

## CHAPTER 1

# Introduction

## Islamic Finance in the World Economy

**KAREN HUNT-AHMED**

President, Chicago Islamic Microfinance Project

Lecturer, DePaul University

The religion of Islam has existed for 1,400 years but Islamic economic theory and its financial institutions as an industry emerged only in the 1970s. Islamic banks are late twentieth-century institutions designed, against the backdrop of a global economy dominated by capitalist business practices, to help Muslims conduct business internationally while simultaneously upholding traditional Islamic values related to trade finance and currency movement. The basis for their existence is the Islamic moral prohibition on charging interest—interest is a central component of capitalist banking—yet Islamic banks conduct billions of dollars of business annually in the world economy and the *de facto* Islamic banking transaction is—in most cases—virtually identical to a capitalist banking transaction. The industry of Islamic Banking and Finance (IBF)<sup>1</sup> is the manifestation of attempts to apply Islamic law and Islamic economic theory to financial dealings.

An Islamic Financial Institution (IFI) refers to any financial institution that performs Islamic transactions derived from either Islamic law or Islamic economic theory. An Islamic Bank is an institution that performs conventional banking services<sup>2</sup> (or their Islamic equivalent) such as checking accounts, savings accounts, loans, and so forth. An IFI may or may not be a bank but an Islamic bank is always an IFI. Islamic financial institutions include venture capital firms and insurance companies, and may be distinguished from conventional banks by three primary elements (Bahrain Monetary Agency 2002):

1. Prohibition of prohibited financing arrangements and business practices. The most important prohibition in Islamic finance is the prohibition of *riba* (interest or usury). This means not only that financing transactions are structured differently than in conventional finance, but also that the asset structure of the institution is based entirely upon tangible assets and partnership arrangements instead of on interest-based financial assets. *Gharar* (speculation) and *maysir* (gambling) are prohibited, as well as trading in *haram* (forbidden) goods such as alcohol, pork, and owning equity in *riba*-based institutions (Lewis and Algaoud 2001).

2. Integration of religious practices into daily life by governing business under Islamic law.
3. Existence of a Shari'a Standards Board (SSB) composed of Islamic scholars. The SSB's purpose is to insure that Islamic law is being followed accurately in the business practices and financial arrangements of the IFI. A member of the SSB (called a Shari'a Scholar) has been trained formally in Islamic law, but has not necessarily been trained in finance. A separate financial standards board evaluates the efficacy of financial transactions, just as it does in a conventional institution, and the two boards often work together.

Ideally, an IFI should combine the elements of Islamic financial practices with some effort to uphold Islamic daily life practices (Lewis and Algaoud 2001).

The industry of Islamic banking and finance is growing daily. There are hundreds of Islamic financial institutions worldwide and the world's potential market for Islamic finance consists of more than one billion Muslims, in addition to non-Muslims, who are welcome and encouraged to participate in Islamic finance. When I began my fieldwork in 2002, Islamic assets were estimated to be around USD 200–300 billion. By 2011, estimated industry assets under management topped USD 1 trillion and is growing at a rate of at least 10 percent per year.<sup>3</sup> The *Financial Times* reports that at least one bank, Dubai-based Saadiq (the Islamic banking arm of Standard Chartered Bank), saw revenue growth of 65 percent in 2011 over 2010.<sup>4</sup>

This book speaks to an audience that is dynamically involved in—or thinking of being involved in—the Islamic finance industry. As the industry grows rapidly, finance professionals, investors, attorneys, educators, and students demand more detailed and sophisticated knowledge. Innovations abound as practitioners find ways to reconcile existing practices and regulations with Shari'a requirements. This volume will provide a useful and timely guide to Islamic finance for anyone interested in learning about basic concepts, current issues, and best practices predominant in the industry today.

## GLOBALIZATION AND MUSLIM SUBJECTIVITY

World conditions due to globalization have contributed to the formation of the industry of Islamic finance. (Please see Chapter 4 of this volume.) Geographic mobility and technological advances made possible (and desirable) by globalization have profoundly changed definitions of personal, community, and religious identities of humankind. Islamic law does not allow for individuals or institutions that lend money to charge interest on that money. Muslims who orient themselves according to Islamic practices would be acting against their moral constitutions to participate in transactions that involve the charging of interest. Yet in the early twenty-first century global economy, trade finance and other crucial banking transactions are clearly dominated by capitalist financial institutions whose return on investment is based upon charging interest. Heretofore, a Muslim wishing to participate in the global economy has had to invest in capitalist institutions and act in opposition to his or her religious and moral belief system. As financial resources in the Islamic world have grown over the past three decades, Muslims have increasingly sought alternatives to capitalist investment that are more in keeping with Islamic practice. Islamic banks provide a framework for

Muslims to invest their money “morally,” in accordance with Islamic law, while at the same time they do not miss out on profit opportunities provided by the global form of capitalist exchange. Islamic banking must locate itself as a Muslim institution in the world economy, yet it is also an industry that explicitly engages with the capitalist institution of banking and as such must be studied in the context of globalization and its relation to capitalism.

