

PRIMARY RESEARCH

***Maqāṣid al-Sharī‘ah*, Islamic Financial Industry and Addressing the Concerns**

Lakhi Muhammad ^{1*}, **Gul-E-Rana** ², **Irum Saba** ³, **Shahab Aziz** ⁴

¹ Department of Management Sciences, Capital University of Science and Technology, Islamabad, Pakistan

² Department of Information System, Kulliyah of Information and Communication Technology, International Islamic University Malaysia, Kuala Lumpur, Malaysia

² Department of Management Sciences, Yanbu University College, Yanbu, Saudi Arabia

³ Department of Finance, Institute of Business Administration (IBA), Karachi, Pakistan

⁴ Business Studies Department, Bahria University, Islamabad, Pakistan

Keywords

Islamic Finance

Islamic Banking

Maqāṣid al-Sharī‘ah

Received: 7-Apr-19

Accepted: 25-Nov-19

Abstract: Banking system is the backbone of every modern economy. Role of Islamic banking is rising in economy of different countries. Meanwhile, criticism on Islamic finance is also rising with the passage of time. A careful review of literature suggests that researchers are raising concerns on the way the Islamic banking is operating closely on the lines of conventional banking. They claim that the difference between these two banking system is only limited to documentation level. Aim of this paper is to identify the concerns about Islamic finance industry in literature and to provide suggestions on how to address these concerns in line with the *maqāṣid al-Sharī‘ah*.

KAUJIE Classification: B4, I23, L0

JEL Classification: L31, M14, E6

© 2019 JIBM. All rights reserved.

INTRODUCTION

Stability and growth of Islamic financial service industry is well documented. It is due to the inherent feature of stability and growth that “Islamic financial services are very popular even in the countries which have small Muslim population like United Kingdom, Singapore, Australia and even South Korea” (Muhammad & Gul-e-Rana, 2014. p. 197). Islamic finance is growing across the world and currently Islamic finance assets are worth \$2.19 trillion (Islamic Financial Services Board, 2019).

The continuous growth of Islamic financial service industry was concretely supported by the researchers to evolve new and Sharī‘ah compliance financial products. It was due to these efforts that this financial services industry gained its full-fledged financial place in the

*Corresponding author: Lakhi Muhammad

†Email: lakhi.muhammad@cust.edu.pk

world. The objectives of the Islamic economic system are many fold; however, the following economic and social objectives of the Islamic economic system are discussed in the extant literature.

TABLE 1
Literature

Source	Economic Objectives	Social Objectives
Ahmed (1987)	To eliminate poverty and deprivation	To eliminate Injustice from the society
Chaudhry (1999)	To provide basic human needs to achieve moral and material development to circulate wealth	To establish social justice to promote brotherhood and unity
Khan (1994)	To achieve <i>falāḥ</i> in economic	To achieve <i>falāḥ</i> in social context
Maududi (1984)	To maintain harmony of moral and material development	To obtain cooperation and justice
Chapra (1979)	To achieve Islamic wellbeing and Islamic moral norms	To achieve universal brotherhood and justice
Zaman (2008)	To spent wealth and material to achieve internal satisfaction and motives	To achieve cooperation and harmony to maximize social interest than personal

In spite of growth in Islamic finance industry, researchers started to raise questions regarding the functionality of Islamic finance not generally in term of legality, but in term of its objectives (*maqāṣid al-Sharī‘ah*). El-Gamal, (2006) criticized that the result of a conventional finance and Islamic finance is same as interest but thinly veiled version of the latter. Further, researchers criticized that the concept of Sharī‘ah compliance is misunderstood, utilized in “mere legalistic perspective with a “mechanical approach”. Whereby product structuring has been reduced at the level of structure and forms and less of substance and spirit brought by the Islamic law and its objectives” (Furqani, 2014. p.52). Sairally (2013) found that the goals and objectives of Islamic finance are lost in the *fiqh* approach, rather than the *maqāṣid al-Sharī‘ah*; further, the spirit of the law has been ignored. The basic thought in Qur’ān and Sunnah is welfare of the society. Muslim society had enjoyed the economic development during their peak times as “the vision of an Islamic society was the welfare of every individual where justice, care, and prosperity prevail” (Muhammad & Gul-e-Rana, 2014).

