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Al-Ashkal al-Mukhtalifahfi-al- al-Musharikah: A-Post 2015 Assessment of the Trends and proficiency of Islamic Equities

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Abstract

Al-Musharikah (partnership) is among the basic components in Islamic equity Models. Since 2015, Islamic equity models have already crossed over to a fresh orientation (*al-ashkal al-Mukhtalifah*) by way of *Sukuk*practices well as on the basis of its returns in the finance sector. The researches revealed the mechanism and inclusion of the Islamic equity models which can play a significant role in the market and an indicator for Per Capita progress through *Halal* (Permissible) merchandise. From 2007-2013, its application and mechanismhas become more competitive with its conventional counterpart with more than $2100bn. Altogether with the global assets and a healthy growth rate of 10-18% per annum (Rated 2010, 2014& 2018-2020), Islamic banking and finance is now being practiced in more than 78 countries with more than 561 Islamic financial institutions participating in the global corporate. From 2017, the Islamic Equity models has taken a new direction as the experts are, now, again involved to concentrate upon its efficacy particularly in South East Asia and the Gulf, being hub of the global commercial activities. The fresh researches in the *Fiqh al Ma'amalat*altogether with the holistic approach of *Maqasid al-Shariah* has emerged with the hope of reallocating the Islamic equity financing as per the challenges in corporate, agriculture and Investment sector. The Islamic equity models have made a considerable growth and impact over the world economy since 2002. In 2004 the proportion of assets of the region was 29% of the world wide Islamic banking assets which grew to 50% in 2008 of the worldwide share. From 2015 onwards, a sustainable growth seems to be occurring by way of increase in PCI (Per Capita Income) and GDP, however, setting new challenges to Muslim societies in Asia and Europe. In the given context, The present article, therefore is an attempt to assess and analyze the competence of Islamic equity finance, its attitude towards emerging corporate challenges and its *Shari'ah*acquiescent in a much broader perspective.

Key Words: *Asset formation,IEM, Products and Services, Shari'ah Complaint, PLS Scheme, Shirkah (Partnership), Shari'ah Advisory Board, Equity Stock-Index (ESI), Sukuk*

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1. Prologue

The study and practices in current Islamic finance now involve a variety of expedite, inclusive approach and consumer matrix. Due to certain socio-economic and political reasons, upheaval and post-modern religiousdiscourse, there has been a crucial debate in the study and position of Islam in the current circumstances.[1] The Muslim intellectuals and scholars are in a constant gear up to study and explore such possible derivations/options (*al-Ashkal al-Mutafariqah al-Musharikah*) that could help in transforming the institutions for a better socio-economic pursuits. This process for the reassessment of "mediums & models" has proved to be a substantial debate to reorient the studies and researches in the contemporary Islam as well its various aspects.This has been also true with the existing urgencies and background in Islamic finance sector which explored socio-economic and intellectual dynamism and brought certain new things to light for community benefits.[2]Approaching Post 1990's and formulating a sizable asset formation till 2010, Islamic finance has become a trillion-dollar industry through its equity models and assets confirming its scope and contribution in the global share.[3] The market consensus and overall impact implies that Islamic finance has a bright future, owing to favorable demographics and rising incomes in the Muslim communities since 2005.[4] Despite skepticism regarding accommodation between Islamic and global finance, leading banks are buying Islamic bonds and forming subsidiaries specifically to conduct Islamic finance. Special laws have been enacted in non-Muslim financial centers – London, Singapore, and Hong Kong – to facilitate the operation of Islamic banks and associated financial institutions.[5]

The *Musharakah* Sukuk(in banking and finance industry) is rapidly growing and contributing to 71%, or USD 1.72 trillion, of the industry's assets as estimated in 2017. The sector is supported by an array of commercial, wholesale, and other types of banks. Yet, commercial banking remains the main contributor to the sector's expansion. There were 505 Islamic banks in 2017, including 207 Islamic Banking windows. However, the number is not necessarily indicative of the size of the industry, in terms of assets. Islamic finance's second-largest market, Saudi Arabia, has 16 Islamic banks, including windows, which is less than the smaller markets of Malaysia and the United Arab Emirates.With the rapidly growing popularity of mobile banking, particularly among younger people, according to PwC's 2018 Digital Banking Consumer Survey, a growing number of digital-only, or 'disruptor banks' with no physical branches, have emerged. Islamic banks are also catching up on this trend, with the launch of digital-only subsidiaries, such as Gulf International Bank's Meem in Bahrain and Saudi Arabia, and Al-Barakah Türk's Insha in Germany and other European countries with large Muslim communities.Islamic banking is commonly seen to have two advantages over conventional banking. The first is a perception that Islamic banks are bound to a higher moral standard. They will not take on irresponsible amounts of risk or pay outsize bonuses to their top bankers. The second is that earnings come from identifiable assets, not opaque combinations of derivatives and securities.

