

# Prospects of islamic banking in mauritius finance essay

[Finance](#)



Islamic banking comprises a broad range of financial products that are designed in compliance with Islamic transaction law; the Shariah. According to Ibrahim Warde (2000) Islamic financial institutions are those that are based, in their objectives and operations, on Quran's principles and operate according to the Shariah principles.

## **Principles of Islamic Banking**

Islamic law prohibits usury that is the collection and payment of interest also commonly called riba. This is so because interest is considered as unlawful according to Islamic principles as money for exchange of money does not have any value otherwise invested in business. Siddiqui (2002), Khan (1968) and Ahmad (1952) criticized that when borrowers reap higher profits compared to which the interest is relatively small, then this leads to an increase in inequality in the distribution of income and to an inefficient allocation of society's resources as the bank will receive only that stipulated rate of interest. However, with Islamic banking, there is not this problem as interest is not charged. However, according to Khusro an interest-free banking will make the demand for capital rise which will eventually lead to a rise in consumption and hence might lead to high inflation. Rather Islamic banks operate on a profit and loss sharing principle as well as the sharing of risk. In contrast to interest, profit is lawful according to Islamic principles. Saqr stated that a profit sharing is a contractual agreement between two parties and that this agreement can be changed only by a mutual consent and not by a third party such as the central bank. Moreover Uzair and Siddiqui refer the profit sharing principle as a monetary policy tool that can be used by central bank. Profits earned by Islamic banks are shared not only

to investors but to depositors also because as observed by Bashir (2000), deposits in Islamic banks are treated as shares and accordingly their nominal values are not guaranteed. Islamic banks are also not allowed to involve in products or activities such as alcohol, illicit drugs, gambling and tobacco which are prohibited in Islam. This is so because Islam wants to develop an ethical and friendly environment in the society (Imeson, 2007).

## **Compare and Contrast between Islamic Banks and Conventional Banks**

Islamic banks and conventional banks may be two different forms of banking but still they remain banking institutions. Hence they similarities as well as they have differences. This section is an attempt to compare the similarities and differences that exist between these two types of banking institution.

### **Similarities between is Islamic and Conventional Banks**

#### **Nature of Banking Services**

Islamic banks and conventional banks both offer the traditional forms of deposit accounts that are current accounts, savings account and investment account and almost the same range of payment facilities such as clearing mechanisms, bill of exchange and bank drafts. Holders of current accounts can make use of cheque in either institution.

#### **Profit-Making Aim**

Despite that their approach is different, both institution aims is to make profit. Hence they will both attempt to do business in those sectors that offer the highest profit-sharing ratios to investors.

## **Differences between Islamic and Conventional Banks**

### **Prohibition of Interest (Riba)**

In contrast to conventional banks that charge and pay interest on loans and deposits respectively, Islamic banks are not allowed to do so. This is so because they have to operate under the Shariah principles whereby the payment or receiving interest is prohibited.

### **Emphasis on Collateral**

Conventional banks are more concerned with the value of the collateral that a borrower has to give as guarantee to the bank. Even if the project is not viable but if the borrower has the required collateral, the latter is granted the loan. As such financing of better projects might be denied just because of lack of collateral. However, in Islamic banking the feasibility of the plan is taken into consideration rather than the worth of the collateral. This is so because Islamic banks involve themselves into a profit sharing strategy and hence if the project fails or makes loss, the bank will have to bear those costs.

### **Guarantee of Returns on Deposits**

Since Islamic banks are involve in profit sharing when financing projects rather than charging interest, their revenue is not fixed and hence cannot be determined in advance. Hence unlike conventional banks, Islamic banks cannot guarantee a fixed rate of return on deposits.

### **Liquidity and Solvency Risk**

Unlike conventional banks, the liquidity and solvency risks of Islamic banks are related to the institutions with whom they deal. The more stable the  
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economy is the lesser the liquidity risk and solvency risk will be for an Islamic bank as compared to a conventional bank and vice versa.

## **Method of Financing**

Islamic banks adopt several modes of acquiring assets or financing projects. Some mode of financing in Islamic banking are Mudarabah, Musharakah, Murabahah, Bai' Bithaman Ajil, Ijarah Thumma Al Bai', Ijarah, Qard Hassan, Bai Salam, Kafalah, Wakalah, Sukuk and Istisna. These can all be classified into four categories namely investment financing, trade financing, lending and other financial services. The most commonly used contracts or methods of financing in Islamic banking are Murabahah, Bai' Bithaman Ajil, Ijarah, Musharakah, Mudarabah and Istisna. It is to be noted that all the products offered by Islamic banks are Shariah compliant ones.

## **Islamic Bank Deposit Accounts**

Three types of deposit accounts are operated by Islamic banks; current accounts, savings accounts and investment accounts. Current accounts are the same as in conventional banks whereby the depositor can withdraw money at any time, earns no return on these deposits and can make use of cheque. Savings accounts are used by those who want to save some funds but might be willing to withdraw same as when they are in need. The bank shares some of its profits to the savings account holders at the end of the year depending on the size and duration of their deposits (Abdul Gafoor, 2007). Investment accounts are normally used by those who want to invest their surplus funds. The bank will invest the money in a project and the depositor will obtain a return on the investment made. The funds deposited

can either be for a fixed period or unlimited period of time. It might be that these three accounts are the same as offered by conventional bank but the functioning of these accounts are to some extent different from those of the conventional banks. As previously mentioned, deposits in Islamic banks are considered as shares of the bank and hence they have a right on the bank's profit as the actual shareholders have (Bashir, 2000).