Throughout history, Jewish and Christian religious doctrines have objected to what they defined as unsavory business practices, including the practice of usurious loans. De Roover (1974) emphasizes that usury at that time in history referred to *any increase* over principle and that usury was prohibited; consequently, any increase was considered excessive. Christianity and Judaism resolved this moral problem in a way that advances capitalist enterprise—by declaring loans at interest as acceptable transactions as long as they are not usurious, whereas Islam seems to be engaging with capitalism in a way that critiques capitalism while at the same time advances it. The industry and its resultant institutional structure act as a culture broker (cf. Mazzarella 2004), providing a bridge between capitalist business practices and a competing Muslim sensitivity for its practitioners, who are comfortable in both cultural systems. Furthermore, IBF acts as a bridge between competing subjectivities—or practices of Islam—within Islam itself.

## HISTORY OF ISLAMIC FINANCE

Islamic finance is a subcategory of the discipline of Islamic economics, which is in turn informed by Islamic legal thought. Chapters 2 and 3 of this volume (Farooq’s “Contemporary Islamic Economic Thought” and Shawamreh’s “The Legal Framework of Islamic Finance,” respectively) introduce those two concepts. In this section, I take you through a brief history of the industry’s evolution. This account is informed by Kuran (2004), Warde (2010), and Askari et al. (2010), and draws upon the history of economic thought as its basis. This chapter is meant to be a brief introduction to the formation of the industry from a psychological perspective; the specifics of Islamic economic thought, and a critique of that thought, are discussed elsewhere in this volume (Chapter 2 and Chapter 5).

Whereas textual and traditional sources of Islamic law date to the time of the Prophet Mohammed and the ensuing three hundred years or so, Islamic economic theory is a contemporary theory. It has its roots in postcolonial India and its tenets have been widely debated since the middle of the twentieth century. Islamic economics is always written about with reference to classical economic theories that form the basis of capitalism. Early writings about Islamic economics were often presented as critiques of one or more economic theories prevalent in the world, such as communism, socialism, or capitalism (cf. Chapra 1976; Zarqa 1981; Siddiqui 1981). Since the fall of the Soviet Union and the apparent victory of capitalist economics over other forms of economic structures, critiques of communism and socialism are no longer at issue, so most of the contemporary critiques are direct reactions to capitalist economic values. Timur Kuran, in his book *Islam and Mammon*, recognizes the emphasis of values in the theory of Islamic economics: “at least initially, the *economics* of ‘Islamic economics’ was merely incidental to its *Islamic* character” (italics in original; Kuran 2004, p. 82).

The framework of Islamic economic theory was developed in India in the early twentieth century by Islamic scholar Mawlana Mawdudi (1903–1979) and expounded upon by one of his students, economist Khurshid Ahmad. Indian Muslims as a group were relatively disadvantaged economically compared with the majority population of Hindus. The British Raj had provided some economic protections to Muslims, farmers in particular, but it was unclear how or if a Hindu-led government would provide the same protection (Kuran 2004). Mawdudi believed that economic activity and technology were crucial to the success in the modern world, and he was dedicated to providing Muslims in India with economic opportunities that allowed them both to function in the modern world and to retain their Muslim identity. Many Muslims did not participate in conventional banking activities because of the prohibition against *riba*. Mawdudi himself adhered to this belief, as we learn from reading the notes to his own translation of the *Qur'an*. In particular, Mawdudi stresses different ways in which loaning at interest can erode communal bonds between men (1988). Nonetheless, Mawdudi believed it was detrimental to the Muslim community in India to abstain from banking activities. He and Ahmad believed that it was possible and desirable for Indian Muslims to embrace systems and institutions of Western modernity while at the same time adhering to the teachings and practices of Islam (Mawdudi 1980). One goal of Mawdudi was to redefine Islamic practices to conform to economic changes. He felt that Muslims in India could use practices to retain their Muslim identity in the face of the postcolonial Indian modernization project. In one of his last books, a short history of the founding of Islam, Mawdudi wrote (1974, p. 11):

The Islamic way of life can be revived and reconstructed again and again with the help of the *Qur'an* and the traditions if ever, God forbid, the freshness of its true spirit wanes. The world no longer requires any new Prophet to revive Islam to its pristine glory. It is enough to have among us the learned people who know the *Qur'an* and the traditions of the Prophet and who are able to apply their teachings to their own lives and stimulate others to adopt and apply them in their lives as well. This is how the stream of Islam will continue to flow, refreshing the eternal thirst of mankind.

Khurshid Ahmad argued that economic systems are value-based systems; even the capitalist economic system was founded on certain cultural values, which are reflected in that system. This belief is not unlike Max Weber's (1930) assertion that Calvinist religious practices served to advance capitalism. Therefore, if Muslims are to be economically empowered, a theory of Islamic economics is necessary. Other theorists took up that line of thought, such as Umer Chapra, who states: "Virtue lies . . . not in shunning the bounties of God, but in enjoying them within the framework of the values for 'righteous living' through which Islam seeks to promote human welfare" (Chapra 1976, p. 173). In Islam, all fields of life are interrelated. Goals and values of each segment of life should be aligned, so the economic system's values are aligned with those of society.

Kuran (2004) asserts that the emergence of the industry grew out of the debate on whether or not Muslims in India should have a separate homeland or remain part of a greater India after the Partition of 1947. Mawdudi favored the latter

## INTRODUCTION

5

proposition—cultural reassertion—and contended that a separate homeland was unnecessary because if Muslims practiced their religious duties faithfully, the matter of a national homeland would be irrelevant. In this view, group solidarity depends more on shared beliefs and practices than on shared geographical territory. This principle foreshadows many of the basic principles of globalization, namely the belief that group solidarity or identity can be based on something other than geographical place.

