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# Comparision Of Conventional And Islamic Banking With Regards To Loan Syndication

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**ABSTRACT**

*Islamic banking procedures and its governance and the loan procedures of Islamic banks are subjected to higher risk compared to that of conventional banking. There is a negative correlation between the ratios of banks saying that, the bank's operational costs, cost to income is higher if it is operating at a retail level banking. However, there is a wider scope of including Islamic banking procedures at a higher level, to cater the requirements of other banks. This results in serving the society as a whole and also results in development and prosperity in long run. This study is an attempt to understand the opinion of Indian bankers about the inclusion of Islamic banking procedures in India, comparing the lending procedure of Islamic banking with that of conventional banking, and to analyse the financial performance of Islamic banks. Four ratios are correlated to check the efficiency of the banks. Data is collected from the Indian Bankers to know their opinion on inclusion of Islamic banking procedures in Indian economy. The analysis showed that there is a need of creating awareness among Indians with regard to*

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*Keywords: Islamic Banking, Islamic finance, conventional banking, Riba, Islamic loan*

## INTRODUCTION

Islamic banking is a finance management system that is based on the Islamic rules of Shariah. The main concept of the Islamic banking is the prohibition on collection of interest and its utilization for the business purposes. Banking in Islam is a saving money framework that depends on the standards of Islamic law, additionally known as Shariah law, and guided by Islamic financial matters. Two fundamental standards behind Islamic banking concepts are the sharing of benefit and misfortune. Gathering interest or Riba isn't allowed under Islamic law. Islamic banking concepts have an indistinguishable reason from traditional managing an account aside from that it works as per the guidelines of Shari'ah, known as Fiqh al-Muamalat. It is important that you understand the rules to know how does Islamic banking work. There is consensus among the Shariah scholars that credit price of a commodity can genuinely be more than its cash price. The Islamic Fiqh Academy of OIC and Sharia Boards of all Islamic banks, approve the legality of this difference. However, no addition to price once mutually agreed.

Keeping in mind the end goal to procure cash without charging premium, Islamic banks utilize value support frameworks. This implies if a bank credits cash to a business, the business pays back the advance without premium, yet it gives the bank an offer in its benefits. In the event that the business defaults on the advance or do not win any benefits, the bank does not get any benefit either.

## REVIEW OF PREVIOUS LITERATURE

### Emerging Islamic Banking: Its Need and Scope in India-Khurram Ajaz khan

Muslim Started interest free banking under the Islamic law called sharia, and now we all call it Islamic banking. Today that Islamic banking industry showing an average growth rate of 15%-20% annually and comprises around 400 institutions with an asset under management in excess of US $1 trillion, according to Standard & Poor's Ratings Services the potential market is $4 trillion worldwide, therefore this can be a tool for enhancing economic development in India. India is prospering, but Indians are not. On an average, there has been one farmer's suicide every 32 minutes since 2002 because of heavy financial burden. Twenty richest Indians earn as much as what 30 crore poorest people are earning, writes Bimal Jalan, the former RBI Governor (RAQEEB, 2012). With these two issues, the growing Islamic banking and Indian economic problem, this paper is going to investigate the growth of Islamic banking worldwide and will try to find out how an Islamic banking can benefit Indian society. The paper will try to answer two questions, why Islamic banking is growing & its present status worldwide, how an Islamic banking is beneficial for India and how it can help India in boosting economic development in order to enhance India's world competitiveness.

**An Empirical Analysis of Financial Performance of Retail and Wholesale Islamic Banks in Bahrain-Iqbal Thonse Hawaldara, Lokeshb, Sheila Sison Biso**

Islamic banking, as an alternative to conventional banking system, is currently one of the most rapidly growing segments of the global financial market industry operating with more than 300 institutions spread over 75 countries. Undoubtedly, Islamic banks has cogent contribution towards the economic growth of any nation. This paper explores the analysis of the financial performance of retail and wholesale Islamic Banks operating in the Kingdom of Bahrain. For the empirical investigation, six retail and seven wholesale Islamic banks were selected for the study. Financial ratio analysis, standard deviation and correlation analyses were employed for the time period 2009-2013. The study found that there is a negative relationship among asset utilization ratio with staff cost to income ratio, operational efficiency ratio and cost to income ratio of retail Islamic Banks. Empirical results for wholesale Islamic banks revealed that there is a positive relationship among staff cost to income ratio, operational efficiency ratio and cost to income ratio.

