

## **BOOK REVIEW**

**Muhammad Ayub; Understanding Islamic Finance;**

**John Wiley & Sons Ltd, 2007 pp. xxvi + 516; ISBN: 9780470030691**

**Reviewed by: Khurram Khan\***

The book under review is invaluable addition to the reading materials on emerging discipline of Islamic finance. It fills a long-felt need for a standard text in Islamic finance and covers almost all areas of Islamic banking and finance. It is encyclopedic in nature and simultaneously academic, religious, legal, political and economic. The author provides a clear exposition of all the basic building blocks of Islamic finance with critical review of various objections raised against ethics based system of Islamic finance. It is not only a good reference for any professional who seeks understanding of Islamic financing, but also a standard textbook for undergraduate and graduate students in universities and business schools around the world.

A number of myths occupy the peoples' mind about Islamic financial system. Removing those myths and promoting Research & Development is crucial in promoting the system. Policy makers, bankers, business community, industrialists, Sharī'ah scholars, students of business schools and the people at large need to know what Islamic finance is, what are its features and philosophy and how it works. The book under review provides an authentic reading material in this regard. An additional plus point of the book is that it represents the mainstream view of Islamic finance. The author does a commendable balancing act in dealing with juristic matters that are often characterized by divergence of views. The Shariah principles, accounting, risk management and other performance standards as being developed by the standard setting institutions like AAOIFI and IFSB are also based on the mainstream view.

The book is divided into three parts each part spanning over a number of chapters. The first part is to lay a foundation for discussion while studying and understanding Islamic financial system. It begins with a strong criticism of capitalism and the neoclassical framework based on greed. Quoting from John Perkins, the celebrated author of "*Confessions*

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of an *Economic Hitman*”, the author asserts that conventional debt based capitalist system is extremely vulnerable, the best example being the US economy and that growth *per se* may not lead to socio-economic justice. Contrary to assertions of some Islamic economists, the author rules out possibility of re-adoption of gold standard and emphasizes on the linkage between financial and real sectors as the panacea for all that plagues the global economic and financial system. At the same time, he feels that "keeping in mind the low ethical standards in almost all present societies, it will be a challenging task".

Chapter two discusses the key features that distinguish an Islamic economic system from a conventional one. Chapter three undertakes an elaborate analysis of the fundamental prohibitions of *riba*, *gharar* and *maysir / qimar*. In the words of Dr. Obaidullah (*Islamic Economic Studies, January 2008*), “The analysis is, thus, complete. The author dispels many misconceptions about the prohibitions (such as the definition of *riba* as excessive interest or interest with non-productive loans) using simple logic and lucid language and seeks to provide the economic rationale underlying the prohibitions from the standpoint of Islam as well as of other religions and secular economic ethics and efficiency. The definition of *riba* provided by the author as "any increase over and above the principal amount payable in a contract obligation, not covered by a corresponding increase in labor, commodity, risk or expertise" is indeed the most comprehensive of many definitions one comes across in Islamic finance literature.”

Part Two spanning over three chapters provides an overview of the Islamic law of contracts focusing on loans / debts and *ba'i*. Chapter 5 presents a general framework of contracts in Islam, broad rules for their permissibility and also discusses the controversies surrounding the status of promises (*w'adah*) and contingent contracts. Many of the ideas presented in this chapter are fundamental to a good understanding of the theory and practice of Islamic finance. Chapters on *ba'i* and *qard ldayn* take care of much of the controversies arising out of ignorance. Issues such as sale of debt (*dayn*), sale on the basis of part payment of price (*'arboon*), sale and buy back (*ba'i al 'inah*) are covered in chapter 6, while issues related to loan/debt, such as, time value of money, admissibility of rebates with pre-payment, penalties for delays, defaults and delinquencies, assignment (*hawalah*) vs. sale of debt, provision of guarantee (*kafalah*) or collateral (*rahan*) as a way to managing default risk, impact of inflation on debt are covered in chapter 7.