Mawdudi favored thinking of Islam as a *way of life*, rather than as a system of faith. In a treatise of his interpretation of the *Qur'an* published immediately after his death (1980), Mawdudi asserts that the *kalimah*<sup>5</sup> affirms that there is one God, Allah, and Mohammed is his Prophet. Mawdudi considers this to be the primary doctrine of Islam: The real difference between believers and unbelievers “lies in the acceptance of this doctrine and complete adherence to it in practical life.” (Mawdudi 1980, p. 62) An emphasis of the connection between belief and practice is the foundation for Mawdudi’s entire project of strengthening Islam worldwide. A Muslim must not only believe in the doctrine of Islam, but internalize and incorporate its practices in everyday life. It is only in this way that Islam (and Muslims) will survive in a world that is increasingly influenced by modern inventions and systems. We can see this idea at work in the thinking of contemporary scholars of Islam. It had particular relevance in the anxious times of postcolonial India, and has gained relevance in a globalized and post-9/11 world in which Islam has frequently come under attack from the prevailing world order.

In contrast to politicians who wanted a territorial solution for Muslim independence (Pakistan), Mawdudi sought to keep Islam salient in the minds of its practitioners without necessitating a territorial division. He fully recognized the prudence of tying economic behavior to religious beliefs. According to Kuran (2004), a technologically advanced world requires complicated economic decisions. In the dominant world economic order, those decisions are thought of as secular decisions. If Muslim traders and customers were making daily economic choices based on religious thought instead of on secular economic principles, the average person could think of business activities as religious activities. Therefore, religion would always be prominent in their minds (Kuran 2004). In this way, Muslims would remain politically visible despite their minority status. In this sense, Mawdudi advocated the creation of an Islamic economic actor in order to allow citizens to pursue economic activities in a morally acceptable way.

According to a comprehensive survey of Islamic economic literature, Professor Muhammad Siddiqui has outlined some of the key philosophical underpinnings of Islamic economic theories. The practitioner is meant to use these philosophical points as a guideline for developing practices in an (theoretical) Islamic economic system. Of course, no purely Islamic economic system exists in the world today, but it is held up as a goal to which Muslims should strive. Some of the major Islamic economic values are (Siddiqui 1981):

- A person should be a “God-conscious” human being. He or she should practice *tawhid*, or unity, at all times. This means that all earthly actions must be pleasing to the will of Allah.
- Economic enterprise is encouraged, as long as moderation is practiced and special attention is paid to social justice.

- Ownership has both an individual and communal component. Private property ownership is encouraged but it is a human responsibility to make sure that all humans have their basic needs met.
- Humans are encouraged to cooperate with each other in production relations, rather than to compete (i.e., as in capitalism).
- Economic development is a necessary human condition and must be undertaken in the spirit of social justice.

Throughout this volume, we will see much evidence that Islamic finance practitioners pay particular attention to these principles of Islamic economics in discourse and in practice.

## ISLAMIC BANKING: ORIGINS IN PRACTICE

Whereas the theory of Islamic economics was never actually enacted systematically in Mawdudi's India, it was put into practice in the Arabian Gulf. The first successful Islamic bank—Dubai Islamic Bank—opened in Dubai, United Arab Emirates, in 1975.<sup>6</sup> Until this time, Muslims had been carrying on their business activities in one of two ways: Either they used conventional banks or they just used other, private methods of financing outside of the capitalist banking system. Islamic financing was originally part of interpersonal business dealings and not meant to be an institutional function (Udovitch 1970). But by the late twentieth century, if Muslims wanted to participate in the world economy, they would have to engage in some way with the capitalist banking system. In particular, the Arabian Gulf of the 1970s was undergoing tremendous and rapid changes as significant cash poured into the region from recently discovered oil (Ali 2002). Businessmen sought to use their newly acquired oil wealth to put into practice an idea that was theoretically conceived to solidify Muslim identity. The formation of Islamic banking was introduced as a practical solution to this problem.

There were several political developments in the Arab world around the same time that contributed to a heightened sense of urgency about asserting pan-Islamism. In an article written on September 9, 2001 in the online version of *Le Monde*, Ibrahim Warde, a researcher of Islamic finance and adjunct professor at Tufts' Fletcher School of Business, reminds us that in 1967 Arab losses in the Six Day War had given birth to Nasser's secular pan-Arabism as well as to Saudi Arabia's Islamist domination in the Arabian Gulf region.<sup>7</sup> These political developments in addition to the inflow of cash into the Gulf provided the impetus for the establishment of the Organization of Islamic States (OIS) in 1970. Banking reform quickly made its way onto the OIS agenda (Warde 2010).

Dubai Islamic Bank (DIB) was the first Islamic bank in the context of the contemporary Islamic banking industry formation (Henry and Wilson 2004). There has always been considerable trade between Dubai and the Indian subcontinent, especially in the late twentieth century, when large numbers of Indians/Pakistanis migrated to the Gulf as guest workers. It is highly likely that ideas such as the theory of Islamic economics accompanied the people and goods that have always been traded between these places. In addition, Gulf Arabs also go to India or Pakistan for an education and must have been exposed to theories such as Mawdudi's during their stay. I consider it a natural extension of the theoretical origins of Islamic

banking that its practice was taken up in the Gulf: Material prosperity enabled the theory to be enacted. This origin story seems to be important to bankers in Dubai, at least, and at any rate DIB is one of the most active of the purely Islamic banks.