2. Asset formation and Islamic Equity (*Musharakah*)Trends

Shirkah is the major component in Islamic finance. As the Islamic banks cannot make money through interest (*Riba*) or illicit (*Haram*), they rely on ties to tangible assets, such as real estate and equity, charging 'rent' instead of interest.GCC Regional OverviewShariah-compliant assets represent a significant portion of total banking assets of the GCC. While in the Middle East & North African (MENA) region, Islamic Banking assets represent 14% of total banking assets. In the GCC, the market share of Islamic banking crossed the 25% threshold, which suggests that Islamic banks have become systemically important in these countries.GCC Islamic banking assets reached USD 490 billion by the end of June 2013, with Saudi Arabia dominating the region with a 49% share, followed by the United Arab Emirates (19%), Kuwait (16%), Qatar (11%), and Bahrain (5%). This segment is still nascent in Oman (Islamic Financial Services Board (IFSB), (2015)). Islamic banking has acquired systemic proportions especially in Kuwait, Saudi Arabia, and the United Arab Emirates, in line with IFSB's definition of systemic, at least 15% of banking system assets. Retail Islamic banking in Bahrain has reached systemic proportions with a 27% asset share in retail banking, and a 13% asset share in total retail and wholesale banking. Oman's entry in Islamic Banking was in late 2012.

i) Musharaka Sukuk

The Accounting and auditing organization for Islamic institutions defines the *Musharaka Sukuk* in the following way. ''*Musharakah Sukuk is investment Sukuk that represent ownership of Musharakah equity. The Musharaka agreement is a form of joint venture agreement between the issuer and (usually) the originator to engage in a Shariah compliant investment activity in accordance with a business plan that is appended to the Musharakah agreement. Any profits received from the Musharakah arrangements are distributed between the issuer and the originator as agreed*'' (Source: Academy for International Modern Study, 2009& 2017, p.1-4). According to Luxemburg Tax Authorities,*Musharaka*h is defined as: "*Investment via a holding in which the share of the profit is determined beforehand and the losses apportioned to each investor are limited to the amount invested. The payments made in installments represent part repayment of the capital and part allocation of profit*" (Source:Rabia, S. & Dascotte, J. (2010), *Luxembourg Tax Treatment of Islamic Finance. Islamic Finance News*'', 7 (6).p. 13, Available via: http://www.wildgen.lu/pdfs/IslamicFinanceNews_feb2010.pdf (Retrieved: 02.04.2010-14).

ii) The Basic Principles of *Musharakah*

Musharakah is an investment contract for conducting any Halal (Permissible by *Shariah*) business in which all parties contributed the capital in accordance with a specified ratio. Hence, all partners have right to take active part in the management of the business and have executive powers but it is not obligatory.

The partner may agree on some partner who can manage the business on behalf of the other. The Profits are shared in accordance with the pre-determined ratio. But in case of sleeping partner it should not be grater then the ratio of the capital invested by that sleeping partner.

Loss should be suffered by each partner in accordance with the ratio of capital invested rather than the predetermined profit sharing ratio. The liability of the partners is unlimited. But it can be limited to partners who do not authorize other to incur debt during the conduct of business.

All the partners are owners of business assets so any appreciation in the value of assets is also subject to share among them in accordance to the predetermined ratio. (Source: Al Zubi, H., & Maghyar, A. (2006), The Relative Risk Performance of Islamic Finance: A New Guide to Less Risky Investments, *International Journal of Theoretical and Applied Finance*, 10 (2), 235-249.