Part Three, the most strategic of the Book, gives an overview of financial products in conventional and Islamic perspectives and discusses the main Islamic modes of business and investment and how they have to be used by IFIs as modes of financing. Explanation on the concepts of credit and forward sales – *murabaha muajjal*, *salam* and *istisna'a*, leasing of assets and services–*ijarah*, partnership based modes like *musharaka*, *mudaraba*, diminishing *musharaka* and some accessory contracts that could be used by IFIs (along with other main contracts), is followed by the procedures that IFIs could adopt for respective modes to facilitate a variety of clients ensuring Sharī'ah compliance.

Chapter 14 discusses the application of Islamic financial products to fulfill the needs of IFIs' customers and deals with operational aspects like procedures and processes of product development, ensuring Sharī'ah compliance through Sharī'ah audit and maintaining relationship with conventional banks and the central bank. It also covers application of the Islamic modes in working capital finance, trade finance, project finance, management of risks, issue of credit cards and offering of various fee-based services, such as, underwriting, letters of credit and guarantee.

Chapter 15 discusses sukuk and securitization explaining their concept and the procedures. It explains as to how the concept of sukuk can be used to realize the huge potential of Islamic finance. The author emphasizes that sukuk are different from the conventional bonds, because in principle, the return on sukuk and other Islamic instruments would be quasi-fixed, unless an independent third party guarantee is provided, as admissible under Sharī'ah rules. The chapter also discusses the concept of Islamic depository receipts as a means of developing Islamic capital markets.

Chapter 16 is devoted to the concept, practice and potential of *takaful* - the Islamic alternative to insurance. It provides a comprehensive coverage and critique of all the models being practiced based on *mudaraba*, *wakala* or a combination thereof and advocates the use of the *waqf*-based model. Finally, while chapter 17 provides an appraisal of common criticisms of Islamic banking of finance, chapter 18 discusses the prospects, issues and challenges facing the Islamic finance movement. An exhaustive glossary and an elaborate list of suggested readings at the end of the book further enhance the value of the book.

On the whole, the book fills a long-felt need for a standard text in Islamic finance. The author does a commendable balancing act in dealing with *fiqhi* matters that are often characterized by divergence of views. For most issues, he prefers to present the consensus position as captured in the

AAOIFI Standards. At the same time, he does not show any reluctance to exercise his "own" judgment. Using a critic's lens, however, one finds a rather inadequate discussion on managerial aspects of IFIs. For instance, while the author devotes five chapters exclusively to contractual aspects of Islamic modes of finance, he covers all the institutional and operational aspects of IFIs as well as Islamic financial markets in just one following chapter. A more detailed discussion on various risk factors confronting IFIs and ways to manage them should have been included. Similarly, the exposition of various concepts and structures could have been made more reader-friendly. A good example: Explain how an IFI operates or is different from a conventional FI with the help of a hypothetical financial statement.

Despite the above, the book is a welcome addition to the ever expanding literature on the field. The author has rendered a commendable job by making available standard reading material which is equally relevant to students, researchers and Islamic finance practitioners. Each chapter is both readable and useful and well suited to serious Bachelor's or Master's level students. It reveals that the author knows the subject area and he sounds authoritative throughout. The analytical approach adopted is conducive to bringing into light the potential areas of research. As per reports from various sources and regions, it has been prescribed as a textbook on Islamic finance for students of universities and business schools across the world, particularly in England, US, Bahrain, UAE, Pakistan and Malaysia. The research students in the area of Islamic finance thus should find this book as a must reading. It is also of significance for financial engineers who wish to design financial instruments compatible with the requirements of Islamic jurisprudence. Keeping in view its rich contents, Riphah international University, Islamabad has published Urdu version of the book while Malaya Bhasa version has been published from Indonesia. Work on Arabic is said to be in progress.

The author should be appreciated for writing such a useful book and the publisher for its befitting production.