The objective of this paper is two folds. First, to identify the aspects of Islamic finance that have been undermined by the practitioners during the product development. Two, to put forward some suggestions to rectify the disruption caused to gain a win win situation for financial organization related to commercial need of stakeholders. Next, this study considers literature review on importance of *maqāṣid al-Sharī‘ah* and efforts to pinpoint the emerging critics on Islamic finance industry. Finally, this paper suggests a method to practitioners on how to address such concerns, and ends with conclusion.

LITERATURE REVIEW

Islamic financial service industry is the most strategic part of Islamic economic system. In commercial context, the Islamic financial organizations have the responsibility to pursue the depositors and shareholders benefits as well as to contribute for the achievement of socio economic goals accordance to aims of Islam (Sairally, 2013). It is since 2004 that researchers are raising the debate in the literature regarding the divergence in Islamic economic theory and the way practical course of action has been taken in Islamic finance, but now the spectrum of criticism is getting wider. Organizations having lack of attention towards the social stakeholders increase their risk and face competitive and economic consequences (Molteni & Pedrini, 2010).

The study of *maqāṣid al-Sharī'ah* in Islamic finance industry is highly important as the current phase is inviting the critics of the researchers. This criticism can shake the trust of the Muslim society; the prime users of Islamic financial products. The critic of the researchers must be pursued concurrently, which may enhance the development and survival of an organization and the industry as a whole. In case the decision makers do not focus on the dynamics where any organization operates, they fail to have progress in productivity as well as in efficiency (Molteni & Pedrini, 2010).

This paper contributes in the literature by identifying overlooked aspects of Islamic finance particularly related to *maqāṣid al-Sharī'ah*. Conventional economic system is supposed to deal with the efficient allocation of resources, but sociological world considers the distribution of resources as well, which is crucial for the social needs. If there is gap between these two aspects, then an imbalance would occur. Therefore, there is active search for the economic core conducted within the framework of socioeconomics (Keizer, 2005). The rich are getting richer and poor becoming poorer. This issue is more concerned in developing countries. Muslims might be optimistic about Islamic economic system that served well if we look back to the past glorious history of the Muslims. Islamic finance being a strategic part of Islamic economics, something is missing in the system as being currently operated, as the expectations are not being turned to realities. This study identified three concerns in literature pertaining to Islamic financial industry. One, the objective of Islamic law is missing in Islamic finance products. Two, taxation on Islamic finance is same as of conventional. Three, Islamic financial industry is serving the same segments as the conventional industry, instead of reaching the impoverished customers.

Objective of Islamic Law is Missing in Islamic Finance Products

Researchers raised concerns regarding the Islamic financial products that the same do not serve the objective of Islamic law. Islamic finance as being operated is same as the conventional finance, just the difference is sophistication in number of sub contracts to finalize a financial deal with some Arabic names (El-Gamal, 2006). Islamic finance fulfills the legal requirements of Islamic aspects, but the spirit of Islamization is missing (Furqani, 2014; Sairally, 2013). The major reason offered by these researchers is the fictitious sale and purchase activities, as in *tawarruq*, just to fulfill the legality of Islamic finance. It shows deviation from the objective of the law (*maqāṣid al-Sharī'ah*) as there is no economic ac-

tivity regarding the utilization of the goods involved in sale and purchase. Second, Islam forbids raising debt in the society unnecessarily, but current Islamic finance is following the spirit of conventional finance to increase the debt in the society (Furqani, 2014). This is reflected in the assets and credit structure of the Islamic banking, which dominates the Islamic finance industry with 71% share. The asset portfolios of Islamic banks are dominated by the debt-based modes where Islamic banks ensure a certain amount of return. There is a lack of use of profit sharing modes within Islamic asset portfolio. Lately, Islamic banks in Pakistan have started *mushārah* based working capital finance to the corporate sector, the size of which is around 25% of Islamic banks total portfolio. But, that practically is a fixed return financing and a replica of the conventional overdraft facility (Khaleequzzaman, Mannsoori, & Rashid, 2016).

Third, only to use the mechanical approach in legal aspect of Islamic financial products is a hindrance to innovation to Islamic finance products. It can be marked that *taqwá* (protecting oneself from displeasing Allah) is missing somewhere in Islamic finance, and profit maximization looks the main focus.