The impact of Islamic equity finance since 2015 has again been very much significant both in the corporate as well as at conceptual level. Its share, especially to facilitate and shape the social economics is a living positive sign of growth in the current geo-economic situation. How should these developments be viewed from the perspective of Western finance and economic analysis? Does Islamic finance really constitute a viable alternative financial system? How Islamic equity models can perform and act as efficient mechanism in the corporate sector? These and similar other questions are expected.[6] Not so long ago, Islamic finance was superficially dubbed a zero-interest-rate system that would lead to inadequate and inefficient resource mobilization. Ironically, mainstream central bankers today routinely use precisely such policies when pursuing massive "*quantitative easing*."There are two central precepts of Islamic finance: (a) absolute prohibition on charging interest on financial transactions, and (b) high moral standards on the part of lenders and borrowers. Interestingly, the best economic rationale for a zero-interest-rate system is provided in John Maynard Keynes's *The General Theory*: "Provisions against usury are amongst the most ancient economic practices of which we have record….In a world, therefore, which no one reckoned to be safe, it was almost inevitable that the rate of interest, unless it was curbed by every instrument at the disposal of society, would rise too high to permit of an adequate inducement to invest.[7]"Importantly, although interest is prohibited under Islamic finance, profit is not; the latter is derived from various arrangements that combine finance and enterprise in Islam. In essence, this is a profit-sharing and risk-sharing system that is based entirely on equity finance models.[8]

3.Structure and Sustenance (*Shari'ah* Compliance)

Islamic finance thus contrasts with the current dominant system based on interest-bearing debt, in which risks are theoretically transferred to debt holders, but in practice are socialized during crises.[9] Other things being equal, most economists will agree that debt finance leads to greater instability than equity finance. It follows from the second major tenet of Islamic finance that if people adhered strictly to its ethical requirements, there would be fewer moral-hazard problems in Islamic banking. Moral hazard exists in all systems in which the state ultimately absorbs the risks of private citizens. But, whether any particular system is efficient in avoiding moral hazard is a matter of practice, rather than of theory.[10] Islamic finance could prove to be a serious alternative to current models of derivative finance. Moreover, the basic tenets of Islamic finance force us to re-think the ethical basis of modern monetary arrangements, which have evolved into a global reserve-currency system founded on fiat

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money. In the past, gold had been the anchor of monetary stability and financial discipline, even if it was deflationary. The test of any alternative financial system depends ultimately on whether it is – or can be – more efficient, ethical, stable, and adaptable than the prevailing system. For now, there is no Islamic global reserve currency and no lender of last resort. But the Islamic world is the custodian of huge natural resources that back its trading and financial activities. As the Islamic world grows in stature and influence, Islamic finance will become a formidable competitor to the current financial system. The world would have much to gain if the two systems were to compete fairly and constructively to meet people's needs for different types of finance.[11]This trajectory of Islamic finance has compelled the conventional financial institutions to make a way for Islamic financing techniques and beginning to incorporate them, either in their lending practices or via separate Islamic departments (windows).The cost efficiency of Islamic finance is higher than conventional finance and development of new Islamic products and services is imperative.[12] The most profitable banks were found in Iran, Qatar and Saudi Arabia with Islamic financial centers often achieving higher levels than conventional Banks. Islamic banking and finance is growing so rapidly that it emerged as global phenomena and is gaining regulatory approval to operate alongside conventional western-style orientations.[13]

4. A Post 2015 analysis of Islamic Equities (*al-Ashkal al-Mukhtalifah fi al-Musharikah*)

Islamic Equities are identical with PLS and the *Shariah* complaint models.[14]From 2015 onwards certain areas of *Shirkah al-Inan* have been again focused for mitigating demands in agriculture and loans. The equity finance in Islam owes its origin in *Fiqh al M'amalat*(Economic jurisprudence) whereupon the relevant content from Quran and Sunnah has been interpreted and supported for the commercial discourse in connection with socio-economic human activity.[15] In the approved forms of *Ba'ih* (Trade and Sale), a number of options along with practicality and mechanism has been elaborated for socio-economic benefits.[16]The objective of Islamic banking system is to make a positive contribution to the fulfillment of economic growth and sustainable development of the society. [17]

