



# Importance of Islamic Banking Towards the Growth of SMEs

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# Meaning of Islamic Banking

- Despite its name, Islamic banking is not a religious operation.
- It is rather banking and financial services developed to meet the requirements of people in a way that does not contradict Shari'ah principles or Islamic commercial law.
- Shari'ah means a legal framework within which all affairs of Muslims' life are governed

Relevant components of Islam/Shari'a to Islamic banking:-

**Islam:** - Aqidah (Beliefs)

- Akhlak (Ethics)

- **Shari'ah** (Islamic law): - Ibadat (Acts of worship)

- **Mu'amalat** (Relation with others): - Siyasah (Politics)

- Munakahat (Marriage)

- Jinayat (Crime)

- Uqubat (Sentences)

- Mirath (inheritance)

- **Mu'malat Maliya** (Islamic Banking)

# Ideology in Islamic Banking Product



Islamic banking promotes financial transactions that directly link to the real economy e.g.;

- i) Equity-based or Partnership products e.g. Musharaka (Profit & Loss Sharing) financing

Islamic banking is founded on principles of equity participation, equitable distribution of risk, and cooperation between the financier (lender) and the entrepreneur (borrower).

Islamic banking shifts the overall focus from the financial worth of the borrower to the entrepreneur's expertise, trustworthiness, and project's viability.

Partnership products ultimately lessen the over indebtedness of the entrepreneur. Thus, circulation of wealth where one party cannot benefit while the other is suffering.

Overall, these products help in reducing the cost of doing business, where each party contributes in capital and proportionately shares business losses.



ii) Debt-based or Exchange products e.g.; Murabaha (Cost Plus Mark-Up) financing

ASPECT	CONVENTIONAL LOAN	MURABAHA FINANCING
Subject Matter	Amount of money	Commodity/Economic Asset with intrinsic value
Parties	Lender and borrower	Buyer and Seller
Rollover	Typically applicable	Impermissible
Collateral	Put up before the loan is processed	May be posted but after the Commodity is purchased
Cost Disclosure	Not a condition	Stipulated/ a condition
Compensation	Interest (money charged on money), which may change over the loan period	Profit (money charged on economic activity) which cannot change over the financing period

# Ancillary Islamic Banking Principles that are Useful to SMEs

## i) **Late Payment Charges**

The financier is entitled to compensation of ONLY the actual loss suffered.

Any extra charge over and above the actual loss is channeled to charitable causes.

## ii) **Rebate (Ibra')**

The financier has to grant a rebate (Ibra') for an amount when the customer prepays or wishes to make early settlement of their financing obligation.

## iii) **Shari'ah Governance**

The requirement for Shari'ah compliance of products and operations complements SMEs governance.

# Islamic Banking in Other Economies



Islamic Banking has been successfully adopted in Europe, Asia and the Middle East.

USA, UK, Bosnia, Denmark, France, Germany, Holland, Luxembourg, Russia, Canada, Switzerland, Australia, Spain, China, Japan, Singapore, Thailand, South Africa, Kenya, etc. have all been flexible to adopt this new global trend.

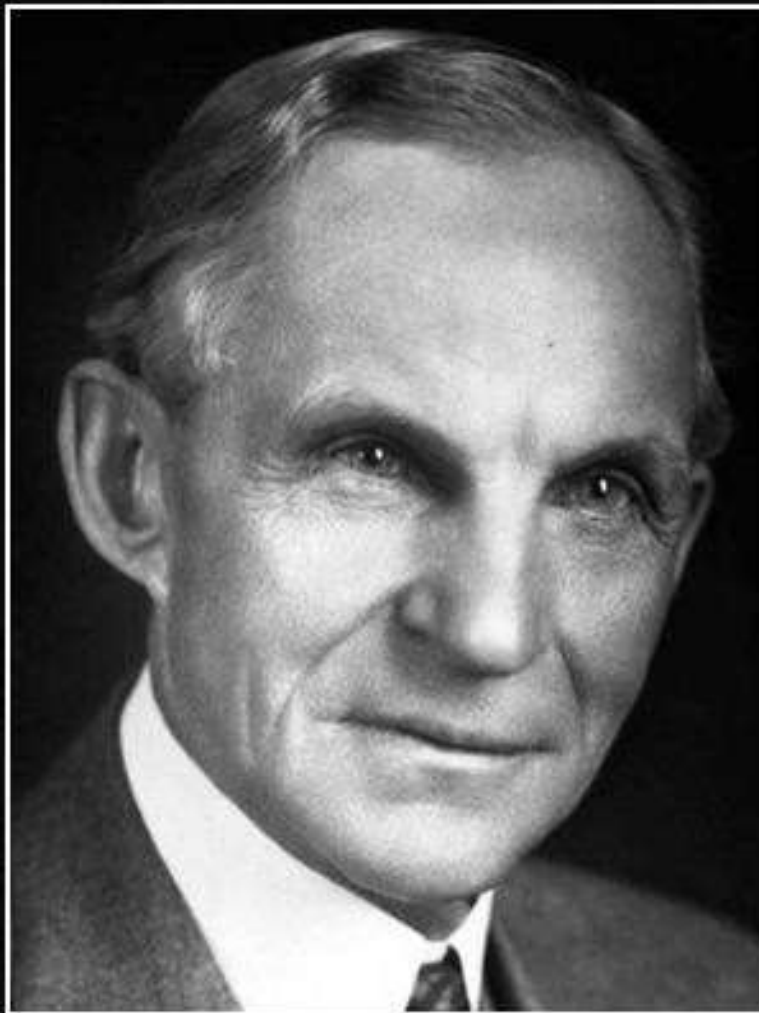
In 1995, the late Sir Eddie George, former Governor of the Bank of England, gave a proper account of non-interest banking;

*“When I looked into it a bit more, it seemed to me that in fact many of the financial products commonly used in this country already had some, at least, of the characteristics consistent with the teachings of the Qura’n: if only we could come to a better and more precise understanding of the Islamic financial products being talked about at that time... Indeed, it seems to me also that as a matter of general principle, a wide range of financial products would benefit the whole of our community, and that Islamic products could prove to be attractive beyond the purely Muslim sects”.*



**“The ethical principles on which Islamic finance is based may bring banks closer to their clients and to the true spirit which should mark every financial service” Pope Benedict XVI (the Vatican’s official newspaper Osservatore Romano, 4 March 2009, cited by Bloomberg.com, 2010)**





It is well enough that people of the nation do not understand our banking and monetary system, for if they did, I believe there would be a revolution before tomorrow morning.

— *Henry Ford* —

**AZ QUOTES**



# Crisis in the Interest-based Banking System

- In 1930, Gottfried Haberler noted;

*“The theory of interest has for a long time been a weak spot in the science of economics, and the explanation and determination of the interest rate still gives rise to more disagreement among economists than any other branch of general economic theory”.*

- Thus:

Islam forbidden interest (riba) because Interest develops a culture of selfishness and exploitation of the hard earnings of the entrepreneur (borrower).



## Conclusion

- The core ethical and value-loaded principles which are rooted in Islamic banking and Shari'ah commercial law in general are well suited to respond to challenges the SMEs are currently facing in building the economy.
- Secularization (the gradual decline of religion and its authority over human life, as occurred in western civilization in the age of enlightenment) would not take our businesses very far.
- Thus, factoring the Islamic banking principles into our investment and development decisions shall help us to revamp economies as they have helped various economies in the Middle East and Asia to thrive such as UAE and Malaysia.