## A CONTEMPORARY INDUSTRY

Trade and finance have always been part of Islam's history. The Prophet Mohammed, the founder of Islam, was a business owner in the seventh century of the Christian era, as was his wife Khadijah. Nonetheless, there was no such thing as an Islamic bank until the late twentieth century. Classical Islamic jurisprudence has always been concerned with regulating trade and financial transactions between individuals and has produced a large body of rules on the subject; however, those rules did not give rise to an Islamic financial system until the 1970s. Udovitch (1970) points out that trade finance was always prevalent in Muslim societies, but that merchants would provide financing instead of financial institutions. This arrangement is similar to the function of merchant lending in Europe at the same time (Udovitch 1970). For example, *bancherius*, or merchant institutions in Venice that accepted deposits and made loans, were not specialized and were usually part of larger business operations, like cloth merchants. In the mid-twentieth century, a few individual Islamic banks were started in Egypt and Turkey, but they either failed on financial terms or were folded into the national banking system and converted to conventional banks (Kuran 2004, 2001). A corporation founded in Malaysia in 1963 eventually evolved into the Bank Islam Malaysia, incorporated in 1983.

Contemporary Islamic banks were formed in the 1970s when considerable oil wealth became available in the Arabian Gulf States. Muslim populations in other parts of the world—notably Indonesia, Pakistan, and Malaysia—have since generated sufficient steady income growth to develop a network of Islamic financial institutions that strive to integrate themselves into the global financial system. Growing Muslim populations in the United States and Great Britain have very recently begun to contribute to the Islamic financial network both institutionally and intellectually.

## MY HISTORY WITH ISLAMIC FINANCE

Many people wonder how I got involved with Islamic finance. The story of how and why I got involved with the industry is a large part of the story of how I study the industry, so I will tell the story briefly. While studying for an MBA at Washington University in St. Louis, I learned about microfinance. I began to pay attention to and explore how people who cannot or chose not to participate in the conventional financial system get their businesses financed. I recognized that there may often be something else driving business practices other than the profit motive, as we are traditionally taught in a capitalist economic system. Ideas about morality play a role in business decisions more often than I had thought possible and it was interesting to me to explore those ways of thinking, especially in the world of finance.

After working for a time in commercial banking in Chicago, my family and I moved to Dubai, United Arab Emirates, where I worked in a private equity

firm that had some “Islamic” transactions on its books. I observed that the money flows in a Shari’a-compliant transaction looked the same, but that the philosophy behind the transactions expressed a concern with a holistic view of the business relationship rather than focusing on whether that particular transaction was going to be profitable. This was interesting, of course, but life and work took over and I filed away this observation while I got on with living.

As fate would have it, my family was transferred back to Chicago for my husband’s job as an asset manager. In addition to raising children and in lieu of getting a “real” job I entered into the PhD program at the University of Chicago. I did not intend to study business *per se*, so I applied and was admitted to an interdisciplinary social science program called Psychology: Human Development, which was more closely aligned with my undergraduate degree in psychology than a PhD in business would have been. A discussion in one of my classes led me to recall the Islamic (Shari’a-compliant) transactions I had worked with in Dubai and prompted me to think about the implications of applying one’s moral values in a business setting, especially when those moral values did not always correspond to prevailing practices. Thus, my research idea—and my career—was formed. I asked the question that began this chapter: The religion of Islam has existed for 1400 years. Why did Islamic finance emerge in the world financial system in the late twentieth century? To answer this question, I needed to talk to Islamic bankers in the place where it all began: Dubai, United Arab Emirates.

My family and I moved back to Dubai for a year so that I could do dissertation fieldwork. We had family and professional connections there and had lived and worked in Dubai, so the move was almost seamless for us. After almost a year of ethnographic observations and in-depth interviews, and almost 20 years of traveling to and/or living in the UAE while observing Islamic finance, I now conceive of IBF as a particularized industry highly relevant to the plight of Muslims in the context of contemporary globalization. The existence of this industry is a partial answer to the question: How can Muslims living in the diaspora integrate their identities as Muslims with identities as global citizens? In a sense, the existence of IBF is an answer to the question of what happens when Muslims—and Islam—travel and live around the globe.

## CONVENTIONAL FINANCE VERSUS IBF

IBF claims to be different from conventional finance but most of the financial transactions look the same to most people who examine them. Islamic finance professionals often explain Islamic finance with reference to conventional finance, though there is a movement in the industry to progress beyond this practice. When asked to compare and contrast with conventional finance, most Islamic finance professionals I talk to concede that Islamic finance is just like conventional finance, but without the immorality. “Immorality” in this case is related to both business practices (specific and general) and to the details of financial transactions. When asked, most Islamic bankers will tell you that the most immoral financial practice is charging interest on loans.

Because a large part of a conventional bank’s income “is in the form of interest on the claims it holds” (usually loans) (Moss 2004), Islamic finance seeks to retain the useful features of conventional finance while adjusting practices to adhere to

Islamic principles. IBF began as a response to the needs of investment bankers and corporate finance professionals, although more recent activities have focused on retail banking, or personal finance. Chapters in this volume address both institutional and personal or retail financial activities.

