

# THE STATE AND PROSPECTS OF DEVELOPMENT OF THE MARKET OF ISLAMIC INVESTMENTS

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## ABSTRACT

*Banking and finances based on ethical standards of Muslims are now an integral part of international financial market. Vitality and stability of financial institutions in crisis period arose more and more interest to the in Russia and abroad. In article is presented analysis of condition and effectiveness of use of Islamic investment instrument, are detected major tendencies of this branch development. It was determined that financial instruments that correspond Islam principle have a big potential for development even in period of economic crises. But absence of special regulation slows process of their development.*

*According to standards of Islamic ethic, righteous is only that wealth that is a fruit of own labor and entrepreneurial efforts, and also the one that is received as heritage or as a gift. Therefore, profit is considered as award for a risk associated with any business enterprise. Religious standards and taboos that are mandatory for conduction and adherence for every one Muslims, became a reason for genesis of Islamic investment funds (Bekkin R., 2015, p. 141). Increase of Islamic population size in developed countries promoted expansion of Islamic financial institutes; and, respectively, increased interest of investors from Islamic countries in geographical diversification of investments portfolios; increase of demands for socially responsible investment anticipating ranging of companies from point of view of their attentiveness to issues of environmental protection, improvement of labor conditions etc.*

**Keywords:** *marketing, investment fund, ethical finances, Islamic banking.*

## INTRODUCTION

Recently interest for Islamic banking and Islamic security papers, same as to alternate forms of banking activity and financial instruments is increasing. Authors of article, after studying of Islamic banking and finances condition, agreed upon opinion that today they can be considered as alternative in Russia too, but at this they are sufficiently perspective and actively developing. A range of Russian banks is interested in experience of applying of Islamic instruments for a long time. However, as noted by experts, in accordance to a current legislation it is impossible to create a bank or "Islamic window" operating in correspondence to principles of interest-free financing. In order to overcome existing situation, Association of regional banks in 2011 had proposed to write into Strategy of development of banking sector of Russian Federation for period till 2015 a clarification in part of creation and development of alternative (Islamic) finances (in article 10, paragraph 3.5). However, these propositions were not taken into account in Strategy. Similar destiny also befell an attempt of group of scientists from Financial university affiliated to the Government of RF to enter for consideration into State Duma of RF a legislative proposal "On financial organization - partner". Developers used experience of Turkey where term "partner banks" is used for interest-free banks operating in accordance to principles of division of profits and losses.

According to opinion of scientists, acceptance of law would promote formation of law field for progressive development of alternate finances.

## MATERIALS AND METHODS

As theoretical and methodological basis for this research served separate conceptions and assumptions of micro- and macroeconomics, finances, economic analysis, mathematic modeling, dedicated to theory of investments, theory of management etc. There were considered conceptions and assumptions of domestic and foreign authors, represented in modern economic literature, dedicated to principles of investment by Shariah laws (Zakirova O.M., Bulankina E.V., Popova E.A., 2007., p.125).

Setting and proving of work assumptions were performed on basis of system analysis with applying on complex of general scientific and mathematic methods, providing authenticity and reliability of received results.

## RESULTS

Investment fund is an institution that perform collective investments. Its essence is in accumulation of savings of private and legal entities for cooperative (including portfolio) investment through purchase of security papers instead of real industrial assets (Chizhik V.P., 2015, p. 21). As purchase of security papers is conducted by a professional market participant, risks of private investors are substantially reduces.

According to Koran all material earth values and goods are property of Allah who entrusts them to Muslims in a kind of beneficial ownership. Faithful Muslims should use the gift of Allah exclusively for productive purposes and for the good of all society. Therefore, to use services of common investment funds does not seem possible for Muslims. Islamic investment fund implies a general cash-box (general fund) where investors put their surplus funds in order to earn halal profit in strict correspondence to Shariah principles. These are independent investment companies in which participants have equal rights for ownership of company assets shares, its profits and losses.

There are different categories of Islamic investment funds: funds of joint stocks, funds of real estate and property, commodity funds, Ijara funds, Murabaha funds and also commingles funds.

The main peculiarity if Islamic finance system is denial of borrowing rate of interest. That's why the award of capital owner should not take form of preliminary set and guaranteed payment, independent of earning power of enterprise. Strict prohibition of usury excludes market of bonds and fixed deposits for Islamic investors (exclusion - bonds, where earning power is ties to profitability of business), and prohibition for pork consuming force them to be selective at determination if investment object among meat-processing companies. Koran do not allow to invest money in production and sale of alcohol, in sphere of unethical entertainment: casino, gambling, "adult" movie industry, yellow press. Under prohibition are banks and even insurance companies, because in traditional insurance there are three elements denied by Islam at once: riba (usury), meisir (hazard) and gharar (risk, uncertainty). Typically are excluded tobacco companies and manufacturers of military production, although by Islamic laws they are not a strictly prohibited objects of investment (Bekkin R., 2014, p.148).

