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ISLAMIC FINANCE AND ITS PRODUCTS IN KINGDOM OF SAUDI ARABIA

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ABSTRACT

Islamic banking means how individuals in Muslims world contribute, store and utilize their cash in the banks as per Islamic law. Islamic fund significantly forbids the charging of intrigue, hazard bearing by one gathering alone; offer of dubious things, for example, protection and the back of business adventures, which manages the exercises depicted as unholy by the Quran Global Outlook of Islamic Finance. In this examination, we have utilized subjective philosophy to consider, talk about and break down the effect of Islamic back items on the Kingdom of Saudi Arabia. Distinctive items were dissected under the light of budgetary emergency that world may see and how Islamic fund can avert it.

INTRODUCTION

Islamic banking alludes to the methods by which the Muslim world, contribute or store or fix their cash in the banks and other loaning establishments agreeing with Sharia, or Islamic law [1]. Since this sub-part of fund, it is a quickest developing field, this examination will offer a review to fill in as the premise of learning or for further investigation. Islamic back and its items are growing these days and their utilization is generally expanding because of their offers. They are generally utilized in Islamic speculation, saving money and different projects that include Islamic morals as opposed to business purposes. Despite the fact that the Islamic back software engineer is being

used since the beginnings of Islam in the seventh century, Islamic keeping money and fund is formally utilized since the late 1960s [2].

In light of colossal oil riches which, filled reestablished enthusiasm for and interest for Sharia consistent items and practice. The fundamental thought of Islamic keeping money and back is the comprehension of the significance of hazard sharing as a component of raising capital and the evasion of riba (usury) and gharar (hazard or vulnerability) [3].

Islamic law expresses that "loaning cash with premium installments as a relationship that supports the bank, which charges enthusiasm to the detriment of the borrower is hurt" [4]. Since as indicated by Islamic law cash is an estimating apparatus for esteem and not a benefit in itself. The law expresses that one ought to not have the capacity to get wage from premium cash given by the borrower. Esteemed riba, such practice is restricted under Islamic law as it is viewed as usurious and exploitative. By opposite, Islamic saving money exists to facilitate the financial objectives of Islam.

As needs be, Sharia-agreeable fund (halal, which implies allowed) comprises of benefit keeping money in which the budgetary organization partakes in the benefit and also loss of the endeavor. On equivalent significance is the idea of gharar, characterized as hazard or vulnerability. In money related setting it alludes to the offer of things whose presence isn't sure. Models of gharar would be types of protection, for example, the buy of premiums to guarantee against something that could conceivably happen or subordinates used to fence against conceivable results. Variables, for example, expanding government spending, changes activities, a low loan cost condition, and high liquidity, are favorable for a lively Islamic obligation capital market. The legislature emphatically trusts that the job of Islamic fund is unavoidable in giving the vital assets to multilateral banks to achieve the goals of maintainable development and advancement. The Governor of SAMA, Dr. Fahd Abdullah Al-Mubarak, has proposed that the Islamic fund devices are showing the quick development in money related exchanges in every Muslim nation, the worldwide center points, and emphatically engendered the utilization of Islamic Development Bank (IDB) as a method of advancement [5].

Islamic back significantly denies the charging of intrigue, chance bearing by one gathering alone, offer of dubious things, for example, protection and the fund of business adventures, which manages the exercises depicted as unholy by the Quran Global Outlook of Islamic Finance. Islamic fund comprises approximately 1% of the worldwide money related part, and its greater part is moved in nations with a high level of Muslim populace, for example, Malaysia and the Middle Eastern nations [6]

They have profoundly developed oil and gas industry, which guarantees that Islamic fund in these countries, will get tremendous capital inflows. Saudi Arabia is the second biggest Islamic fund advertise with resources assessed at USD 338 billion. Islamic back has become quickly over the previous decade with its managing an account fragment foundationally extended in different locales, including the western nations, making Islamic fund one of the quickest developing budgetary areas on the planet, especially in the GCC

nations. The worldwide Islamic populace is anticipated to develop by 35%, by 2030, and the interest for Islamic bank administrations is set to increment Islamic Finance in Saudi Arabia [7].