## Credit and Risk

Just as Jews and Christians found trade to be impossible without some kind of financing situation, Muslims recognize the necessity of finance. As with conventional finance, Islamic finance falls under two types: equity financing and debt financing. Equity financing means, generally, that the financier and the manager of a business are partners. There are different ways to structure a partnership, but the implication of an equity partnership is that each partner will receive a return (or profit) proportionate to the amount of the investment. Debt financing simply means that one party (the financier) provides money for a business venture. The financier expects to make a profit on the investment whether or not the business is successful. Islamic law allows most types of equity financing, but debt is problematic. Lending can occur, technically, but it must be interest-free, a so-called benevolent loan. The industry of Islamic finance was formed to address the prohibition of interest-bearing debt finance. As we will see throughout this volume, there are various ways to finance trade using debt instruments, but we must begin with a discussion of credit and risk, and why interest is prohibited under Islamic law.

Some standard definitions of *credit* are as follows (quotes from dictionary.com):

- Trustworthiness; credibility.
- Confidence in a purchaser's ability and intention to pay, displayed by entrusting the buyer with goods or services without immediate payment.
- Reputation of solvency and probity, entitling a person to be trusted in buying or borrowing: *Your credit is good.*
- Influence or authority resulting from the confidence of others or from one's reputation.
- Time allowed for payment for goods or services obtained on trust: *90 days' credit.*
- Repute: reputation; esteem.
- A sum of money due to a person; anything valuable standing on the credit side of an account: *He has an outstanding credit of \$50.*

The definitions of credit listed above are seven of the ten definitions found on dictionary.com. The extension of credit can potentially lead to something called usury. The Islamic finance industry is premised on one concept: avoidance of *riba*, which is often translated to English as usury. This translation is disputed, as we will learn throughout this study, but IBF practitioners generally agree that the prohibition of something called *riba* is the basis for the industry. Usury is defined in today's terminology as "an exorbitant amount or rate of interest" or at a rate higher than the legal rate (dictionary.com); however, usury at one time referred to any increase over the amount of money lent.

The definition of credit, as we can see, encompasses concepts such as trustworthiness, repute, or confidence. These are not merely descriptions of a transaction,

but meanings embedded in the concept of credit that speak to how humans relate to one another. For this reason, participation in a credit transaction is a situation in which people make judgments about one another. Credit, and by extension usury, becomes a symbol or metaphor of certain aspects of the human existence. Credit speaks to the temporal aspects of economic life. Credit provides a way to deal with the future in the present.

Due to the symbolic nature of credit and risk, their definitions and views about them are subject to human variations and interpretations. As such, there will be cultural differences between interpretations of credit. For example, usury can be used as a way to work out uncertainty about definitions of the self versus the other, the sociocultural institution's obligations for the well-being of individuals, and the extent to which divine morality is encoded in secular law. Credit, in the sense of loaning money for a definite period of time and for a specific purpose, has been seen as both necessary and somehow sinister.

Another crucial difference between bank credit and financial markets is the concept of risk. Bank credit evolved as a way to mitigate risk. Future uncertainty is embodied in the calculation of interest and part of the function of interest is to reimburse the lender for potential future losses and for the lost opportunity to use that money in the present. Risk in this case is a negative concept, one that must be eliminated as much as possible from the equation. On the contrary, risk has a very different meaning in financial markets. Investment risk is a positive concept, one without which financial markets would not even exist (cf. Knorr-Cetina and Preda 2005). In this case, risk means the opportunity for gain. The Islamic finance industry was created to address matters of bank and investment credit for institutional and large investors, not the credit needs of small investors. Credit is the crucial way by which investments and trade are facilitated. The prohibition of usury creates a special circumstance for the Muslim investor that distances him or her from international financial markets. As a result, matters of risk management are salient topics in the discourse of Islamic finance professionals (see in particular Chapter 7 of this volume).

### General Business Ethics

In addition to specific prohibitions and requirements of an Islamic bank and its financial transactions (see Chapter 3 of this volume), an Islamic financial institution encourages adherence to general Islamic behavioral ethics. Lewis and Algaoud (2001) consider this increased attention to business ethics to be an important part of the corporate culture of an Islamic financial institution. They state that, ideally:

[T]he corporate culture of an Islamic bank should be one in which Islamic values are reflected in all facets of behaviour ranging from internal relations, dealings with customers and other banks, policies and procedures, business practices through to dress, décor, image, and so on, consistent with Islam as a complete way of life. The purpose is to create a collective morality and spirituality which, when combined with the production of goods and services, sustains the growth and advancement of the Islamic way of life. (Lewis and Algaoud 2001, p. 165)

IFIs do take seriously the commitment to providing an Islamic environment, and this commitment is illustrated both in the literature and in my observations. For example, in a chapter of the book entitled *The Politics of Islamic Finance* (Henry and Wilson 2004), Kristen Smith of Harvard's Kennedy School of Government illustrates how Kuwait Finance House (KFH) takes public steps to foster a religious environment by organizing communal prayer in the office, showing a hiring preference for men who have demonstrated their devotion to Islam and by conducting non-banking business in a recognizably "Islamic" manner (Smith 2004). Islamic practices include providing a prayer room and encouraging prayer breaks, striving to maintain ethical business practices, structuring financial transactions to conform to Islamic law, maintaining gender segregation, and any other activity that falls under the jurisdiction of Islamic law. In practice, IFIs primarily strive to adhere to financial regulations, though some organizations take into consideration other aspects of human resources practices (see Martin and Hunt-Ahmed 2011 and Chapter 13 of this volume).