For complicated cases, when corporation is involved in several types of activity, there is a "rule of 5%". If enterprise earns less than 5% of its profit from issuing of production prohibited by Islam, then mullah who is included in directors board of every Islamic fund, will likely permit to buy its stocks.

There is more than one trillion USD under management of Islamic funds (Islamic business and finance, accessed on 11.5.2016). Peculiarity of Islam is the absence of unified police on majority of issues. Decision of every problem is assigned to specific mullah. Cases are known when Islamic advisors forbade deals with airline companies on the ground that one of targets of their activity is selling of alcohol on board, although it was only 3.5% of total amount of sales. Sometimes happens that mullahs ban purchase of papers of a well-known socially responsible corporation just on that ground that at current moment in has too much free cash that can be used for purchasing of instruments with fixed profitability. By most often Islamic finds are capable to find compromise between economic logic and fidelity to religious dogmas.

Prohibition of investments into stocks of companies connected to alcohol, gambling, unethical entertainment, unites Islamic funds with so-called socially responsible funds. But social funds can allow them self purchase of instruments with a fixed profit and bank products, while for Islamic funds investments with guaranteed interest, like bonds of deposit certificates, are not acceptable.

Purchase of bonds is prohibited because they are a loan instrument. But this does not prevent Muslims to own stocks of companies. Stocks of such companies can become an object of investment, but at one condition - sizes of such borrowings cannot exceed a certain threshold. It is approximately 30% of average annual capitalization of company. This threshold should not be exceeded by debts of partners to this company. I.e. in balance of company should not prevail neither bills payable, nor bills receivable.

For selection of "halal" companies stocks in global economics there are so called Islamic indexes (DJI100X, accessed on 11.5.2016). So, index S&P BRIC Shariah Index includes stocks of the largest and most liquid companies of Brasilia, Russia, India and China that are corresponding to Shariah standards and traded on stock exchanges of developed markets. List includes 58 companies, fifteen of them are Russian corporations presented at international share markets. Among them are concerns "Gazprom", "Surgutneftegaz", RAS "UES of Russia, "LUKOIL" and "Tatneft".

Islamic doctrine recommends involving of money funds on basis of principle of share financing, i.e. depositor or investor earns a right to share profit and losses on business enterprise. In business practice of Islam both sides share e risk between them. A peculiar feature if Islamic investment is obligatoriness of charity deductibles. As soon as Islamite, in financial aspect, reaches a "nisab" condition - a kind of break-even point, when all his major expenses can be laid for - certain percent of remaining money goes to charity deductibles or "zakyat". Islam welcomes a long-term investments. But a paper profit formed by portfolio (increase of its market cost) can stay unrealized for years. Islamic lawyers came to a conclusion that for acceleration of zakyat payment is allowable to calculate difference between market value of portfolio for beginning and end of every year by Gregorian calendar and pay as zakyat 10,3% (10% by lunar calendar) of this difference is it is positive.

At present time in the world are developed two models of Islamic finances: "conservative" - oriented at strict following of Shariah requirements (Saudi Arabia, Bahrain etc.) and "light" that is limiting by use of external, formal signs of Islamic finances (Malaysia, Great Britain etc.).

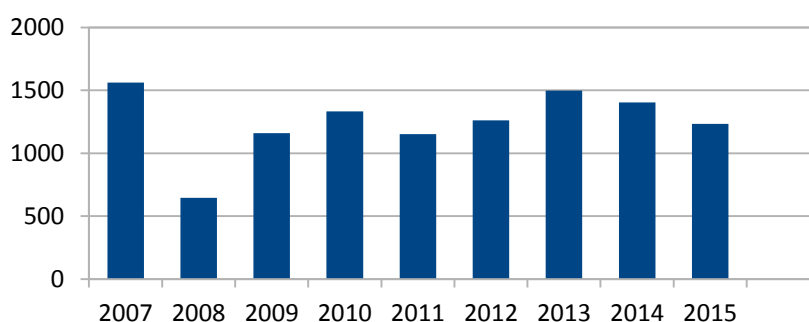
Bank financing of companies is conducted by participation in project or provision of interest free credit in form of material help or short-term subsidy. And consumer loans are provided by "murabaha" method, when bank purchase a merchandise and sell it to customer on installment plan, earning on difference in prices, It must be said that even in case of overdue payment, bank is not capable to charge extra interest. Instead of consumer loaning, learned interpreters of Koran came to idea of using leasing and rent. Automobile lending is drawn not as a sale, nut as leasing of automobile: respectively, interest became a payment for

usage of car. Purchase of apartment by expense of mortgage is drawn as renting. Profitability by bank deposits is tied to earnings of a bank, protecting investors from accident receiving of injustice profit.

The largest global banks IAG, ABN, