
The Underlying Concepts Of Islamic Finance

Islamic Finance is a financial set up that had a big role in the growth and infrastructure systems for the region such as enabling the funding for the Shard and the London Gateway (Parmley, 2020) It operates in accordance with the Islamic law which is known as the Sharia which insinuates that it is sharia-compliant (Jamaldeen, 2012). It is like conventional banks in the sense that Islamic Finance contains an approach of banking and undertaking financial transactions (What Is Islamic Finance? - dummies, 2020). This essay will discuss how Islamic Finance does not perceive wealth as a commodity and has no value of its own but enables the purchase of services and goods in accordance with Islamic economics and the difference among conventional finance. This essay will also evaluate the working of a Sukuk product and will analyse the advantages and disadvantages in comparison to a conventional bond. Additionally, this essay will evaluate and analyse the growth of the first Islamic UK bank as well as discussing the attainments and the challenges that were faced will also be raised.

The time value of money is significant as it is based on receiving income now rather than later this may have an influence on business finance (Wilkinson, 2020) From an Islamic perspective the concept of the time value of money is totally different in contrast to the conventional aspect. The reason being is that income can be seen as a medium of exchange and not as a store of value (Hamza and Jedidia, 2017) which implies that for it to work effectively then it must be of basic value and that it should not be leased out or brought at a cost higher than its monetary value by anybody (Medium of Exchange Definition, 2020) This is because from an Islamic perspective the amount of income an individual has or makes must be pure so when it does get invested the income is paid by a fixed share of the investment return (Hamza and Jedidia, 2017) In addition to this, (Iqbal and Mirakhor,2006) suggests that income is seen as possible capital which insinuates that for it to officially become capital then it must be involved in participating in a specific activity. This demonstrates that in terms of Islamic economics the return of investment should not be associated with Riba.

From an Islamic perspective, the most important purpose of Islamic economics will have to be the banning of Riba which suggests that money is not viewed as a commodity as money has no fundamental value. This suggests that money cannot always be used to fulfill the basic needs of individuals which indicates that income does not always make a person happy and does not always have significance. According to (Today's Beautiful Hadith is about Being Content, 2020) The prophet Muhammad peace be upon him believed that "Happiness is due to him who is guided to Islam and possesses provision that suffices him for his day and remains content (Tirmidhi)" This insinuates that for an individual to be fully content and pleased in life then they must be practicing deen.

Whereas, from a conventional finance aspect capital is a commodity that is used to acquire many supplies. This may be due to believing that money is eternal and that it is long-lasting which implies that it can be used to buy a lot of things as well as being profitable due to it being high in demand which insinuates that it is used regularly by individuals. (Nurrachmi,2012) It also suggests that being great in value indicates that It is also limited which insinuates that as a reward for capital interest is given which may be due to the time value of money playing a big factor in charging interest on capital (Habib, n.d.) According to (Nurrachmi,2012) income is a

type of good alongside store of value and medium of exchange which can be sold and leased out at a price higher than its monetary value.

According to (Godlewski, Turk-Ariss and Weill, 2013) Sukuks are Islamic financial certificates that are dispensed in agreement with the principles of the Sharia and are organised in a way that generates profits which implies that it has different obligations in comparison to a conventional bond (Mohd Saad, Haniff and Ali, 2019) both Sukuk and conventional bonds are supplied to lenders and are secure alternative in contrast to equities. The difference being is that Sukuks include asset ownership in which a share of the underlying asset is signified and must be sharia-compliant in contrast to conventional bonds which are debt agreements in which a share of debt is signified and is used to finance a business that practices authorisation . (dummies, 2020) The rating of both Sukuk and conventional bonds are both associated with price. An example of this could be that an increase in rating could lead to an increased price (Habib, n.d.)

Sukuk's are a way of lending income to an issuer for a certain amount of time and are dissimilar from other existing debt instruments in the sense that it has the qualities of both debt and equity (Ho, 2020). When a shareholder invests in this type of bond then the income is invested into an asset which allows investors to benefit from the revenue made from the asset. In which the agreed amount of margin from the profit made is given to the shareholder. Individuals who invest in Sukuk receive an evidentiary ownership certificate which enables them to obtain daily payments which may be based on the sum that they have invested and are entitles to get back the sum of investment after a certain period. (Ho, 2020) Shareholders that invest in Sukuks are given dividends on profit sharing deals which are a type of financial aspect that is reliant on the internal information of the investors instead of fixed interest costs in contrast to conventional bonds. This implies that Sukuks are vulnerable to issues to do with the information in comparison to conventional bonds.

There are two types of Sukuk which are known as asset-based and asset-backed Sukuk. According to (White & Case LLP, 2020) asset-based Sukuk are extremely popular which means that the focus is not on the asset but is more reliant on the funding. Whereas, for asset-backed Sukuk's to thrive then individuals should focus more on looking at the cash flow aspect. In terms of differences, the payment aspect for asset-based arises from the cash flow of the debtor. In comparison to asset-backed in which the expenses come from the income made from the asset.in terms of documenting the asset for asset-based, the asset stays on the balance sheet of the debtor in contrast to asset back which doesn't Hidayat, S. (2013). The one that is more sharia-compliant will have to be asset-backed in contrast to asset-based Sukuk which behaves more like a conventional bond.