## AN OVERVIEW OF THE BOOK CONTENTS

The idea for this book was developed after I had been teaching Islamic finance for a few years to overflowing classes of students at DePaul University's Driehaus School of Business in Chicago, Illinois. There are few Islamic finance classes taught in business schools in the United States and I found that young business students were eager to learn about this growing industry because they had heard so much about it in the media. My students were Muslim and non-Muslim, and all held a deep interest in international business. Most realized that if they wanted to be a part of the global financial industry, they would need to understand the basic ideas of Islamic finance, as they were likely to encounter these concepts as a matter of course in international business.

Most of the books I used for teaching purposes provided excellent introductory, legal, or technical material on Islamic finance, but the idea for the present volume was conceived when I realized there was room in the literature for a book that advanced the industry beyond descriptive terms and onto a broader, more academic discussion of some of the innovations and applications of earlier research and practical developments based on daily practices. It is my hope that this book will appeal to those new to the industry and also to practitioners and researchers already familiar with the industry. For this reason, I have divided the book into two primary parts: Part I, "The Contemporary Islamic Finance Landscape," addresses the most current thinking about Islamic economic theory and Islamic legal thought, then moves on to a series of chapters that present a new level of thinking about a wide variety of topics in the industry. While the topics may be familiar to the reader, these chapters represent the latest thoughts on the subject. All chapters are written by innovative academics and innovative practitioners who are on the ground and see what works and what does not work in the industry environment today.

Most chapters in this volume presume that readers have a rudimentary understanding of the basic principles of Islamic finance, but will be accessible to readers new to the industry as well. For this reason, I have foregone the inclusion of chapters specifically dedicated to describing the technical aspects of basic structures.

Individual chapters include descriptions as necessary. For readers who want to learn more about Shari'a-compliant financial structures in detail, there are many excellent books containing this information. I particularly recommend Ayub's *Understanding Islamic Finance*, Kettell's *Islamic Finance in a Nutshell: A Guide for Non-Specialists*, or Iqbal and Mirakhor's *An Introduction to Islamic Finance Theory and Practice*.

Novice readers may want to pay particular attention to Chapters 2 and 3 of this volume and may use these chapters as an abbreviated introductory text. In Chapter 2, "Contemporary Islamic Economic Thought," Farooq traces the history of Islamic economic thought from pre-modern times through the present, highlighting themes and concerns of the discipline and its relationship to both conventional (i.e., neoclassical) economic thought and what we now know as Islamic finance. Farooq advances scholarship in this area by comparing current formulations of Islamic economic thought and urging us to move beyond reliance on the neoclassical economics paradigm by developing a more theoretically and empirically rich body of work on Islamic economics.

In Chapter 3, "The Legal Framework of Islamic Finance," Shawamreh provides the reader with a basic introduction to the principles of Islamic legal thought. This framework is based in a system originating in the seventh century and refined through a precise juristic process in the intervening centuries. Shawamreh's contribution to the literature is the recognition that Islamic finance operates within a legal framework that developed concurrently—sometimes parallel with, sometimes separately from—an Islamic legal system. An often difficult task for practitioners new to Islamic finance is making the connection between centuries-old legal opinions and contemporary international regulatory environments. In this chapter, Shawamreh discusses some particular challenges associated with constructing and enforcing Shari'a-compliant financial transactions within a dual legal framework. This chapter is a particularly timely primer of Islamic legal thought and its resulting financial structures, followed by a discussion that makes the evolution of legal thought relevant to today's applications.

The cultural origin of Islamic finance is often overlooked in more practical treatises on the subject. Yet those new to Islamic finance often ask, "The financial structures look the same as conventional finance. If that is the case, why do we need this industry anyway?" Chapter 4, "Globalization and Islamic Finance," provides a social scientific explanation for the question of why we need this industry. I reach beyond a discussion of whether the financial structures are the same or different to explore motivations of individual practitioners and how they think about their participation in the industry.

Waleed El-Ansary, in Chapter 5's "Islamic Science and the Critique of Neoclassical Economic Theory," moves scholarship beyond a neoclassical interpretation of Islamic economics, just as Farooq has suggested that scholars approach the subject. El-Ansary dives into this critique by connecting the analytical tools of economic theory and the sciences of nature. In this groundbreaking work, the author connects the spiritual roots of Islamic thought with its economic principles in a new way. He contends that the debate between Islamic and neoclassical economics ultimately depends on the all-important debate over the hierarchy of levels of reality and the secular philosophy of science. He critiques the overly scientific analytical tools currently used to evaluate the theoretical claims of Islamic and

neoclassical economics and urges greater synthesis of the spiritual and scientific when addressing such questions.