Taxation of Islamic Finance Products

Growth of Islamic finance brought opportunities and challenges for the practitioners (Muhammad & Gul-e-Rana, 2014). Islamic finance is different from conventional finance and mostly involves assets in a transaction. The involvement of the assets demands further path to reach the final deal. This type of deal raises serious concerns regarding the taxation of Islamic finance products. The taxation for Islamic finance is being tailored same as the conventional finance spirit. Most of the countries made changes in their taxation system to toggle the challenges of taxation to treat Islamic finance on same footages as conventional finance taxation (Muhammad & Gul-e-Rana, 2014). The conventional taxation system is not serving its purpose particularly in third world countries where most of the taxes are spent on non-socio economic activities. Socio economic activities like human development, poverty reduction remain ignored due to the deficits in the third world countries budget. Secondly, the institutions are still weak in third world and need billions of dollars to be strengthened. Poverty reduction remained a real challenge to the Muslim world. Growth of Islamic financial industry inspired the Muslim societies to have greater expectation for poverty reduction.

Serving all Segments of Islamic Finance Industry

The basic objective of Islamic finance is to serve the Muslims for financial needs according to Shari'ah perspectives. But the Shari'ah perspective when mingled with profit maximization concept, the solution does not look serving the theme with true objectives of Islam. In operational perspectives, the eligibility criteria for financing the Islamic finance are more or less same as conventional finance. Islamic finance industry is focusing on the segments like high net worth or the institutional investors but ignoring the small savers; the basic concern is the profit motive, rather than the society (Furqani, 2014).

METHOD TO ADDRESS AFORE MENTIONED ISSUES

Suggestion to Overcome the Concern: “Objective of Islamic Law is Missing in Islamic Finance Products”

Religion Islam is very clear about the legality and the objective of legality fulfilment. Allah almighty in Qur’ān says “O you who have attained to faith! Be conscious of Allah with all the consciousness that is due to Him. . .” (3:102); hence, both legality and the objective of legality need to be addressed for *taqwá*. Further, innovational product development is required in a way where the law and the objective of the law both can meet. This will help the organizations to serve the purpose. Molteni and Pedrini (2010) identified two types of top management responsibilities: i) to gain financial performance assuring growth of the company as well as offering satisfying rewards to the stake holders; and ii) to offer valuable products and services to the customers, as well as meeting the social expectations beyond the obligations enforced by legality for the stake holders.

Lots of research and resources have been designated to work on the legality of Islamic financial products. Now it is researchers’ responsibility to suggest the practitioners about more sophisticated product development beyond the legality variables to socio focused variables. Contrived sale and purchase of assets, just to fulfill the legal requirement is the core area to be focused. It is fictitious sale creating debt in millions by utilizing similar assets, which are transferred many times in book management without taking the ownership; it stops the circulation of the goods in the economy creating problems for the real economy (Furqani, 2014).

This concern needs to be addressed by researchers and practitioners, assets sold or purchased be real in nature, and transfer of ownership taking place that would help the economy by creating a circulation of valuable assets in the economy. It is well understood that the financial institutions are commercial in their nature and they have to protect the depositors and shareholders rights. But, still there is a need to find the equilibrium where commercial and social interests meet to find a win-win situation. This situation looks mandatory for the whole industry as once the trust of Islamic finance product seekers shake, it will create severe challenges for the sustainable growth and efficiency of the Islamic finance industry.

Suggestion to Overcome the Concern, “Taxation for Islamic Finance Products”

Taxation for Islamic financial products is being treated on the footage of conventional finance. It is due to the specific feature of transactions in Islamic finance to involve the real sector asset; this involvement of assets gave birth to taxation challenges in Islamic Finance. The system of *zakāh* is a solution to deal with the taxation issues on Islamic finance (Muhammad & Gul-e-Rana, 2014). Muslim society is considered to be free from extreme of both wealth and poverty (Ahmed, 1987). *Zakāh* serves for this purpose in a better way as the flow of wealth changes from the rich to the poor. The current scenario demands the attention of the practitioners and tax authorities to carve out the ways to treat Islamic banking on the footage of *zakāh* instead of conventional taxation. Muhammad and Gul-e-Rana (2014) explained that it is the state responsibility to collect the *zakāh* as in Qur’ān Allah almighty says “*Those (Muslim rulers) who, if We give them power in the land, (they) order for iqamat al-ṣalāt. [i.e.,*

