
A LITERATURE STUDY ON THE CONCEPT OF ISLAMIC BANKING AND FINANCE: HISTORICAL AND LAW PERSPECTIVES

Eko Suyono¹, Wahyudin^{2*}, Agung Praptapa³

¹Universitas Jenderal Soedirman; ekyo75@unsoed.ac.id

²Universitas Jenderal Soedirman; wahyu6655@gmail.com;_corresponding author

³Universitas Jenderal Soedirman; agung.praptapa@gmail.com

Abstract

The concept of Islamic banking and finance significantly departs from its basic sources which are Quran and Sunna of the Prophet. Both sources strictly prohibit riba (usury) and gharar (gambling) in financial transactions and recommend for profit and loss sharing basis. Based on this principles, many Islamic financial experts and scholars try to develop some financial products which are in-line with the Islamic principles. Since then, Islamic banking provides several financial products such as Mudharaba, Murabaha, Musharaka, Istisna'a, Ijarah, Salam, etc, which are not violating the Islamic principles. When Muslims are able to utilize the Islamic principles in financing the business, thus the Islamic banking will be the best alternative for Muslim populace around the world.

Keywords: *Islamic banking, Islamic principle, financial*

INTRODUCTION

One of the most important principle of Islamic banking and finance that is largely agreed upon among Muslims today, the most important is the Qur'anic prohibition of *riba*, which, according to a significant number of Muslims, covers modern bank interest. One of the important points of emphasis in the Qur'an is that the disadvantaged should not be exploited through *riba*-based transactions. In this context, the Qur'an prohibits *riba* in no uncertain terms. However, there is some debate today on the precise definition of *riba*, and on whether the term covers modern bank interest. Despite this debate, Islamic economists and bankers have remained insistent that all forms of interest which are in practice today are indeed manifestations of *riba* and have no role in an Islamically acceptable financial system. They argue that the prohibition of interest is based on clear Qur'anic instructions and on the Sunna of the Prophet (Siddiqi, 2006).

Apart from avoiding interest, Islamic banks are also required to avoid transactions that involve excessive speculative risk (*gharar*): that is, contracts in which a significant element of uncertainty exists, or similar transactions such as gambling. In addition, Islamic financial institutions must continue to follow the rulings that are provided by the Qur'an and Sunna in relation to other prohibited contract.

Islamic saving money is managing an account or saving money movement that is predictable with the standards of Sharia (Islamic law) and it is down to earth application through the improvement of Islamic financial matters. In that capacity, a more right term for Islamic managing an account is Sharia agreeable back. (Khan and Batti, 2008).

Moreover, Sharia restricts acknowledgment of particular premium or charges for advances of cash (known as *riba*, or usury), regardless of whether the installment is settled or coasting. Interest in organizations that give merchandise or administrations considered in opposition to Islamic standards (e.g. pork or liquor) is likewise haraam ("prohibited"). Despite the fact that these restrictions have been connected generally in fluctuating degrees in Muslim nations/groups to forestall un-Islamic practices, just in the late twentieth century were various

Islamic banks shaped to apply these standards to private or semi-private business foundations inside the Muslim people group (Ali and Ahmed, 2007).

Islamic saving money is sans premium managing an account, in which there is no settled rate of return. Islamic keeping money in the managing an account framework which is kept running as per the Islamic laws and the Sharia board; that aides the establishments. This Sharia board approves the items that whether these are Sharia agreeable or not. The premium is restricted in Islamic methods for saving money as it is additionally clear from Quran. The Islamic managing an account has expanded as far as branches, stores, capital assets, sources, etc. The proportion of wage to costs is high which demonstrates expanding the productivity of the area. Riba actually implies increment, expansion, or development. It is however not each expansion or development, which is denied by Islam. In Shariah, Riba, in fact, alludes to the exceptional that must be paid with no thought (Khan and Batti, 2008).

