



Achieving Financial Inclusion for Muslims in India:
How Can Islamic Finance Help?



- What is financial inclusion?
 - How much of financial inclusion has India achieved?
 - Financial status of Indian Muslims
 - How can Islamic finance help India?
 - Islamic finance in other Muslim minority countries
 - Demand for Islamic finance in India
 - Status of Islamic finance in India
 - The road ahead
 - Ways to implement true Islamic finance in India:
Ideas and a Case study
 - Q&A
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What Is Financial Inclusion?

- “Financial inclusion is the process of ensuring access to appropriate financial products and services needed by vulnerable groups such as weaker sections and low-income groups at an affordable cost in a fair and transparent manner by mainstream institutional players.

K.C. Chakrabarty, Deputy Governor, RBI

- A fundamental right to receive banking services without discrimination
 - Direct correlation of financial exclusion and poverty
 - Includes payments, savings, insurance and credit
- Financial inclusion has gained importance since the early 2000s and is now a common objective for many central banks among the developing nations.

India: Financial Inclusion Statistics



- India has a third of the world's poor, 68.7% of Indians live on less than US\$ 2 per day (World bank).
 - Just 34% of people have access to formal banking services.
 - Approximately 500,000 (out of 600,000) villages have no banks.
 - 80% of Indians do not have insurance.
 - Over 40% of India's working population have no savings.
 - Huge disparities exist between different segments of the Indian society.
 - The "Top 20 rich Indians earn as much as 30 crore (300 million) people in the country" - *Former RBI Governor, Bimal Jalan*
 - For India to facilitate more balanced economic development, universal access to basic financial services is essential.
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India: Financial Inclusion Policies



- 100 million basic "no-frills" banking accounts <20% used.
 - One bank for every village with 5,000 plus people (2012).
 - Banking correspondents (BCs) for smaller villages.
 - Rural credit cards, micro-insurance and micro-pension products.
 - Strong technology focus.
 - SHG-Bank Linkage (SBL) model – National Rural Livelihoods Mission (2011).
 - Rural Development and Self Employment Training Institutes (RUDSETIs).
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Indian Muslims And Financial Inclusion



- Indian Muslims: 180 million
2nd largest Muslim population (11% global share).
 - Largest minority group (75%).
 - Sachar Committee report revealed that on many indicators Muslims are behind even the SC/ST community, especially in terms of financial inclusion.
 - 40% of Muslims are self-employed.
 - Muslim dominated areas are not adequately serviced by banks (Red Zones).
 - Muslims largely absent from the top of the pack in the list of wealth creators (BT500).
 - Motto for the 12th Five year plan: Faster, sustainable and more inclusive growth.
 - **Muslims need a specific approach to get them financially included – Islamic Finance!**
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- “It is noteworthy that the share of Muslims in the ‘amount outstanding’ is only 4.7% compared to as high a share of 6.5% for other minorities.”

Table 6.1: Priority Sector Advances extended to SRCs by Type of Bank in India and 44 Selected Minority Concentration Districts
(Average of 5 years ending 31 March 2001 to 31 March 2005)

Parameter	Public Sector Banks			Private Sector Banks		
	Muslims	Other Minorities	Others	Muslims	Other Minorities	Others
[a] All Districts in India						
No. of Accounts (% of Total)	12.2	8.1	79.7	11.3	10.5	78.2
Amount outstanding (% of Total)	4.6	6.3	89.1	6.6	7.9	85.5
Amount outstanding per Account (Rs./account)	19837	40686	59055	111634	201840	274911
% Share in Population	13.4	5.6	80.9			

- “On an average the amount outstanding per account for Muslims is about half that of other Minorities.”
- “In West Bengal, just above 29% of accounts are held by Muslims...but the share of amount outstanding is an abysmal 9.2%.”
- “Muslims avail just 4% and 0.48% credits from NABARD and SIDBI respectively.”
- Muslims credit deposit ratio is much lower than the average (47% vs. 74%) – collective loss to the community worth billions of dollars!**

- “The financial exclusion of Muslims has far-reaching implications for their socio-economic and educational upliftment.”
 - “To empower Muslims economically, it is necessary to support self-employed persons by ensuring a smooth flow of credit to them.”
 - “Steps should be introduced to specifically direct credit to Muslims.”
 - *No analysis of the real cause for the financial exclusion of Muslims.*
 - *A recommendation to further participate in the conventional banking system.*
 - *No mention of the need to introduce Islamic finance/banking.*
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Do the present Government schemes address Muslim sensitivities?