Arabia has the most astounding infiltration of Islamic bank against customary fund on the planet, with 53% of its populace having presentation to Islamic bank. Islamic fund is extending these days and with its development, the new items are propelling also. In this examination, we will learn about what is the utilization of Islamic Finance and its items in KSA.

This examination intends to discover the extension of Islamic fund and its items and needs to contemplate its job in KSA. This exploration will help us in knowing how Islamic bank functions and the new items that are propelled in Islamic fund. It includes subjective strategy for research – Literature study and work of different researchers on the theme. This exploration will show weaknesses because of the varieties gathered from various sources.

METHODOLOGY

In research, strategy is the way toward gathering information and data for making determinations and reaches to a choice. The system may incorporate research papers, talks with, reviews and present and recorded data. There are two sorts of research techniques: Quantitative and Qualitative. The quantitative research technique manages settled numbers and rates. It manages factual information. While, subjective manages searching for an example by exploring writing work done by different analysts and researchers. For this examination paper, we are picking the Qualitative research strategy. We will utilize optional assets for this examination strategy. The optional sources comprise of talk, remarks, examination and assessment of other essential sources and research papers done by different specialists. They can be articles, diaries, books or magazines. In this research, we will look at different cases and studies related to Islamic finance and banking and the role of their products in KSA section.

LITERATURE REVIEW

Islamic finance is an interesting phenomenon not only in the Muslim countries but also in the other parts of the world as its present itself as an alternative to traditional financial methods. At times it has attracted non-Muslims countries as well [8] (In the middle ages Islamic finance was practiced in the Muslim countries only. Later, European businessmen and financier adopted many concepts and techniques from it. Islamic finance system is not limited to banking only; it includes financial instruments, financial markets and every type of financial intermediation [9]. Socio-economic justice in the Islamic vision is to eliminate interest and all other exploitative kinds of elements from economic sphere [10]. In Islamic community there is a debate over the use of interest in the banking system. Banks plays vital role in economic growth of a country but the question that arises is how effective is interest-based banking system for this objective. There are also some debates over if interest-based banking system is responsible for recurring variabilities. In response to interest-based system, a new system named Profit-Loss Sharing (PLS) has emerged. This banking system is currently integrated in sixty countries. Over

250 Islamic institutions are operating using this banking system. The main reason for establishing this system other than the economic debate was the desire of Muslims to reorganize their financial activities to complement the principles of Sharia (the Islamic Law) which prohibits the use of interest (rib'a). The Islamic law prohibits all types of rib'a forms. There are two rib'a forms: Rib'a al-nasi'ah and rib'a al-fadl. Based upon the value of justice, efficiency, stability and growth the Islamic community has rationalized the prohibition of interest. PLS system provides cohesion between social classes because banking instruments are available for everyone with the great idea [9]. The main aim of Islamic finance is to fulfill the teaching of Holy Quran rather than reaping profit off of financial assets. Islamic economist stressed that the financial crisis that occurs happens because of the weak existing financial systems. Finance would require high standards of due conscientiousness and active monitoring if equity mode of finance is emphasized. Following the Islamic principle can prevent from facing the financial crisis but some of the sector can get vulnerable to the same crisis [11] Widely used instruments of tawarruq can do more harm than benefits as said by Siddiqi [12]. The key points that can cause financial crisis can be divided into three levels: 1. Derestricted environment, 2. Institutions which are involved in reaping higher profits (risk taking) and 3. Using innovative complex products.

People examined the products and drifts that Islamic finance follows and operates similar trends that cause the financial crisis can be found. At the institutional level, the standards for Islamic finance are in elementary stages. They are weak and still evolving. Islamic financial industry has perceived rapid growth with innovation of complex Shari'ah compliant products. Risk in these new products are complex as they can have multiple types of risks and they can change and evolve at different stages if transaction.

As discussed, the steps that can lead to financial crisis can occur in Islamic finance as well. The following table shows that how the steps that leads the crisis of traditional financial method can occur or can be replicated in Islamic finance as well [11].