Conventional banking acknowledges stores and pools those assets to give credit, either specifically by loaning, or in a roundabout way by contributing to the capital market. Inside the worldwide money related market, these organizations associate market members with capital shortfalls (borrowers) to market members with capital surpluses (speculators and banks) by exchanging stores from those gatherings who have surplus assets to contribute (monetary resources) to those gatherings who acquire assets to put resources into genuine resources (Beck et al., 2013). Meanwhile, Islamic Banking is a banking movement that is predictable with the standards of Islamic Law (Sharia) and its pragmatic application through the improvement of Islamic Economics. Sharia restricts the installment or acknowledgment of particular enthusiasm of charges (known as Riba or usury) for advance of cash. Putting resources into organizations that give merchandise or administrations considered in opposition to Islamic standards is additionally Haraam (taboo). While these standards were utilized as the reason for a thriving economy in prior circumstances, it is just in the late twentieth century that various Islamic banks were framed to apply these standards to private or semi-private business foundations inside the Muslim people group (Arris, 2010).

Several Islamic finance products are Mudharaba, Murabaha, Musharaka, Istisna'a, Ijarah, Salam, etc. Mudharaba is a venture association, whereby the financial specialist gives Capital to another gathering so as to attempt a speculation movement. While benefits are shared on a pre-concurred rate, loss of venture is conceived by the speculator as it were. The financial specialist loses its share of the normal wage (Khattak and Rehman, 2010). Types of Mudharaba such as saving account and Iqra account in certain Islamic banks. Saving account is designed specifically to meet the requirements of customers who authorize the Bank to invest their cash deposits. Customers can deposit or withdraw money at any time they wish. Meanwhile, Iqra account is the account in an investment scheme, which enables families to make a monthly contribution amount to cover the basic costs of their lives.

Murabaha is a purchase and resale activity, instead of lending out money, the capital provider purchases the desired commodity from a third party and resells it at a pre-arranged higher price to the capital user. By paying this higher price over installments, the capital users have successfully obtained credit without paying interest (Henry and Wilson, 2004). Types of Murabaha such as Auto Finance and Tasheel Finance in certain Islamic Banks.

Musharaka is a profit and loss sharing relationship where profits are shared as per agreed ratio whereas the losses are shared in proportion to the investment of each partner. Types of Musharaka such as Mortgage Finance (Investments Finance) (Siddiqi, 2006).

Istisna'a is the second kind of sale where a commodity is transacted before it comes into existence. It entails ordering a manufacturer to manufacture specific goods for the purchaser.

If the manufacturer undertakes to manufacture the goods for him, the transaction of Istisna'a comes into existence (Siddiqi, 2006).

Under the terms of an Ijara transaction the investor, or lessor, would purchase equipment from a manufacturer and lease it on to the company, or lessee, for an Agreed period of time. Moreover, Salam is a sale whereby the seller undertakes to supply some specific goods to the Buyer at a future date in exchange for an advanced price fully paid on the spot (Siddiqi, 2006).

LITERATURE REVIEW

Ali (2014), states that Mudaraba component, for example, a bank taking an interest in the premium free keeping money plan may put its surplus liquidity finances in another bank. These assets might be contributed on the premise of Mudaraba for the time of venture that may differ from overnight to 12 months on a concurred benefit sharing proportion.

Iqbal (2007) observed that Islamic money related markets gained a standing ground amid the most recent two decades and this prospering development has expanded the hunger for agents and investors to see more about this developing business sector, incorporating valuable references to recorded practices and budgetary instruments utilized by Muslim social orders.