- “It will be ensured that an appropriate percentage of...lending...is targeted for the minority communities.” - PM’s 15 Point Program for Welfare of Minorities.
 - Self-employment programs have in-built bank credit components.
 - National Minorities Development & Finance Corporation (NMDFC):
 - Main function is to promote income generation among minorities.
 - Interest-based loans provided.
 - Outlay and disbursement is small.
 - Needs to be restructured to provide Islamic finance.
 - NABARD’s and SIDBI’s schemes are also interest based.
 - Ex: NABARD’s Dairy Entrepreneurship Development Scheme: 40% bank loan component.
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“Another area that falls broadly in the ambit of financial infrastructure for inclusion is the provision of interest-free banking. **Certain faiths** prohibit the use of financial instruments that pay **interest**. The non-availability of interest-free banking products (where the return to the investor is tied to the bearing of risk, in accordance with the principles of that faith) results in some Indians, including those in the economically disadvantaged strata of society, not being able to access banking products and services due to **reasons of faith**. This non-availability also denies India access to substantial sources of savings from other countries in the region.”

“While interest-free banking is provided in a limited manner through NBFCs and cooperatives, the Committee recommends that measures be taken to permit the delivery of interest-free finance on a larger scale, including through the banking system. This is in consonance with the **objectives of inclusion** and growth through innovation. The Committee believes that it would be possible, through appropriate measures, to create a framework for such products without any adverse systemic risk impact.”
(Chapter 3: Broadening Access to Finance, page 35)

Dr. Raghuram Rajan (Report submitted to the PM of India on Sept. 2008)

Why India Needs Islamic Finance?



“To have true financial inclusion in India and meet the goals set out by the government, it is imperative that the Indian Muslim community...be considered from their actual needs and aspirations perspective...a growing number of Muslims will increasingly exclude themselves from the conventional banking and financial system due to their religious sensitivities and not because of poverty or illiteracy thus further marginalizing their already backward status...Thus it is imperative that Islamic finance be introduced in the country and Muslims be allowed to conduct financial activities as per their preferences...”

Saif Ahmed at 29th Skoch Summit on Financial Inclusion, Mumbai 2012

- The religious dimension and Muslim perspective to financial inclusion is lacking in the present discourse from all stakeholders: politicians, bankers, bureaucrats, press, etc.
 - Without financial inclusion of Indian Muslims, their economic development is not possible, and it will also not be possible for India to achieve true, inclusive growth.
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Why India Needs Islamic Finance?



“.. in India it will mean the inclusion of a disadvantaged minority. Lot has been said today about how the minorities, the Muslims particularly, are not even participating in the banking process. I started by saying they have left out of this whole banking and therefore you will be able to, through these means, include them in this banking process and then gain from the quantum of potential investment of minority. The economic as a whole will gain. Those thousands of crores which are lying without investment they will be invested. Where will they be invested? They will be invested in India’s economy.”

“Islamic banking focuses on transparency, cooperative ventures, shared risk and ethical investing which attracts a wide range of both Muslims and non-Muslims alike. Can you afford to ignore it is a question for our country – not only for Muslims.”

“If poverty persists, the poorer, including sections of minorities, could become a national economic liability. Instead of actually participating and contributing to the development process, they will start acting as a retardation of the development process.”

Wajahat Habibullah, Chairman, National Commission for Minorities (NCM)

How Will Islamic Finance Help India?



- “Islamic banking may be the solution to the farmers’ suicide crisis.”

Dr. M.S. Swaminathan, father of the Green Revolution

- “Ethical investment goes on to develop the society. It can help in promoting the interests of the underprivileged people in the community.”