No serious industry or academic discipline is without controversy. In Chapter 6, "Juristic Disagreement," Shoiab Ghias provides evidence for the seriousness of the Islamic finance industry in the form of a controversy over the permissibility of the existence of the industry itself. In virtually all of the prevailing industry literature, two chief principles motivate thinking on the subject: first, that *riba* (interest) is banned under Islamic law and second, that Islamic banking is the inevitable practical expression of this ban. Ghias finds that in 2008, a panel of Pakistani Shari'a scholars issued a *fatwa* (legal opinion) stating that Islamic banking is unacceptable under Islamic law. For this volume, Ghias has translated this *fatwa*, provides a discussion of its authority, presents arguments for its validity, and presents us with a resolution of the matter. Because this volume is meant to address contemporary issues in Islamic finance, the editor finds this chapter a particularly important tool to stimulate discussions within the industry.

### Innovations

Chapter 7, "Managing Liquidity Risk in Islamic Finance," written by Muhammad Al-Bashir Muhammad Al-Amine, and Chapter 8, "Elements of Islamic Wealth Management," written by Paul Wouters, are exceptionally relevant and timely topics for inclusion in any finance volume during and after the 2007 worldwide economic crisis. For this reason, this volume devotes considerable attention to the theory and application of products in these categories. Chapters 7 and 8 present the reader with a general discussion of each topic, with special emphasis on products that connect the investor to international capital markets and allow individual and institutional investors to manage wealth and the risk inherent in wealth management. Chapters 9 through 12 discuss contemporary formulations of specific products used in these endeavors.

Michael McMillen, the author of Chapter 9, "*Sukūk* and the Islamic Capital Markets," is an internationally respected attorney and pioneer in the development of *sukūk* structures. *Sukūk* are relatively new products in international finance and are designed to bridge Islamic and conventional capital markets as a risk management tool. He explains the connection in Chapter 9:

Islamic capital markets will emerge from the current financial downturn as a central feature of the Islamic finance and investment industry and will increasingly be integrated with the larger conventional capital markets. *Sukūk* will likely be the vehicle of choice in achieving that integration.

Chapters 10 and 11 focus on Shari'a-compliant mutual funds and the indices that measure their returns. Monem Salam (Chapter 10, "Shari'a-Compliant Mutual Funds") has managed one of the most successful mutual funds of all time; that this fund is Shari'a-compliant is a boon to the industry and a particular bonus for mutual fund investors looking to invest their money according to Islamic principles. This success appears to be a feature of Shari'a-compliant funds, as Tariq Al-Rifai discusses in Chapter 11, "The Evolution of Shari'ah-Compliant Indexes and Why They Outperform Conventional Indexes over the Long Term." Al-Rifai

has been an industry leader in evaluating Shari'a-compliant financial products since the 1990s and has extensive knowledge of the field. He is optimistic in his outlook for the industry, an opinion based on solid evidence and its track record.

A relatively new product on the scene is *takaful*, or Shari'a-compliant insurance. Insurance is both a risk management tool and a wealth management product, as it can be structured as an investment. Insurance was originally a controversial topic in Islamic finance, as Farrukh Siddiqui explains in Chapter 12, "Takaful." Siddiqui traces the history and evolution of opinions on this issue and illuminates contemporary structures and *fatawa* supporting the creation and sustainability of *takaful* as a viable and necessary part of a functioning international financial industry.

Chapters 13 through 15 complete the section on innovations by discussing relatively unexplored topics. Because the industry is so new, it has taken time to develop scholarship on the arguably less glamorous (than international financial structures) but crucial inner workings of an industry. In Chapter 13, "Islamic Human Resources Practices," William Martin examines the relatively unexplored topic of human resource management. He reviews the purpose of attending to issues of human development in the workplace and reminds us that Islam puts great emphasis on this very issue. A truly Islamic financial institution must pay attention to the needs of its employees including, but not limited to, providing Shari'a-compliant methods of compensating employees for their work.

Chapters 14 and 15 address the uncomfortable yet vital topic of poverty alleviation. If Islamic finance intends to stay true to its stated principles of attending to social justice concerns, it must not ignore the parts of society that are not able to participate in big-money financial transactions. In fact, the competitive advantage of Islamic finance is that it is self-reflective about its role in the whole economy, not just international financial institutions. In Chapter 14 "An Integrated Islamic Poverty Alleviation Model," Kabir Hassan and his student Ali Ashraf present a model for poverty alleviation that utilizes the institutions of *Zakat* and *Awqaf*—also, not coincidentally, wealth management tools—to achieve its purposes. Sabur Mollah and Hamid Uddin, in Chapter 15, "How Does an Islamic Microfinance Model Play the Key Role in Poverty Alleviation?" further this discussion with a more focused look at how Islamic microfinance can work and is working toward this goal in Europe.

## Applications and Best Practices

Part II, "Case Studies," the last part of this volume, moves away from theory to present the reader with examples of how products and structures are implemented in real life. Chapters 16 through 23 show us how international marketing and financial structures are implemented in a globalized world. Offshore banking structures are a major part of globalization and make the international focus of Islamic finance a reality. Mutual funds are active all over the world and we see how mutual funds in Saudi Arabia perform, as well as how the realities of ratings services function worldwide. Because this is such a global industry, it is easy to forget that the United States is a relatively new market for Islamic finance, and we explore its opportunities and challenges as a case study. We revisit the challenges of risk management by discussing individual situations in more detail. Finally, we

conclude our section on best practices by comparing efforts to institute Islamic microfinance in various parts of the world.