As defined technically, an Islamic bank is a financial institution that identifies itself with the spirit of *Shari'ah*. The *Fiqh al-Maamalat* (economic/financial jurisprudence) as explored in the juristic literature tries to manifest public good (*Istehsan*) and *Maqasid al-Shariah*identical factors that determine the course of operations in the commercial activity. An Islamic bank does not normally lend money except interest-free loans which are termed as *Qard Hasanah* (Benevolent Loans) while loans on service charge, not exceeding the actual administrative cost of such loans, have also been permitted by Muslim jurists. To replace interest and its possibilities in finance, the ideal mode of financing under the Islamic banking system is *Mudharabah* "*Financing on Profit & Loss Sharing*" (PLS) basis that makes the depositors share holders. [18]*Qard Hasanah*, therefore is for the benefit of the weaker sections of the society at large. To safe-guard the interest of depositors/investors, these provisions and loans, as a matter of policy, do not constitute a significant source of financing by Islamic banks, However, if in any country, the Islamic System of *Zakat* is mandated to the Islamic banks, the requirements of *Qard Hasanah* would primarily utilized for the weaker sections of the society.[19]

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However, the immensity of financing by Islamic banks has to be equity based. In this mechanism, the losses are shared by the financier along with the entrepreneur in the ratio of their respective capitals. The profits are, however, shared in an agreed ratio. The rates of returns in this system are thus replaced by ratios.[20] The Islamic financial experts, while designing an alternate to the existing interest-based system, realized that large scale resorting to PLS system of Islamic banking could pose serious risks and hazards to Islamic banks due to high growth of the conventional banking system. It is therefore, considered necessary to devise various other modes of financing in addition to *Mudaraba* &*Musharaka* based on PLS system and *Qard*-Hasan.[21]

5. **Competence and Character*(La Gharar wa la al-Riba*)**

Minimizing risk (*Gharar*) and eliminating interest (*Riba)*is the core concept in *Musharikah* Finance.Although, The history of Islamic finance in the West began in 1982 when the Jeddah –based Al-Baraka Investment Company set up the Al-Baraka Bank in London, but the Islamic corporate experiences from Egypt, Syria and Iran made its advance again from 2005, which provided it many new dimensions in the areas of *Musharakah*.[22] Al-Barakah bank offered services like current accounts, investment deposits, housing finance and investment management that resulted in practical Islamic finance provisions. The London based United Bank of Kuwait, set up its special Islamic banking unit in 1991, to cater the needs of its Middle-Eastern clients for Islamic trade-based investment and in 1995 it was re-named as Islamic Investment Banking Unit and later merged with AL-Ahli Bank to form a new entity, Al-Ahli United Bank.[23]

Islamic banking sector has gained foothold in the major cities of the United Kingdom, U.S.A and Western Europe with a non- banking Islamic finance service entities presently in operation.[24] Three Islamic leasing companies are currently operating in U.S.A and United Bank of Kuwait has recently begun to offer retail Islamic mortgages in the U.S.A. At the same time, U.S.A and foreign based multinationals, such as general electric, Exxon and Royal Dutch shell have all utilized Islamic financing in recent years. The Muslim community cooperative Australia (MCCA) established in 1989 operates from its head office in Bur wood, Victoria. It involves financial dealings and transactions on Islamic finance operations and no interest based transactions are involved. In 2003-2005, a US $100million Islamic equity fund was launched to invest in private Australian and New-Zealand companies compatible with *shariah.*[25]

London's conventional Banks provide, an extensive range of Islamic financing services, including investment banking ,project finance , Islamic trade finance, Leasing, private banking and mortgages. The London law also provides legal advice on carrying the Islamic financing techniques and has emerged as a global ancillary centre for Islamic financing.[26]Islamic financing business in London is booked from Muslim countries mainly from Middle East and most of the services cater the international clients rather than the local Muslims. Although there are more than two million, Muslim inhabitants in the UK, the potential of the domestic market is not fully tapped. The Islamic banks in U.K are mainly concerned with providing investment banking, corporate finance and trade finance but the retail banking is still in the juvenile stage.[27] A significant development in Islamic finance in the UK was the establishment of Islamic Bank of Britain (IBB), started its operations in 2001, providing retail Islamic banking market, current, savings, treasury accounts and personal finance to the Britain Muslims.[28] It started Islamic mortgage (*Ijarah*) market in 2005.[68]Other banks entering Islamic home finance in U.K were HSBC *Amanah* in 2004, *Al-Burraq*,(a subsidiary of Arab Banking Corporation), Lloyds TSB (2005), Citi Bank, Dresdner Kleinwort Benson, west Building Society, Norton Rose, Dawnay Day and Clifford Chance.[29]The number of Islamic financial institutions (investment banks, retail banks, *Takaful* operators, several corporate Finance Advisory firms, principal investment firms and asset management firms) in UK exceeds the total for the rest of Europe combined. International financial services London (IFSL) produces a report about the size of the global Islamic finance industry and as per its report published in January 2010, UK has $19.4billion *Shariah* compliant financial assets placing UK at 8th position worldwide.[30]

6. Investment Experiences Across

Islamic equities and the banking practices had been widening its spectrum in North America till 2008. Soon after the 9/11 scenario, the political and economic strategies were re-formulated and Islamic banking, unfortunately, faced heavy criticism. But in due course of time, studies and researches revealed it to be a pure economic activity. Islamic finance in the U.S.A is in its formative period, with few small and geographically dispersed institutions providing home, vehicle finance and small business funding.[31] As California has the largest Muslim population in the United States approximately 7 lac (2005), it is the place where Islamic financial activities started initially, focusing on LARIBA (Loss Angeles Reliable Investment Bankers Association), the American Finance House based in Pasadena.[32]In Illinois, where an estimated 3.8% of the population is Muslim(2009), the Devon bank, serves as a community based savings and financing institution. In addition, the Shape Financial Group also provides Islamic mortgage products in the mid-West through the University Bank of Ann Arbor, Michigan. The Guidance Financial Group in Virginia and HSBC Amana provides some Islamic Home purchase financing[33].In November, 2008, the U.S Treasury Department announced that it would convene on Islamic Finance Forum to teach Islamic Finance to U.S Banking regulatory agencies, congress and other parts of the Executive Branch in Washington DC Collaborating with the Harvard University Islamic Finance Project. The purpose of this forum is to help and inform the policy makers about Islamic financial services which are an increasingly important part of the global financial industry.[34]

Similarly, in Australia, the IslamicEquity finance has beenin infancy till 2002.Here, the only two prominent Islamic financial institutions that offer*Shariah*financial products include

Muslim Community Cooperative Australia (MCCA) and *Iskan* Finance.[35] The former was established in 1989 in Melbourne with capital of A $ 20,000 by some 10 members with a view to provide Islamic financial practice focusing on Muslim Community of Australia. In 1997, the membership of the institution reaches up to 1600 with capital increase over A $ 80, 00,000. In the mean time the MCCA expanded its operations to Sydney and New South Wales.[36]The MCCA has gained a well market reputation by offering specially designed, approved products under the oversight of the *Shariah* Advisory Board and has attained a descent response through its financing options and social responsibility.[37]. *Iskan* finance is another player in Islamic finance sector offering Islamic Mortgage (*Rahn*) and leasing (*Ijarah*) products.[38]From 2010, the reputed institutions from Malaysia and Bahrain have been successful in initiating a wide-ranging Islamic goods and services that reveal an advance of the Islamic finance practices.

Conclusion

Since 2015, the Islamic Equity modelshave gained paramount significance due to their simplicity, consumer matrix and efficacy in the global corporate (*al-Tamaul al-Aalami*).The Islamic equity models have made a considerable growth and impact over the world economy since 2000. In 2004 the proportion of assets of the region was 29% of the world wide Islamic banking assets which grew to 50% in 2008 of the worldwide share. From 2015 onwards, a sustainable growth has occurred in some Muslim societies by way of increase in PCI (Per Capita Income) and GDP due to the inclusion of Islamic equity models with references in stock indexes. The contemporary literature on Islamic Banking and Finance obtains its legitimacy and support from the Islamic financial jurisprudenceformulated within the *Shari'ah* paradigm. With important functions and covenants in place, equity financing can be used and isbeing used widely for investment and banking purposes throughout the globe. It is interesting to study the size of debt and equity market in developing countries of the world. In South Asia, for instance, in Pakistan and Malaysia Corporate bond market hardly exists, whereas equity financing is more prevalent and widely used by the investors. Hence the position and impact of Islamic equity finance has become thrust of the concern both in academics as well as in the worldwide banking and corporate sector.

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