to perform the five compulsory congregational *ṣalāt* (prayers) (the males in mosques)], to pay the *zakāh*. . .(22:42)”. Beauty of *zakāh* is that it has no concern with sale and purchase price. It deals with the value of asset, hence it does not increase the inflation in the market. It only focuses those segments, which are capable to pay instead of the segments which are unable to pay taxes but are forced to pay indirect taxes. Shirazi and Amin (2010) made their study on potential of *zakāh* (with sample of 38 OIC countries) for poverty elimination. Their research cements the potential of *zakāh* to eliminate poverty from the Muslim countries. If we consider financial institutions role towards the society, *zakāh* is a best tool for the society as well as for these institutions to grow. This is justified while looking into the present Islamic finance industry architecture. The Islamic finance industry is presently dominated by Islamic banks, which follow only the commercial interest, rather than the social interest that is the key objective of the Islamic economic system. Hence, it can involve the institutions like *zakāh* and *waqf*, which could help in achieving Islamic social objectives (Ayub, 2018).

The role of the financial industry, particularly the banks, did not remain as it was in earlier period when this industry evolved. Banks are more trusted as compared to other serving entities (Sapienza & Zingales, 2012). It is the banks responsibility to manage *zakāh* in such way to deploy SME experts helping the rural areas population to set up their businesses. Further, banks can attract the segments which are willing to help the poor but unable to reach the poor. Such types of accounts can be introduced where the customer may be motivated to keep deposits and profit can be shared to the poverty reduction schemes (Hassan, 2010). Such countries where share of Muslim population is higher, these settings can motivate the customers to deposit more to serve for the poverty reduction. Banks can introduce such deposit products, while customer will find it a trusted platform where they could fulfill their religious responsibilities to help the poor.

Suggestion to Overcome the Concern: “Islamic Finance Serving Only the Richer Segments of Society”

As discussed earlier the Islamic finance industry is mostly focusing on high net worth and corporate customers for profit maximization objectives. It supports the rich to be richer as Islamic commercial banks only lend to the wealthy and business and no credit facilities exist for the poor. Islam prohibits such distribution of wealth where it goes in fewer hands. In Qur’ān Allah almighty says “. . .so that it (wealth) will not be a perpetual distribution among the rich from among you (59:7)”. Financial entities need to maintain some balance among different groups even though financing in consumer banking is riskier as compared to the other segments. Islamic financial institutions should also focus on substance rather than just the legality of the forms, while developing and structuring Islamic financial products (Abozaid & Dusuki, 2007). Otherwise, it will be an exercise of semantics, which will lead to failure in achieving the overall Sharī‘ah objectives of the Islamic economic and financial system.

CONCLUSION

It took three decades to the researchers from 1970-1990 for the foundation building of the Islamic finance product (Furqani, 2014) according to the Sharī'ah requirements. This effort provided a solid foundation to Islamic finance to grow in such a marvelous rate. The high growth rate made this industry popular even in many non-Muslim states. Going forward, researchers are raising questions on the fulfilment of *maqāṣid al-Sharī'ah*. This is due to the deep research beyond the product development phase to further considering *maqāṣid al-Sharī'ah* by inculcating the spirit of *maqāṣid* in the products to be applied and implemented. There is a need to further strengthening the literature on how to develop *maqāṣid al-Sharī'ah* based products. Later, the knowledge on *maqāṣid al-Sharī'ah* would further stimulate the knowledge as “knowledge breeds knowledge incessantly as flows” (Choudhury, 2012, p.72).

The current challenge of Islamic finance industry is to run not only with legal compliance of the business contracts with the Sharī'ah principles, but also encompassing the *maqāṣid al-Sharī'ah*. The trust gained by the Islamic finance industry needs to be strengthened further and maintained. This paper contributes to theory by supporting the product development teams and researchers to modify the existing mechanical approach of developing products by focusing on Arabic names only and making fictitious sale purchase contracts, and increasing the cost of Islamic finance.

The concept of *zakāh* in financial service industry as suggested may further serve the purpose of *maqāṣid al-Sharī'ah*. It will also support to the practitioners particularly in banking industry and taxation authorities to address the concerning issues that how *zakāh* can be placed in financing to the needy and the taxation system? Such settings can better be managed by the authorities of tax department and politicians as the changes in taxation system some time require most legislators' support. This paper will also help the practitioners to formulate the strategies regarding the surveillance of socio-economic aspect. The basic view of this paper is that Islamic finance needs to enter from mere mechanical approach for product development phase to the next phase of realizing the *maqāṣid al-Sharī'ah*. It is necessary to encompass the core purpose of betterment of society and to serve all groups in the society (Choudhury, 2012).