At the institutional level, Islamic finance should minimize the risk related to legal and regulatory in the industry. One of the key roles of the regulators is to minimize market failures which can lead to instability of financial system. The non-compliance of Islamic law can be the reasons which lead to reputation risk. Due to the reputation risk, Islamic finance can become instable and susceptible to instability which can create negative image of Islamic finance in the eyes of stockholders and can cause serious lack of trust on the Islamic law products [11].

Principles on which Islamic finance instruments are based are explained in the following Figure 1 taken from Saudi Arabia – Islamic finance Report from November in 2015. Islamic finance represents approximately one percent of the global finance industry. The Middle East countries along with Malaysia make the bulk of Islamic finance market.

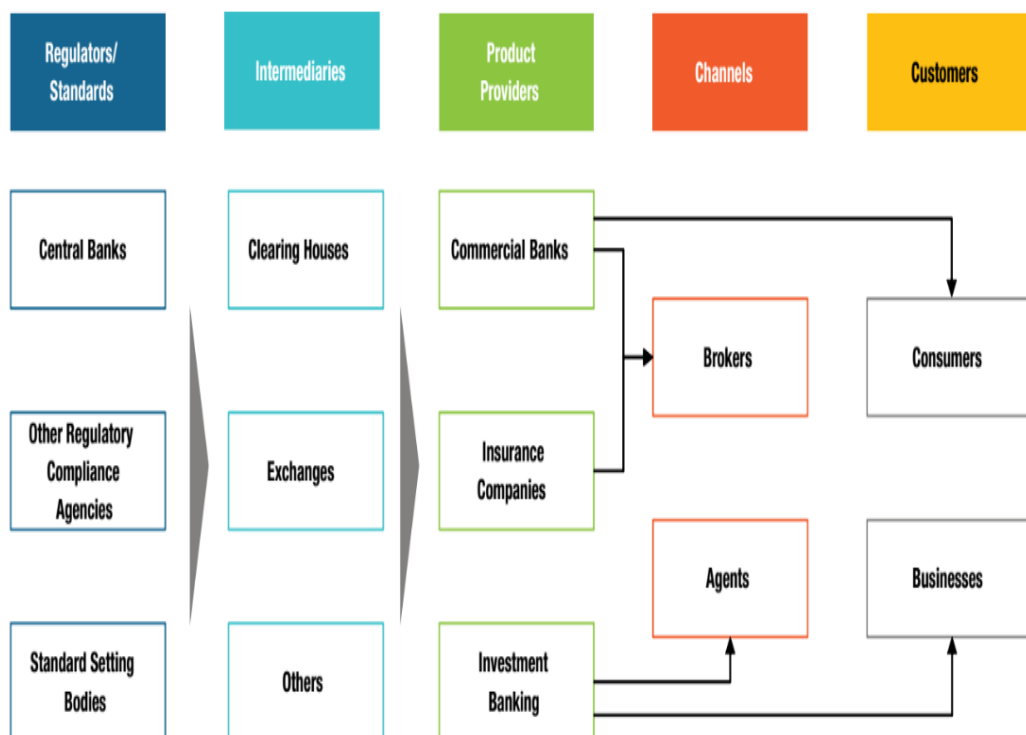


Figure 1: Stock prices from 2010 to 2015

Following chart appeared in Figure 2 was taken from the Islamic advancement report in 2014 by Thomson and Reuters. "The measure of the Islamic back market, toward the finish of 2014, is evaluated to go from USD 1.7 to 2.1 trillion and is required to ascend to USD 3.4– 3.7 trillion by 2018 at a CAGR of ~19.7%. The worldwide Islamic back industry has seen a momentous development direction in the previous decade, with aggregate resources at present evaluated at USD 2.1 trillion, triple the sum in 2005. The business' benefits are evaluated to be worth USD1.87 trillion toward the finish of the primary portion of 2014, having developed from USD 1.7 trillion toward the finish of 2013." [13].

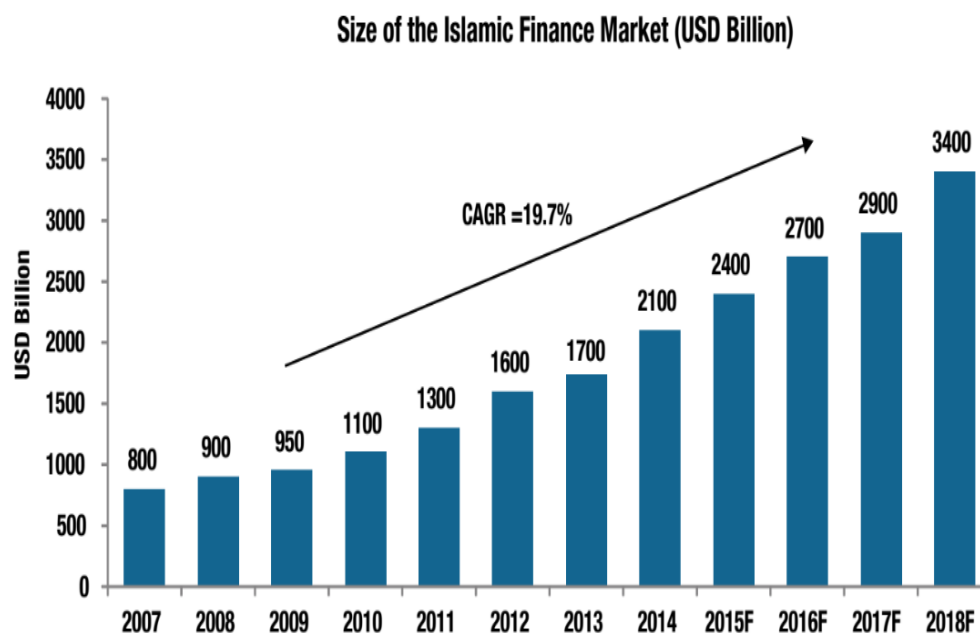


Figure 2: Development of Islamic Finance

In Case of the Kingdom of Saudi Arabia

The motivation of picking this paper starts from the capacity to show up inside the certifiable setting of the overall cash related crises, an altogether startling keeping cash system specific to Arab States. The diverse system may be the reason that the Arab States were not influenced by money related emergency as much as others. The nonattendance of interest, the longing to restrict shakiness and hypothesis, the responsibility to achieving monetary success, these are distinctive components that shape the innovativeness of Islamic banks. A portion of these elements which mirrors the transposition of existing religious Sharia standards' in the Quran and in the money related framework: Musharakah, Murabaha, Ijarah, Imam, Hasan, Qard put their blemish on the hazard and benefit. Political strength, capital market progression, the development rates of stores, resources and credits are a portion of the reasons that have prompted the attention on the Islamic managing an account framework in the Kingdom of Saudi Arabia.

The principle highlights of Islamic keeping money is the sharing of benefit and misfortune between budgetary establishments and its clients. The two gatherings need to think and accept the quantity of dangers that ought to be mulled over with the end goal to accomplish a rate of return as high as could be allowed. This quality is featured especially by techniques for religious decide that underlie the Islamic setting aside extra cash system set out in the Qur'an and Sharia.

Improbability and speculation

One of the guidelines is the opportunity from Gharar (theories) in tasks, exchanges and contracts. For any of these norms to be in concurrence with the standards of Sharia, it is crucial that the subject and their expense is chosen

before the bona fide organization of the task. Fence activities (Maysir) is denied in Islam since credit loaning and offer of Islamic items come without sparing to secure against credit chance, liquidity hazard and market chance. This highlight additionally has any kind of effect between an Islamic bank and a European.

Influence of absence of the interest risk

The most essential factor is the restriction of installment of intrigue (riba). The idea is that there is no distinction among intrigue and usury. "Allah permits exchange, however precludes usury!" (Sura 2, Verse 275, Qur'an). The explanation for this rule is the equity. The capital must expect a section of the peril related with them since he endeavored to make advantage. As indicated by Islam, the saving money system in perspective of the nearness of premium is one-sided in light of the way that one supplier has the conviction that capital will be paid at a settled rate of return, while the recipient of these advantages bears the whole danger.