## A FINAL NOTE

The global nature of this industry necessitates a final word about translations and spellings. The editor chose authors based on their proven innovative thinking and practical experience; therefore, the authors come from many disciplinary backgrounds, industries, and writing styles. We have chosen to leave intact each author's spellings and translations of non-English terminologies. We believe these differences reflect the true nature of the industry, which is to provide a central institutional structure in which many different opinions can flourish and prosper. It is the editor's hope that readers will appreciate our efforts to provide a diversity of opinion and a format for ongoing discussions of advancements in the industry of Islamic finance.

## NOTES

1. I will shorten the reference to 'IBF' throughout this Introduction.
2. A "conventional" bank is the industry term that refers to existing international, interest-based banks.
3. [www.zawya.com/story/ZAWYA20110505062447/Global\\_Islamic\\_Finance\\_Report\\_2011\\_Released/](http://www.zawya.com/story/ZAWYA20110505062447/Global_Islamic_Finance_Report_2011_Released/); accessed 5/21/12.
4. [www.ft.com/intl/cms/s/0/09a99422-7291-11e1-9be9-00144feab49a.html#axzz1yS3ndpCe](http://www.ft.com/intl/cms/s/0/09a99422-7291-11e1-9be9-00144feab49a.html#axzz1yS3ndpCe); accessed 6/21/12.
5. *La ilaha illallah, Mohammed ur-Rasulallah* (there is only one God and Mohammed is his prophet). This is also called the *Shahadah*.
6. The Islamic Development Bank was begun in Saudi Arabia in 1975 as well.
7. <http://mondediplo.com/2001/09/09islamicbanking/>; accessed 6/21/12.

## REFERENCES

- Ali, Ahmad Mohamed. 2002. "The Emerging Islamic Financial Architecture: The Way Ahead." Paper presented at the Fifth Harvard University Forum on Islamic Finance, April 6-7.
- Askari, H., Z. Iqbal, and A. Mirakhor. 2010. *Globalization and Islamic Finance: Convergence, Prospects & Challenges*. Hoboken, NJ: John Wiley & Sons.
- Bahrain Monetary Agency. 2002. *Islamic Banking & Finance in the Kingdom of Bahrain*. Bahrain: Arabian Printing Press.
- Chapra, Muhammad Umar. 1976. "Objectives of the Islamic Economic Order." In Khurshid Ahmad, ed. *Islam: Its Meaning and Message*. London: Islamic Council of Europe.
- De Roover, Raymond. 1974. "New Interpretations of the History of Banking." In Julius Kirshner, ed. *Business, Banking and Economic Thought in Late Medieval and Early Modern Europe: Selected Studies of Raymond de Roover*, 200-238. Chicago: The University of Chicago Press.
- Henry, Clement M., and Rodney Wilson. 2004. "Introduction." In Clement M. Henry and Rodney Wilson, eds. *The Politics of Islamic Finance*. Edinburgh: Edinburgh University Press.
- Knorr-Cetina, Karin, and Alex Preda, eds. 2005. *The Sociology of Financial Markets*. Oxford: Oxford University Press.

- Kuran, Timur. 2004. *Islam & Mammon: The Economic Predicaments of Islamism*. Princeton: Princeton University Press.
- Lewis, Mervyn K., and Latifa M. Algaoud. 2001. *Islamic Banking*. Cheltenham, UK: Edward Elgar.
- Martin, W. M., and Karen Hunt-Ahmed. 2011. "Executive Compensation: The Role of Shari'a Compliance," *International Journal of Islamic and Middle Eastern Finance and Management*, 4:3, 196–210.
- Mawdudi, Sayyid Abul A'la. 1988. *Towards Understanding the Qur'an, Vol. I*. Chichester, United Kingdom: The Islamic Foundation.
- Mawdudi, Abu'l A'la. 1980. *Towards Understanding Islam*. United Kingdom: The Islamic Foundation.
- Mawdudi, Abu'l A'la. 1974. *Islam: An Historical Perspective*. United Kingdom: The Islamic Foundation.
- Mazzarella, William. 2004. *Shoveling Smoke: Advertising and Globalization in Contemporary India*. Durham, NC: Duke University Press.
- Moss, Rita. 2004. *Strauss's Handbook of Business Information: A Guide for Librarians, Students, and Researchers*. 2nd edition. Westport, CT: Libraries Unlimited.
- Siddiqui, Muhammad Nejatullah. 1981. "Muslim Economic Thinking: A Survey of Contemporary Literature," In Khurshid Ahmad, ed. *Studies in Islamic Economics*. Chichester, United Kingdom: International Centre for Research in Islamic Economics.
- Smith, Kristin. 2004. "The Kuwait Finance House and the Islamization of Public Life in Kuwait." In Clement M. Henry and Rodney Wilson, eds. *The Politics of Islamic Finance*. Edinburgh: Edinburgh University Press.
- Udovitch, Abraham L. 1970. *Partnership and Profit in Medieval Islam*. Princeton: Princeton University Press.
- Warde, I. 2010. *Islamic Finance in the Global Economy*. 2nd edition. Edinburgh: Edinburgh University Press.
- Weber, Max. 1930. *The Protestant Ethic and the Spirit of Capitalism*. London: Routledge.
- Zarqa, Anas. 1981. "Islamic Economics: An Approach to Human Welfare." In *Studies in Islamic Economics*, ed. Khurshid Ahmad. Chichester, United Kingdom: International Centre for Research in Islamic Economics.