Rammal (2010) explained that the review assessed Australian Muslims' awareness of benefit and misfortune contributing monetary gadgets. The example size of the review was 300 Australian Muslims. The review utilized a concise survey with question depicting the preparation of respondents to purchase benefit and-misfortune adding to Islamic managing an account items. The outcomes obviously demonstrate that the greater part of the Australian Muslim populace test would be prepared to purchase Islamic managing an account items, yet are not all that all around educated concerning benefit and-misfortune contributing executes. The outcomes additionally propose a lack of appreciating the qualities and morals of Islamic thought. This was derived from the announcements of the respondents. The respondents plainly demonstrated that if credit administrations were not offered or if the money related establishments like banks were partakers in benefits or misfortunes then they would not be among the buyers of Islamic managing account items.

Volk and Pudenko (2010) found that to perceive the principle tests and opening for Islamic retail managing an account in Europe. The review is a correlation between two European markets for the most part (i.e., Britain and Germany). The review additionally recommends a structure that aids in choosing the advancement of Islamic Banking in these nations. The structure of four primary conditions to be a specific request, supply, administrative and societal. The review recommends that loan, when there are changes in the guidelines and the conditions to allow execution of Islamic saving money, arranges and undifferentiated from expense medicines like conventional managing an account happen at exactly that point Islamic keeping money will develop and create in Europe. The Islamic keeping money ought to give better outcomes for it to be acknowledged by European clients. This will likewise require changes in the directions and the circumstances too. The review likewise can characterize the position of the demographic which aggregate up that the clients require taking an interest in the positive and useful capacity in helping the extension of Islamic managing an account in Europe.

Cihák and Hesse (2008) found that the differentiation between the high steadiness in small Islamic banks and the moderately low strength in substantial Islamic banks is especially fascinating. It proposes that Islamic banks while generally more steady when working on a small scale, are less steady when working on a huge scale.

Jaffer (2005) said that ordinary banks in the west opened Islamic windows to benefit their Islamic clients, the foundation of the principal discrete Islamic retail bank in Europe, and the

transformation of whole saving money capacities to Islamic options, Islamic retail items are progressively moving to the standard. Offerings of Islamic home loans, reserve funds, protection and retail suppliers of assets in 2007 showing expanded liquidity needs. The subprime contract emergency focused on the report, brought about lost certainty among banks.

Al-Omar and Abdel-Haq (2003) explained that Islam has a particular way to deal with business exchanges, the law of agreement, and premium charges to be sure to the very way of property. For budgetary establishments working in an Islamic domain, or trying to meet the prerequisites of groups focused on Islamic law, this represents an assortment of issues. This vital book explores how such a test can be met practically speaking.

Enoch and Khan (2006) explained that Bahrain's budgetary part is getting a charge out of good outcomes and development in a positive situation, a soundness markers propose that the framework is strong. The keeping money segment is all around promoted. Resource quality has been enhancing and provisioning is high. Gainfulness surged in 2004-05, yet verifiable, return on value has been direct for some organizations. The protection part is additionally very much promoted. Accessible pointers for nonfinancial areas demonstrate that family obligation in respect to discretionary cash flow is low yet rising, and the corporate segment is overall not profoundly utilized.

Kuran (2012) explained that the review takes a gander at the purposes behind Islamic law not building up a legitimate lawful framework or why Islamic law did not acquire a lawful framework from another routine framework. The paper likewise spots methods that conceded the spread of the legitimate framework. This is notwithstanding when the development and extent of Islamic banks were growing internationally. Group development has been the center of Islam's central goal. Consequently, Muslim adjudicators in the past did not proliferate any thought which would help sectionism. They rather bolstered an unincorporated trust known as "Waqf" through which conditions with incredible business expenses and expected to be there endlessly.

Imam and Kpodar (2010) found that the saving money segment in Kuwait is confronted with many difficulties. Banks in Kuwait are confronting many difficulties that are probably going to influence their capacity to develop and work inside a more aggressive condition. The Kuwaiti economy keeps on depending on oil as its real main thrust. Oil speaks to more than 90 percent of its stock fare income and 80 percent of spending income. Furthermore, its open division overwhelms the monetary circle regarding possession and administration of general exercises. Indeed, even the execution of the private segment and non-oil related exercises are connected to government intercession as far as financed advances and information costs, value infusions, bailouts, and inclinations in government acquisitions. Thus of the over-reliance on oil and people in general parts, it was hard to create numerous gainful speculation opportunity outside the constrained extent of land and securities exchange exercises.