One of the advantages of Sukuk is that if the worth of the asset surges then the worth of the ownership of the asset supported by the Sukuk also rises in comparison to conventional bonds who do not have this trademark (Five Important Differences Between Sukuk and Traditional Bonds - Sukuk | Home of the Global Sukuk Industry, 2020). However, both Sukuk and conventional bonds will have to be the liquidity aspect. This is because both are used within the secondary market which means that many businesses such as insurance companies and banks ply this to their advantage. An example of this how they may do this is by using the income that they may have leftover and using it to purchase Sukuk or conventional bonds (Habib, n.d.)

Another advantage of both will have to be bond ratings which allow individuals to choose which

bond to invest in based on consistency and quality. Therefore, an increased rating insinuates how widespread a bond is (Habib, n.d.) Sukuks are securities that are secured in assets such as ownership in an investment or project compared to conventional bonds which are debt instruments. Looking at this from a Sukuk perspective securities are super favored and are likely to be chosen compared to fixed deposits due to the effective rates of profit that are offered. According to (Weighing the Advantages and Risks of Sukuk | Al Bawaba, 2020) Sukuk securities average return is five percent in comparison to fixed payments of the same currency of 1.75 percent but the disadvantage of this could be that there may be some risks such as credit risk.

Moreover, another advantage of both will have to be the investment prospect which may lead to a higher chance of expansion of the market. This is beneficial for investors who may choose to invest in using a certain volume of income (Habib, n.d.). This may attract individuals such as investors internationally who may have an interest in this sector which would be beneficial as it would lead to an increase in sales as well as the possibility of branching out towards other financial markets. An example of this could be working towards more extensive investment markets that could potentially provide a reputational advantage and may have a benefit due to the increase in the certainty that is offered regarding interest expenses as individuals would have a better idea in knowing that they will receive payments on the specific date given. This may also be of some influence in developing on the financial aspect side as individuals may also be given dividend expenses. According to (Habib, n.d.) Sukuk may be used for equitable distribution of income in comparison to a conventional bond. The reason being is that many shareholders may benefit from the profit generated from the underlying asset.

According to (Nawaz, 2018) Al Rayan Bank is a commercial bank that opened its first branch with the support of the Financial Services Authority which allowed them to introduce it in London in the year 2004. In the year 2006 online banking came into surface and in the year 2018, Al Rayan Bank was the first to introduce a Sukuk in a western country. There are over 13,000 corporations in the UK which insinuate that there are more job prospects available for individuals in need of a job (Al Rayan Bank, 2020).

In terms of growth, AL Rayan Bank is growing at a steady rate as it has an increased amount of Islamic Finance providers which means that Islamic Finance is super popular in the UK in comparison to countries such as the USA. This may be due to having a lot of skilled staff who have relevant knowledge due to the high number of courses available within this field which implies that these employees may be of value for the business due to being trained effectively (News, 2020). This has also had a positive impact on the profit of Al Rayan Bank as they own over 5 billion worth of assets which may be due to their high number of customers who have invested throughout the years many of whom are Muslims and non-Muslims who have invested in AL Rayan Bank (Leap of faith, 2020). According to (History of Al Rayan Bank, 2020) in terms of achievements Al Rayan Bank had achieved in gaining many awards such as in the year 2017 they won the title of being the best Islamic bank in the UK.

However, Al Rayan Bank also faced many challenges along the way. The reason being is that due to the prohibition of interest Al Rayan bank were not able to borrow from the bank of England or other banks in the UK instead they would be dependent on deposits which they split with depositors which may have had an impact on the operation of Al Rayan Bank. Another challenge that Al Rayan Bank may have faced is competition amongst other banks this is because the financial industry is super competitive so when they opened the bank they may

have been less known in comparison to other banks such as Lloyds (King, Schaverien and Papantoniou, 2020). In addition to this, AL Rayan Bank may have faced many regulatory changes such as the elimination of double tax and expansion of tax reliefs on Islamic loans as well as effectively applying the Financial Conduct Authority which helps in safeguarding customers as well as ensuring that Islamic finance is being followed efficiently which will help in maintaining the success of Al Rayan Bank (Financial Conduct Authority, 2020) This may have had an impact on AL Rayan Bank as it may have encouraged them to grow and successfully influence the performance of the company.

To encapsulate, this essay has demonstrated the theoretical background on the underlying concepts of Islamic Finance which has been increasing a lot over time as well as evaluating the working of a Sukuk product and analysing the advantages and disadvantages in comparison to a conventional bond. Many investors opt for corporate bonds as well as Sukuks as a safer investment prospect during times of economic instability. I have also identified that the Al Rayan bank faced many achievements as well as challenges to become a success. However, opportunities such as investing more in digital banking would be better in terms of security.

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