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What Is Islamic Banking?

Islamic banking or Islamic finance is a form of Sharia (Islamic law) Here, the banking and financial practices strictly adhere to Islamic legal practices. It incorporates cultural and ethical components into finance. Some practices like Islamic banking loans, profit sharing, and investing significantly differ from conventional banking.





How Does Islamic Banking Work?

- ▶ Islamic banking development can be attributed to some conventional banking theories and practices which go against and hurt the sentiments of the Muslim communities.
- ▶ Sharia is the Islamic law present in the Quran's teachings.
- ▶ The main objective of Islamic banking and finance is that all society participants should create wealth and benefit.

Principles of Islamic Banking



- ▶ **Based on Sharia** - The Sharia, or the Islamic law, is based on the holy scripture of Islam, the Quran.
- ▶ **Profit and loss sharing** - Since banks do not collect interests, their source of revenue is the profit offered by their clients.
- ▶ **Trading** - Sharia restrictions on trading are comparatively lesser.
- ▶ **Investing** - Banks, when investing in businesses, verify their compliance with the Sharia.

TYPES



- ▶ **#1 - Murabaha**
- ▶ Murabaha is a type of financing or contracts the bank purchases on behalf of a client. The client utilizes the purchased property and agrees to make deferred payments.
- ▶ **#2 - Ijarah**
- ▶ Ijarah is a leasing contract where the bank purchases property or capital goods like machinery, equipment, etc., and leases the property to the client. The client pays rent to the bank. Or, primarily, the bank invests in the business and receives a share of the profit.
- ▶ **#3 - Istisnaa**
- ▶ Istisnaa is similar to Murabaha, except that the client will only be able to utilize the property purchased by the bank on the complete payment of dues.
- ▶ **#4 - Mudarabah**
- ▶ This type of contract involves investors sharing their plans with the bank. The bank then reviews the plan and verifies if it complies with the Sharia.
- ▶ **#5 - Musharaka**
- ▶ A Musharaka is a contract where the bank agrees to a venture with its client. First, they work as partners and raise the capital together.
- ▶ **#6 - Tawarruq (Tawarooq)**
- ▶ Tawarruq, often considered the reverse Murabaha, is a type of contract where the client approaches the bank to make a purchase and buys the property from the bank.