REFERENCES

- Abozaid, A., & Dusuki, A. W. (2007). The challenges of realizing *maqāṣid al-Sharī'ah* in Islamic banking and finance. In *IIUM International Conference on Islamic Banking and Finance*, IIUM Institute of Islamic Banking and Finance, Kuala Lumpur, Malaysia.
- Ahmed, I. (1987). *The concept of an Islamic state: An analysis of the ideological controversy in Pakistan* (Unpublihsed document). University of Stockholm, Stockholm, Sweden
- Ayub, M. (2018). Institutionalising ‘*waqf*’ for realising the shared development objective by Islamic banks and financial institutions. *Journal of Islamic Business and Management*, 8(2), 330-343. doi: <https://doi.org/10.26501/jibm/2018.0802-001>

- Chapra, M. U. (1979). *Objectives of the Islamic economic order*. Leicester, UK: Islamic Foundation.
- Chaudhry, M. S. (1999). *Fundamentals of Islamic Leicester*. Lahore, Pakistan: Burhan Education and Welfare Trust.
- Choudhury, M. A. (2012). The methodology of Islamic economic and socio-scientific inquiry. In J. Biddle and R. Emmett, (Eds.), *Research in the history of economic thought and methodology: A research annual*. Bingley, UK: Emerald Group Publishing Limited. doi: [https://doi.org/10.1108/s0743-4154\(2012\)000030a007](https://doi.org/10.1108/s0743-4154(2012)000030a007)
- El-Gamal, M. A. (2006). *Islamic finance: Law, economics, and practice*. New York, NY: Cambridge University Press.
- Furqani, H. (2014). Economic substance versus legal forms: Some notes in Islamic finance product structuring. In *Proceedings of Roundtable Discussion on Taxation of Islamic Finance*, Selangor, Malaysia.
- Hassan, M. K. (2010). An integrated poverty alleviation model combining *zakāh*, *awqaf* and micro-finance. In *Seventh International Conference on the Tawhidi Epistemology: zakāh and Waqf Economy*, Bangi, Malaysia.
- Islamic Financial Services Board. (2019). *Islamic financial services industry stability report*. Kuala Lumpur, Malaysia: Islamic Financial Services Board.
- Keizer, P. (2005). A socio-economic framework of interpretation and analysis. *International Journal of Social Economics*, 32(1/2), 155-173. doi: <https://doi.org/10.1108/03068290510575694>
- Khaleeqzaman, M., Mansoori, M. T., & Rashid, A. (2016). Sharī'ah legitimacy of Islamic banking practices in Pakistan-An evaluation. *Journal of Islamic Business and Management*, 6(1), 77-98.
- Khan, M. A. (1994). *An introduction to Islamic economics* (Vol. 15). Islamabad, Pakistan: International Institute of Islamic Thought (IIIT).
- Maududi, S. A. A. (1984). *Economic system of Islam*. Lahore, Pakistan. Islamic Publication Ltd.
- Molteni, M., & Pedrini, M. (2010). In search of socio-economic syntheses. *Journal of Management Development*, 29(7/8), 626-636. doi: <https://doi.org/10.1108/02621711011059059>
- Muhammad, L., & Gul-e-Rana (2014). Islamic taxation “*zakāh*” and its potential to remove the taxation issues related to Islamic financial industry. In *Proceedings of Round Table Discussion on Taxation of Islamic Finance*, Bangi, Malaysia.
- Sairally, B. S. (2013). Evaluating the corporate social performance of Islamic financial institutions: An empirical study. *International Journal of Islamic and Middle Eastern Finance and Management*, 6(3), 238-260. doi: <https://doi.org/10.1108/imefm-02-2013-0026>
- Sapienza, P., & Zingales, L. (2012). A trust crisis. *International Review of Finance*, 12(2), 123-131. doi: <https://doi.org/10.1111/j.1468-2443.2012.01152.x>

- Shirazi, N. S., & Amin, F. M. (2010). Prospects of poverty elimination through potential *zakāh* collection in OIC-member countries: Reappraised. *Journal of Islamic Economic, Banking and Finance*, 6(3), 55-74.
- Zaman, A. (2010). Islamic economics: A survey of the literature. *Islamic Studies*, 49(1), 37-63.
