which is critical for achieving India's sustainable development goals.

Furthermore, interest-free financing can promote ethical and responsible investing by adhering to principles of fairness, transparency, and social justice. In Islamic finance, investments must comply with ethical and religious principles, such as the prohibition of investing in industries that are harmful to society, such as tobacco or gambling. By promoting ethical and responsible investing, interest-free financing can help to create a more equitable and sustainable financial system.

Overall, interest-free financing can play a crucial role in promoting sustainable development by encouraging long-term planning, fostering financial inclusion, and supporting socially responsible investments. As such, it is an important tool for building a more equitable and sustainable global economy.Top of Form

To be sustainable, Islamic banks use two basic models: institutional and welfare strategies. According to Mansour et al. (2020) [13], the institutional approach increases the wealth of bank stakeholders. The purpose of the well-being plan is to improve people's well-being in order to bring about Maqasid Al- Sharia. As a result, it is possible to assert that sustainability is linked to and necessary to the concept of Islamic banking. The literature reveals consistent commercial development in Islamic banks over the previous two decades, which is positive in the business sector. Businesses work hard to achieve sustainable growth because it supports the economy in a competitive business environment. Furthermore, it improves the social performance of "Triple-P" multinational firms (planet, people and profit). When asking enterprises to follow the "Triple-P" mindset, the major focus has been on the importance of innovation in supporting long-term corporate success. However, the majority of the existing research focuses on the sustainable growth and innovation associated with large, international firms; as a result, the Islamic banking industry is ignored and continues to be understudied.

One group of bankers believes it has a ready-made solution to the world's rapidly rising environmental challenges. According to its proponents, Islamic finance may aid in diverting financial flows away from human activities that have a negative impact on the environment and society and toward those that have a positive impact. According to Rafe Haneef, Group Chief Sustainability Officer of CIMB bank, there is a growing recognition that Islamic moral values and international conventions such as the United Nations' Sustainable Development Goals (SDGs) have a lot in common (UN).

The SDGs were created by the UN General Assembly in 2015, with the intention of attaining them by 2030. During a 2021 Refinitiv webinar, Haneef noted, "Islamic banking has always focused on social impact: ensuring that socially destructive sectors, such as alcohol, cigarettes, firearms, ammunition, pornography, and gambling, have been outlawed." According to Haneef, by partnering with the UN SDGs, we are now broadening the meaning of social responsibility.

The Sustainable Development Goals (SDGs) are essentially objectives to fulfil the larger goals of Shariah (Islamic law), such as eliminating poverty or ensuring the sustainability of life on land and in the water. According to the Quran, all of these tasks are important to being a human, according to Haneef. Global investors appear to be recognising the convergence of Islamic finance and sustainability: according to Refinitiv, the value of sustainability-linked Sukuks (Islamic bonds) surged more than 13 times in the four years leading up to 2021. According to Refinitiv, the total value of Islamic finance assets (Islamic banking, Sukuk, Islamic funds, and Islamic insurance) will rise to $5 trillion by 2025, up from $2.2 trillion presently. Although there are parallels between Islamic finance and conventional (Western) finance approaches to sustainable investing, there are also differences.

In contrast to Western financial systems, Islamic banking has a fundamentally different attitude on money, believing that money has no inherent value. According to Islamic thinkers, money should only be used to trade products and services. In Islamic finance, the restriction on "creating money from money" is connected to this notion (in the form of interest). As a result, Islamic (Shariah) compatible equity investment strategies routinely screen out whole Western financial sectors and limit the amount of leverage that portfolio components can incur.

The new FTSE Russell FTSE Ideal Ratings Islamic Index Series, for example, prohibits investing in companies that get more than 5% of their total income from conventional finance. The Index Series then screens for excessive leverage: it eliminates firms whose holdings of interest-bearing assets (such as deposits) exceed the same threshold, as well as firms whose total debt ratio over the greater of average daily market capitalization or total assets (calculated over the previous 24 months) exceeds 33 percent. This stringent approach to leverage appears to be at contrast with the values of Western finance. But, is the core idea—that having too much debt leads to a gambling-based economic strategy and raises the risk of financial instability—really that distant from many foreign officials' beliefs?

According to a May 2018 research from the Bank for International Settlements, high household and non-financial corporate debt, for example, has been demonstrated to have an influence on both financial stability and macroeconomic performance (BIS).

According to the BIS, debt "directly weakens financial stability by making borrowers more vulnerable to shocks." Furthermore, it appears that global shocks, such as COVID-19, war, or the increasing climate catastrophe, are occurring more frequently than in the past. The screening techniques for Islamic equity investment strategies differ from typical environmental, social, and governance-focused (ESG) methodologies in various ways. Investment in firms that produce or distribute alcohol, cigarettes, or firearms, as well as those that promote gambling, is sometimes prohibited by Islamic and ESG investing legislation.

"The route to sustainability is just getting started, and Islamic finance is only being started," Ibrahim said. One central banker believes that the convergence of ideas is quickly becoming the convergence of corporate procedures and operational practises. "In Islamic banking, sustainability is becoming increasingly possible." "It has moved from a more philosophical goal to an anchoring strategy in many organisations, including Islamic financial institutions," said Madelena Mohamed, Director of the Islamic Banking and Takaful Department at Bank Negara Malaysia.

Conclusion

According to the study's findings, Islamic banking has various benefits, the most notable of which is the potential to increase financial inclusion while also ensuring sustainability, which is crucial if India is to become an economic powerhouse in the near future. By offering the people of India with an alternative banking solution, Islamic banking may prove to be a prudent move in conquering and resolving economic crises and enhancing the financial system. Aside from alternative banking systems, it can aid in the restoration of social balance by providing interest-free options to debt-ridden farmers, labourers, and other disadvantaged groups.

The largest problem that Islamic financial institutions are likely to face in fully embracing the sustainability agenda is disclosure. Only a handful have signed on to globally recognised standards like the United Nations Principles of Responsible Investment and the United Nations Principles of Responsible Banking, which both require thorough reporting on one's sustainability efforts and impact. The rising desire to do well for the environment, on the other hand, is tempting Islamic finance institutions to capitalise on the growing need to reach a bigger investor base—which is often the driving argument for turning to Islamic sustainable financing in the first place.

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