**Using financial ratios to distinguish between Islamic and conventional banks in Palestine-Ra`fat M. AL-Jerjawi**

This study determines whether it is possible to distinguish between conventional and Islamic banks Palestine on the basis of financial characteristics alone. Islamic banks operate under different principles, such as risk sharing and the prohibition of interest, yet both types of banks face similar competitive conditions. The combination of effects makes it unclear whether financial ratios will differ significantly between the two categories of banks. We input 26 financial ratios into logit to determine whether researchers or regulators could use these ratios to distinguish between the two types of banks. Although the means of several ratios are similar between the two categories of banks, non-linear classification techniques are able to correctly distinguish Islamic from conventional banks in out-of-sample tests at about a 92% success rate.

**Future of interest free Islamic banking in India-Shriya Tiwari,G.H. Raisoni Institute of Engineering and Technology for Women, Nagpur**

Islamic Banking is a new evolution that has grabbed a majority attention over a past few years. Great changes have taken in the financial services sector. India has a potential for Islamic Banking where Muslim population and density plays a vital role. In addition, there are Islamic banks running successfully worldwide and the speed with which Islamic banks have sprung up and the rate at which they have progressed make it worthwhile to study their future in India. This paper is an attempt to explore the growth and development of Islamic banking, its salient features and future in India.

**Islamic banking - tool for inclusive growth in India-Dr. Shalini Dubey**

Islamic Banking refers to a system of banking that is consistent with Islamic law (Sharia) known as Fiqh al-Muamalat, and is guided by Islamic economics. Islamic law restricts usury, which means the collection and payment of interest, commonly called 'Riba'. Islamic law also prohibits investing in businesses that are considered unlawful or 'Haraam'. In this particular paper author has discuss about the Islamic banking as a tool for inclusive growth in India and possible solutions. SWOT and PEST analysis have been done with porter's five force model to get concrete findings and solutions for applicability of the same. Author has an appropriate data and including all aspects of Islamic banking in India and all data is analysed by different techniques that gave a worthy conclusion. This paper may be significant for the Islamic Banking in India and for provide better services to the customers and making policies and plans by government regarding the same it helps in growth of nation.

**RESEARCH GAP**

 

The research in the field of Islamic banking in the recent times sheds light on the Islamic banking and finance and its rules, procedures. This is because of the rapid growth in the market of Islamic banks. Many research papers address the crisis by postulating Islamic banking as an alternative for the future crisis. Many research papers focuses on growth and possibilities of implementation of Islamic banking in India. There are millions of questions unanswered as the core values and governing bodies are placed in such manner and the researches are going on at macro level. There is a scope to study at a micro level by understanding the strengths and weaknesses and impact of implementation in the Indian context.

**OBJECTIVES OF THE STUDY**

- ✓ To analyse the acceptance of Islamic Banking procedures by the Indian bankers.
- ✓ To make a comparison between the procedure of lending in Islamic banking and conventional banking.
- ✓ To evaluate the financial performance of retail Islamic banks.

**SCOPE OF THE STUDY**

Major banks from public and private sectors in India are considered for the purpose of the study.

**HYPOTHESIS**

**H0:** There is no positive correlation among staff cost to income ratio, operational efficiency ratio, cost to income ratio and asset utilization ratio of retail Islamic banks.

**H1:** There is positive correlation among staff cost to income ratio, operational efficiency ratio, cost to income ratio and asset utilization ratio of retail Islamic banks.

**Plan of Analysis**

RESEARCH DESIGN: Descriptive Research

Type of Sampling: Convenience sampling.

a) Sample size- 50

b) Sample units- Indian Bankers

DATA COLLECTION

Primary Data- Questionnaire.

Secondary Data- Internet.

Hypothesis Testing: Correlation.

**ANALYSIS RESULTS AND DISCUSSIONS**

**OBJECTIVE 1**

- The Indian bankers are of the opinion that, Islamic banking as an alternative to the conventional banking, may not be profitable because as Islamic banks governance differ from conventional banks governance. India as a secular country, follows “one nation, one law”.

**OBJECTIVE 2**

- Risk and sharing of risk are the two main parameters that distinguish Islamic banking from the conventional banking. The entire thing comes down to the fundamental nature of money and in theory of Islamic economic model differentiate that from Islamic banking.
- The model says that, nature of money is different. In this model, the nature of money is meant to be a medium of exchange. That means, it measures the value of real goods and services.in the economy rather than being an asset itself, to be traded amongst people.
- One cannot make money out of money and lend it for interest, hence, Riba (interest) is prohibited. Islamic finance tries to remove the loan plus interest element. It achieves by taking the commercial risk which is involved in a transaction.