Musharakah

On the off chance that you don't get enthusiasm on credits and stores got what different devices of loaning and sparing does the Islamic bank utilize? They do it by accomplishing what might as well be called joint endeavor. This is normally use for financing business new companies. The Bank transforms into an accessory of the businessmen by holding a rate of the total number of offers. Where, the association will lead business that will allow gaining advantage, out of which a bit of it, settled early with the Bank, at the complete of the assention, will be conceded to the keeping cash foundation. Some part of the advantage which looks at to the Bank may be managed by applying the rate to the gross advantage, masterminded and not the net advantage. The rate suited in the financing affirmation and associated with the result gained by the association contrasts from the extent of the capital contributed by the Bank and the association's offer capital, settling as demonstrated by the course in which the Islamic Bank will be incorporated into the task and organization of the association where it holds taking a premium premium. Another outstanding component of this financing is addressed by the manner in which that the duty to the capital raised by the Bank and the client may be profited. This is another qualification in relationship with European Union bank.

Ijarah

Another method for allowing subsidizing's to the client is Ijarah which is likeness renting in Western funds. The agreement ought to be as per the Sharia so the rate can't be increment singularly by lessor. Inside the assention an announcement is inserted which stipulates that the obligated individual, if he doesn't adjust to his duties, is required to give a total of money to a helpful store of the Bank. The indication be given is settled on the start of the whole due and the term of the deferral. Moreover, the lessor may not end the assention uniquely.

Mudarabah and Wakala

These standards speak to the inclusion of the Banks with its customers and the division of benefit and misfortunes. The most basic parts of the Musharaka is some of which are never again found in contracts that rely upon the standard of Mudarabah. In case the Bank had the idea of Musharaka purveyor of advantages inside this part Mudarabah is controlled by the customer, the individual who needs saving things, and not crediting. Under this understanding, the Bank is exhibited to less peril because of the manner in which that it has a mission to put the exchange to the customer out demand to get a rate of return as high as could be normal the situation being what it is, with the sureness that it will return and it will be some bit of the advantage. Musharaka, Mudarabah is in like manner depicted by the nearness of an agreement in perspective of a relationship between the client (rabb al-mal) and the Bank. In contrast to the Musharaka, the client does not get incorporated into the organization of Liquidity; this is only the Banks mission.

Mudarabah

Islamic bank purchases an advantage and offer it a higher cost to his customers. The distinction will be the benefit. Advantage from the setting aside extra cash association can be set up as a settled total or as a rate of the sticker price of the advantage. Additional costs caused by the Bank and furthermore those concerning transport and customs commitments may be consolidated into the esteem charged to the obliged individual. Since such a technique for financing thinks about to the benchmarks of Sharia, it is fundamental for the favorable position for be physically there at the time right when the trade occurs. Furthermore, the Bank must be the proprietor of the preferred standpoint in location when it trades it to the customer. The disadvantage for Murabahah is comprised by the manner in which that it can't be issued on the start thereof to trade securities on the helper advertise due to the manner in which that the Act set apart by the borrower would feature its commitment, so the aggregates to be paid by him to the untouchable would be in a comparative cash and would indicate a trade of money, to be released exactly at standard to meet Islamic benchmarks.

Imam

Imam is a technique for financing through which the people who don't have satisfactory advantages for convey items or create structures, are constrained to buy the rough material Products happening due to the gathering method don't should be passed on at a settled time, anyway it sets a period oblige inside which they ought to be made or, on the other hand made. Thusly, on this commence trades can be finished with items that don't yet exist.