### **Potential for Islamic Banking and Finance in Mauritius**

There is a potential demand from both those who follow the Islamic faith and the rest of the population as well for Islamic banking and finance in Mauritius (Sithanen, 2007). He further adds that Islamic banks will promote economic growth, efficiency, investments and capital access. The African opportunities for potential market are characterised by the faster and higher economic growth than advanced economies. Mauritius is counted among those countries that are currently doing well. According to Dr Muniruddeen Lallmahamood, Mauritius has the potential to provide Islamic products but the industry is still not well developed despite that its regulatory framework has been fully revised to accommodate this industry. Some of the reasons are that there is a lack of knowledge, skills and technical capacity as far as it concern Islamic banking and finance. The statements of these two people have been the primary drive of this research and hence the main objectives of this study will be to check the reliability of these statements.

## **Overview of the Mauritian Banking Sector**

### **The Mauritian Banking Sector**

The Mauritian Banking sector forms part of the financial sector of Mauritius which has emerged to being the fourth pillar of the Mauritian economy.

There are 21 banks in the Mauritian Banking Sector with the Mauritius Commercial Bank (MCB) and the State Bank of Mauritius (SBM) being the two largest and dominant banks. The Bank of Mauritius acts as the central bank of Mauritius and is also the supervisor and regulator of the banking system.

### **Islamic Banking**

As far as Islamic banking is concerned in Mauritius, there are only two banks that provides Islamic products to Mauritians one being the Hong Kong and Shanghai Banking Corporation (HSBC) which is a Islamic window and the second being the Century Bank which is a full fledge Islamic bank. HSBC launched its Amanah Islamic banking services in 2009 with international business clients being its primary target. Century Bank was launched in 2011 and it caters mainly for wholesale banking. Islamic banking for retail customers in Mauritius has not yet been launched.

### **Legal Frameworks**

Financial regulation is relatively sound in Mauritius and has become more efficient since the amendments brought about in the Bank of Mauritius Act in 2004 which simplified the banking license structure. Moreover distinctions between onshore and offshore banks have been eliminated. With the introduction of Islamic banking in the Mauritian financial sector, there has

been a need for amendments in legislation and hence the Banking Act was amended in 2008 for that purpose.

## **Ranking**

Mauritius is ranked 8th among 177 countries for economic freedom with a score of 76.9 in 2013 making it one of the freest economies in the world. In addition to that Mauritius has a financial freedom score of 70 in 2013 which is mostly due to the resilience of the banking sector vis-à-vis the on-going global financial turbulence and also due to the declining of non-performing loans.

## **Research Methodology**

### **Definition of the Research Problem**

Islamic banking is not such a recent form of banking but its popularity has increased after the financial crisis due to its excellent resilience as compared to conventional banks. Islamic banking is a more recent development in the banking sector of Mauritius targeting mainly wholesale clients. But how about retail clients? The problem is that since it is a new form of bank in the banking sector of Mauritius, Mauritians are not much aware of it. Hence the aim of this study will mostly be in that respect.

### **Research Objectives and Benefits**

The main objectives of this research are as follows: Assess the awareness of Mauritians on Islamic Banking. Determine whether there is a relationship between Islamic Banking and Religion. Do education level, family practice and income have an impact on the choice of the type of bank for transactions? Willingness of Mauritians to transact with an Islamic Bank. The <https://assignbuster.com/prospects-of-islamic-banking-in-mauritius-finance-essay/>



benefit of this research is that it will determine the position of Islamic banking in Mauritius. Hence this research will help banks to exploit this new form of banking by adopting the appropriate strategies that will suit the current status of Islamic banks among Mauritians. It may also help government in developing policies and programmes that will encourage the implementation of Islamic banks in Mauritius.

## **Methodology**

The Research Methodology can be considered as the basis of a research. There are different methodologies that can be adopted. These can be divided into the, Quantitative and Qualitative, Data Source, Data Collection Method and Sampling Strategy.

## **Quantitative and Qualitative Data**

Quantitative data can be expressed as a number or quantified and are used for statistical analysis. Qualitative data focus more on meanings and experiences and hence gain in validity of data. Both quantitative and qualitative data will be used for this research. The reason behind choosing a combination of both is to allow statistically reliable information to be supported and improved by information about the participants' explanations.

## **Data Sources**

Data sources can be classified into primary data or secondary data. Primary data are data that is not available but which can be obtained through the different methods of data collection that exist. On the other hand secondary data are those data that have already been collected by other authors or researchers for their own research or by certain institutions for sales and hence are more

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easily available. For this study, primary data will be used. The reason for choosing primary data is that we can have more definite data which will be more suitable for our research as compared to secondary data which are most of the time specific to particular issue and hence might not be proper to our research.

## **Data Collection Methods**

There exist different methods for the collection of data such as questionnaires, observation and interview. Questionnaires are forms that contain questions related to the issue being dealt with and the respondent has to fill that questionnaire by himself. Interviews are rather questions-answers session where the questions are most of the time open ended. For the purpose of this research, a mixture of both interview and questionnaire will be used. In other words we will be using a structured interview. A structured interview is where there is a questionnaire that has already been set but instead of the respondent filling it, the researchers do it. The reason for choosing this type of data collection is to increase the response rate and to decrease the scope of errors and hence increasing quality of data.

## **Sampling Strategy**

Due to lack of resources such as finance, time and labour, the whole population cannot be interviewed. Hence sampling is used. In sampling a small proportion of the population is interviewed and the data obtained is used for the whole population. There are different techniques for sampling which can be classified as probability and non-probability sampling. Since for this study we will have time, labour and finance constraint, rather than

surveying the whole population, we will have a sample. A non-probability sampling more specifically a judgement based sampling will be used for this research. The reason for choosing this method is to ensure that both people who have knowledge and expertise in this field and those who do not have any knowledge or expertise in this field form part of this study.

## **The Gantt Chart**