Sufian (2007) found that impact of remote banks in the Islamic saving money segment in the looks at the Malaysia. The review examines the accomplishments of the De Novo bank in Malaysia for the period 2003 to 2013 and analyzes the useful accomplishments of Islamic banks in Malaysia and in different nations. The finish of the review is that utilizing innovation and mechanical know-how Islamic bank division of conventional banks could perform much superior to Islamic banks in Malaysia. The review shows that the De Novo banks have been more skilled and productive than alternate banks working in Malaysia and have subsequently accomplished superior to their neighborhood and remote Islamic bank partner. The review reasons that the entrance of the De Novo bank as an auxiliary adjusted the structure of the

Islamic keeping money part in Malaysia where remote banks had some time ago displayed their wares by means of Islamic sheets.

Al Ajlouni (2007) said that creating procedures for Islamic banks to confront the future difficulties of monetary globalization. The review finished up results, for example, the money related globalization will effectively affect Islamic bank's self-sufficiency, net revenue, and focused position. It will likewise upgrade the Islamic banks' capacity to make new speculations, liquidity administration instruments, and techniques, and build up the current ones. What's more, to build its capacity to exploit the openness Islamic managing an account will extend its operations into new markets. Al Ajlouni (2007) said that creating procedures for Islamic banks to confront the future difficulties of monetary globalization. The review finished up results, for example, the money related globalization will effectively affect Islamic bank's self-sufficiency, net revenue, and focused position. It will likewise upgrade the Islamic banks' capacity to make new speculations, liquidity administration instruments, and techniques, and build up the current ones. What's more, to build its capacity to exploit the openness Islamic managing an account will extend its operations into new markets.

Warde (2000) found that this review demonstrates the development of Islamic saving money industry and the evaluation of it. On one hand, because of its development, we can term Islamic keeping the money as a win as it has turned into a \$200 billion industry and it is as yet growing crosswise over nations. The review additionally spotlights the disappointments of Islamic keeping money. Islamic saving money has neglected to convey an exceptional and spearheading framework, established on hazard commitment, which would achieve public and budgetary advantages to the Islamic world. In spite of the fact that Islamic law dislikes intrigue and presented the benefit and misfortune sharing (PLs) dealings, the review finds that the operation under this managing is just five percent of the elements of Islamic budgetary establishments. The review finds that most Islamic banks are presently possessed in an arrangement in fund, items and increase activities. These modes are not in view of benefit sharing but rather guarantee benefits for the banks subsequently crushing the very quintessence of Islamic law. These exchanges don't realize social and financial advantages to the group. The review thinks that it much like moderate banks.

CONCLUSION

From the various literature, it can be concluded that the concept that underlies Islamic banking and finance sourced from the Quran and Sunna mainly associated with the prohibition of *riba* (usury) and *gharar* (gambling) in transactions. From this point, the principles of Islamic banking are developed by Islamic economists and scholars. By considering the various aspects of Sharia, Islamic banking ultimately provides several products that do not conflict with Sharia principles such as Mudharaba, Murabaha, Ijara, Istisna'a, Musyaraka, Salam, etc.

The future of the Islamic bank relies on the hands of the employees working in the organization. The key features to maintain the relationship with the customers are competence and professionalism. Proper training to be a valuable instrument for enhancing the administrative capacities of Islamic bank staff.

Islamic banks need to plan and actualize feasible administration quality projects. Inability to give the proper services will create problems in the retaining of the existing customers and at the same time attracting new customers. In such manner, Islamic banks must take useful measures to examine the current practices and update their projects for enhancing the nature of their administrations.