Former SEBI Deputy Chairman D.R. Mehta

- “The assets controlled by (Indian) Muslims are estimated to be \$1.5 trillion ... Research reveals that a handsome bulk of money...is lying idle, which if invested in profit sharing basis and utilized properly, can have a major impact on the Indian economy...Islamic Banking may not be a substitute to the conventional banking in India but having it side by side with the conventional banking may at least give an option to the borrowers to choose...”

RBI paper (ref. Bindu Vasu - Legal Officer, 2005)

- “India has the potential of emerging a significant market for Islamic Banking provided there is a favorable change in the regulatory environment and increased awareness among Muslims and India as a whole.”

Grail Research (2008)

How Will Islamic Finance Help India?



- Islamic finance is not just interest-free: it is for-profit, sustainable and scalable.
 - Islamic finance will provide for more competition: Better pricing and more choices to the end user.
 - Ethical investments: universal acceptance – precludes harmful sectors.
 - Emphasis on real assets – will curb inflation, speculation, credit bubbles...
 - Equitable distribution of wealth:
 - Risk sharing prevents a one sided relationship
 - Better returns for all parties (win-win)
 - Livelihood financing possible through Islamic microfinance.
 - Islamic finance will enable broad-based venture capital: entrepreneurs, run of the mill enterprises, SMEs – thereby boosting entrepreneurship.
 - Islamic insurance (Takaful) can make insurance affordable to the poor.
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Why Not India? The Last Frontier



- Islamic finance is now the largest alternative financial system in the world today growing at double digit rates, surviving through the crisis.
 - Growing list of Muslim minority countries who have embraced Islamic finance:
 - UK
 - USA & Canada
 - France
 - Ireland
 - Luxembourg
 - Australia
 - Hong Kong/ China
 - Singapore
 - Sri Lanka
 - South Africa
 - Kenya & Tanzania
 - Thailand
 - Majority of MNC banks and legal firms operate Islamic finance subsidiaries.
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- "I want to turn Singapore into a center for Islamic financial services"

Goh Chok Tong, Former PM of Singapore

- "The development of Islamic finance in South Africa is critical ... to position South Africa as a gateway into Africa."

Pravin Gordhan, Finance Minister of South Africa

- "What is more, Islamic banking is not just for Muslims. Nor is it in any way arcane or esoteric. At its core, it is banking that follows a stringent set of principles, aims to be socially and ethically responsible, and embraces high transparency and shared risk."

*"Islamic Banking: Can You Afford to Ignore It?" (2008)
Boston Consulting Group*

Growing Awareness And The Need...



- The real reason for the financial exclusion of Indian Muslims:
 - It is not discrimination (though this is a factor!)
 - The new generation:
 - Growing awareness of their religious beliefs/identity
 - Want to live according to principles of their faith including all financial transactions and business dealings – which should be *halal*
 - Proof: 2.2% Muslims in overall bank employment (Sachar Comm.).
 - Billions of dollars are lying unproductive in current accounts or under pillows.
 - Islamic finance will bring the community out of the ghetto/victim mindset.
 - Muslims want to be part of the India story – to contribute and build businesses, invest productively, buy assets – this needs finance – Islamic finance!
 - What Indian Muslims need are not subsidies or reservations but Islamic finance.
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- Islamic finance timeline well documented as per Outlook Magazine (2010):

BANKING: SHARIAH RULES

Interested Parties

Islamic banking has some pluses. But with our secular banking rules....

PRAGYA SINGH

Creeping Timeline: No Progress

- 2010 An interim order on a PIL filed in the Kerala High Court has resulted in the state government having to step out of a partnership with an Islamic NBFC.
 - 2009 SEBI allows India's first Shariah-tolerant mutual fund scheme. First VC fund also allowed.
 - 2009 UPA government clarifies that there are no plans to introduce Islamic banking in India.
 - 2008 Raghuram Ramrajan committee recommends interest-free banking to encourage financial inclusion.
 - 2008 Bids called to reconstruct National Minorities Devpt Fin Corp on Shariah lines.
 - 2005 RBI sets up committee to study Islamic banking products, says laws will have to be changed by Parliament.
- 2011: Kerala High Court verdict stating that constitutionally there is no issue in introducing Islamic banking, nor does it violate secularism.
 - 2012: Ministry of Finance has asked the RBI to take a fresh look at introducing interest-free banking on advice of the National Commission for Minorities (NCM).

- The present status of Islamic finance institutions in India is far from satisfactory:
 - Littered with failures: mismanagement and fraud.
 - Cooperative & NGO models - not scalable.
 - Reliance on service fees – Shariah compliance issues.
 - Disconnect with scholars.
 - Unregistered and unregulated.
 - Lack of investment avenues.
 - Lack of human capital.
 - Lack of innovation and transparency.
 - Excessive focus on the capital markets impacting just 1% of population.
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The challenges ahead:

- Awareness.
 - Dedicated pool of Islamic finance-focused Shariah scholars.
 - Human capital (bankers, lawyers, accountants, commerce graduates...).
 - R&D plus innovation.
 - Regulatory support.
 - Changes in regulations are required to introduce Islamic banking/ finance fully.
 - However, many Islamic finance concepts can be introduced by being innovative right NOW!
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- Indian microfinance sector crisis of 2010.
 - Noble ideals consumed by an ugly greed for profits – why is this wrong?
 - Is it really empowerment of the poor to charge upwards of 30% in interest?
 - RBI's *Malegam Committee Report* (2011) recommends capping interest rates and 75% ceiling for income generating loans.
 - India offers a great opportunity to practice Islamic microfinance using PLS modes.
 - Interests of both parties are aligned, no debt trap, poverty alleviation.
 - Technology now available to mitigate adverse selection and agency problems.
 - “Credit provision, without adequate measures to create livelihood opportunities...among the poor will not yield desired results.” – *Raghuram Rajan Committee Report*.
 - India's Dairy cooperative model and *Mudarabah* model.
 - Contract farming and *Bai Salam* (Advance Purchase) model.
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- Obligatory charity (Zakah): Every Muslim whose wealth exceeds 87.48 gm of Gold / 612.36 gm of Silver must pay 2.5% of their wealth per year.
 - Globally Zakah is underutilized by Muslims as a poverty alleviation tool.
 - No national level umbrella organization, arbitrary, credibility issues.
 - Proper utilization of Zakah funds can make the community to stand on its feet.
 - "One would rather take a rope and cut wood and carry it than ask others."
Hadith, Sahih Al-Bukhari, 3:289
 - "Give a man a fish and you have fed him for a day. Teach a man to fish and you have fed him for a lifetime."
 - Muslims dependence on self-employment implies a need for continuous skill development – Zakah funds can be utilized – PM's 15 point program.
 - Will allow Muslims to benefit from various employment opportunities that are now available in the manufacturing and service sectors – financial inclusion.
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- Chit Funds are the Indian version of Rotating Savings and Credit Associations (ROSCAs) that are famous throughout the world (80 plus countries).
- A ROSCA is defined as “a voluntary grouping of individuals who agree to contribute financially at each of a set of uniformly-spaced dates towards the creation of a fund, which will then be allotted in accordance with some prearranged principle to each member (only once) of the group in turn.” – Calomiris and Rajaraman, 1998.
- ROSCAs are a means to “save and borrow” simultaneously – credit and savings.
- Valued for their ability to convert savings in to a lump sum amount and flourish in areas where formal financial institutions do not meet the needs of the public.



- In a survey conducted by the Indian School of Business, it was found that “while most households (72 percent) rank the savings aspects of Chit Funds most highly they also value the flexible provision of credit and the ability to save for a particular target event, for example marriage, education etc.”
- India is one of the few countries, where ROSCAs are institutionalized and regulated.
- Zayd Chit Funds Pvt. Ltd. is India’s first registered and operating Shariah-compliant chit fund developed through a rigorous R&D effort and in consultation with scholars.

For An Introduction...



- Watch Ethica's video "Why Islamic Finance?" at www.EthicaInstitute.com

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