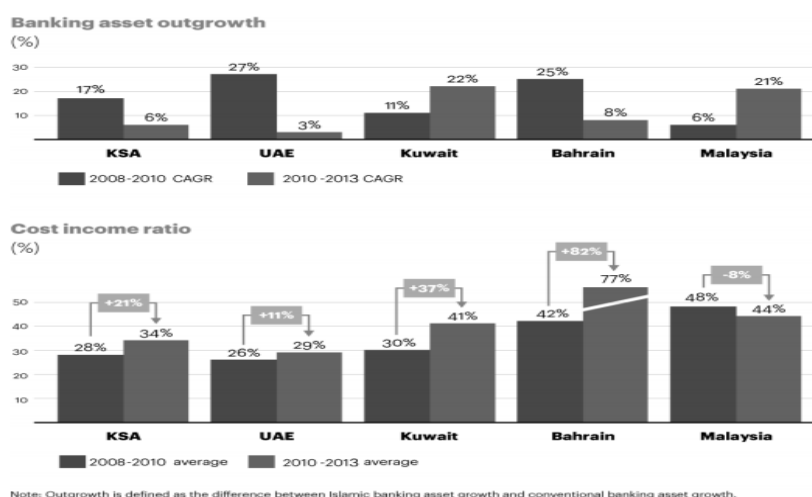
Qard al-Hasanah

This is another strategy for financing through which Islamic banks permitted propels without interest and without building up relationship with borrowers who are constrained to pay the fundamental and administrative costs related to the organization of the development, which was permitted. The people who can benefit by this kind of credit are the people who need to build houses,

furthermore, cooperatives, littler scale adventures and residences that work in the agrarian business. There is a likeness between thusly of financing what's more, that used by the Greemen Bank of Bangladesh, named the "poor man's Bank".

Islamic financing within the Kingdom of Saudi Arabia

Islamic keeping money and back (IBF) and the development related with this framework has been considered as innovator for as long as 15 years as far as worldwide monetary development. It has gathered power to wind up obviously an enormous benchmark of the money related scene in the twenty-first century, for all nations around the globe. A more escalated look, regardless, the figures prescribe that the market movement are changing, in like manner due to the endeavor to recover from the overall cash related crisis. Two key pointers should be explanation behind appearance in the Islamic managing an account industry: financial development and productivity. From the figure 3 it is obvious that the development of Islamic bank is presently backing off. It isn't halting or turning around. Before long the development can coordinate the genera advertise which proposes that Islamic banks may need to change the manner in which they have been working their tasks.



Source: www.alahli.com

Figure 3: Growth rates and profitability

In spite of the fact that the Islamic banks have by and large had a lead on development this is not substantial for benefit. Benefit is still affected by provincial monetary emergency and this has brought about declining net revenues in the course of recent years. Consequently, the Islamic saving money framework needs to begin to handle the issues of something beyond modern utilizing and the way that they have to look for more prominent proficiency over the esteem chain by not absolutely copying a customary bank's putting forth.

SAMA-Monetary Agency

The expert which is in charge of assessing an application for a saving money permit is SAMA. The Banking Control Regulation sets down principal

essentials for getting a setting aside some cash allow. SAMA has furthermore the commitment for coordinating the bank once it has been joined. The Banking Control Direction moreover sets out the managerial need of a store spare extent being kept up together with a dedication for banks to manufacture their capital and holds in the event stores outperform the prescribed whole. As required by most national banks, the Banking Control Regulation submits each bank to keep up a store with SAMA, and gives SAMA the versatility of growing or lessening such stores inside a tight band. Also, banks are blocked from connecting with any one component a development or credit office outperforming through and through 25% of the total holds and paid-up capital of the bank. What are all the more beyond any doubt diverse activities, for instance, giving credit workplaces to various banks, are blocked. Certain different activities, for instance, uniting with another bank, are blocked except if formed approval is obtained from SAMA and subject to fulfillment of the terms and conditions set around SAMA.

CONCLUSION

From financial perspective, the managing an account arrangement of KSA is exceptionally solid. Following the outcomes and diagrams exhibited we can state that religion is keeping the managing an account framework from KSA more grounded and keeps all banks facilitated. It ends up being apparent that the Saudi Arabia Banking territory under the supervision of the SAMA is on a positive upward example. Because of the cash related crisis, for no situation KSA, considered a standout amongst the most grounded economies of the world on account of their advancement rates was not capable remain immaculate by the by and large financial disturbance going on. In any case, the Saudi Banking part is clearly one system that has influenced an advantage when others to have fizzled. It has ended up being clear for the outside world that Saudi Arabian banks are starting at now working in a high viable condition; anyway, even with these phenomenal results it is moreover apparent that there is space for Saudi banks to fabricate their capability.

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