If Muslims have the same orientation and motivation in finance as everybody else, they will end up having the system that has resulted from other people's choices, the one we call conventional financial system. Therefore, the Islamic banking system will be able to provide better financial alternatives for Muslim populace around the world.

REFERENCES

- Al Ajlouni, A. 2007. Developing Strategies for Islamic Banks to Face The Future Challenges of Financial Globalization, *MPRA Paper* from University Library of Munich, Germany
- Ali, M.A., 2014. Evolution and Development of Islamic Banking: The Case of Pakistan, *European Journal of Islamic Finance*, Vol. December No. 1, pp.1-6.
- Ali, S.S. and Ahmad, A., 2007. *Islamic Banking and Finance: Fundamentals and Contemporary Issues*. Islamic Research and Training Institute, The Islamic Development Bank.
- Al-Omar, F., and Abdel-Haq, M., 2003. *Islamic Banking: Theory, Practice, and Challenges*. Zed Books, London.
- Ariss, R.T. 2010. Competitive Conditions in Islamic and Conventional Banking: A Global Perspective. *Review of Financial Economics*, Vol. 19 No. 3, pp.101-108.
- Beck, T., Demirgüç-Kunt, A. and Merrouche, O. 2013. Islamic vs. Conventional Banking: Business Model, Efficiency and Stability. *Journal of Banking & Finance*, Vol. 37 No. 2, pp.433-447.
- Cihák, M.M. and Hesse, H., 2008. *Islamic Banks and Financial Stability: An Empirical Analysis* (No. 8-16). International Monetary Fund, Washington DC, USA.
- Enoch, C., and Khan, M. 2006. Financial System Stability Assessment. International Monetary Fund, Middle East and Central Asia Department.
- Henry, C. and Wilson, R. 2004. The Politics of Islamic Finance, *JKAU: Islamic Econ*, Vol. 19 No. 2, pp. 45-50.
- Iqbal, Z., 2007. Islamic financial systems. *Finance and Development*, Vol. 34 No. 2, pp.42-45.
- Jaffer, S., 2005. *Islamic Retail Banking and Finance: Global Challenges And Opportunities*. Euromoney Book Publisher, Linnaeus, Sweden.
- Khattak, N.A., and Rehman, K.U. 2010. Customer Satisfaction and Awareness of Islamic Banking System in Pakistan. *African Journal of Business Management*, Vol. 4 No. 5, pp.662-671.
- Imam, P.A., and Kpodar, K. 2010. Islamic Banking: How Has It Diffused? *IMF Working Paper*. Retrieved from <https://www.imf.org/external/pubs/ft/wp/2010/wp10195.pdf>.
- Kuran, T., 2012. *The Long Divergence: How Islamic Law Held Back The Middle East*. Princeton University Press, USA.
- Khan, M., and Bhatti, M.S, 2008. Islamic Banking And Finance: On Its Way to Globalization. *Managerial Finance*, Vol. 34 No. 10, pp.708-725.
- Rammal, H.G., 2010. Islamic Finance: Challenges and Opportunities. *Journal of Financial Services Marketing*, Vol. 15 No. 3, pp.189-190.
- Siddiqi, M.N. 2006. Islamic Banking and Finance in Theory and Practice, *Islamic Economic Studies*, Vol. 13 No. 2, pp. 1-480
- Sufian, F. 2007. The Efficiency of Islamic Banking Industry in Malaysia: Foreign vs Domestic Banks. *Humanomics*, Vol. 23 No. 3, pp.174-192.

-
- Volk, S. and Pudelko, M., 2010. Challenges and Opportunities for Islamic Retail Banking in The European Context: Lessons to be Learnt from a British–German Comparison. *Journal of Financial Services Marketing*, Vol 15 No. 3, pp.191-202.
- Warde, I. 2000. *Islamic Finance in The Global Economy*. Edinburgh University Press.