- In a conventional bank, a loan is disbursed and the customer buys the property and resting the charge of the property with the bank. If something goes wrong, the bank will sell the property and if there is any difference, the bank will after to pay the difference.
- In the Islamic model, the bank owns the property, the bank gives the property on rent to the loan seeker. The bank takes the risk and if something goes wrong, the bank is going to bear the difference of the market value of the asset being purchased.
- The concept is further elaborated in the form of an illustration. If a customer wants to buy a house worth of $1,00,000 and approaches the Islamic bank for a loan with tenure of 20 years, the bank will buy the asset and it will take it on its books, and then leases to the customer repurchases the pieces of the asset over the next 20 years.
- This is how an Islamic banking takes the theory of real asset risk. Here, the bank is making money out of the asset, but not money out of money. On the other hand, in a conventional bank, the borrower gets the amount of $1,00,000 into his account to purchase the house and the entire amount is repaid in equated annual installments which comprises the principal amount along with interest.
- In case of conventional banks, the profits from the transaction is the amount of interest earned from the loan over the loan tenure. In case of the Islamic bank, the profit is the mark up on the asset which is priced at a higher level than the cost price of the asset purchased. This is done in order to meet the maintenance and operational costs of the bank.

**OBJECTIVE 3**

- There are certain deviations in operations of Islamic banks with respect to Shariah complaint and operating in the real time, as the banks are customizing the actual processes for meeting the customer requirements.
- There is a negative relationship among asset utilization ratio with staff cost to income ratio, operational efficiency ratio and cost to income ratio of the retail banks in the kingdom of Bahrain.
- The Islamic banking lending procedure may not be profitable in the Indian scenario as the financial ratios of the banks which are currently operating in other parts of the world are facing adverse consequences.

| | | **Staff Cost to income Ratio** | **Cost to Income ratio** | **Asset utilization Ratio** | **Operating efficiency Ratio** |
|---|---|---|---|---|---|
| **Staff Cost To income Ratio** | **Pearson Correlation** | 1 | 0.877 | -0.975** | 0.934* |
| | **Sig. (2-tailed)** | . | 0.051 | 0.005 | 0.02 |
| **Cost to Income ratio** | **Pearson Correlation** | 0.877 | 1 | -0.899* | 0.95* |
| | **Sig. (2-tailed)** | 0.051 | . | 0.038 | 0.013 |
| **Asset utilization Ratio** | **Pearson Correlation** | -0.975** | -0.899* | 1 | -0.924* |
| | **Sig. (2-tailed)** | 0.005 | 0.038 | . | 0.025 |
| **Operating** | **Pearson** | 0.934* | 0.95* | -0.924* | 1 |

| | | | | | |
|---|---|---|---|---|---|
| efficiency Ratio | Correlation | | | | |
| | Sig. (2-tailed) | 0.02 | 0.013 | 0.025 | . |

**INTERPRETATION OF HYPOTHESIS TESTING**

The results of correlation between financial performance ratios of retail Islamic banks presented in Table 6 revealed the existence of significant positive correlation of operational efficiency ratio with staff cost to income ratio and cost to income ratio with value 0.934 and 0.95 respectively which is significant at 0.05 level of significance. The result of correlation analysis also depicts that asset utilization ratio is negatively correlated with staff cost to income ratio, operational efficiency ratio and cost to income ratio with values -0.975, -0.924 and -0.899 respectively which is significant at 0.01 and 0.05 levels of significance. On the basis of the above correlations, the null hypothesis is rejected as negative correlations are significant at 0.01 levels of significance. Thus, there is a negative relationship among asset utilization ratio with staff cost to income ratio, operational efficiency ratio and cost to income ratio.

**CONCLUSION**

Islamic financial system ensures justice between savers and investors. By demolishing risk free return and promotion of profit and loss sharing, justice is ensured for both parties i.e. capital supplier as well as capital user. Under Islamic financial system bank can invest in businesses to earn variable return based on actual results of activities and share profit earned with depositors based on agreed sharing formula. Hence it is ensured to distribute the actual outcome and none is to bear risk alone and none is to earn with zero risk.

There are many instruments that are being used in Islamic banking sector. Using these various tools makes Islamic banking more diversified and effective. According to Alkassim (2005), in Islamic banks, there have been sixteen different lending contracts or sales contracts, some of them will be explained in this section. Hanif & Iqbal, (2010), categorized Islamic modes of financing objectively in two heads; Shari‘ah compliant and Shari‘ah based.

It is clear that Islamic banking is not a negligible or merely temporary phenomenon. Islamic banks are here to stay and there are signs that they will continue to grow and expand. Even if one does not subscribe to the Islamic injunction against the institution of interest, one may find in Islamic banking some innovative ideas which could add more variety to the existing financial network.

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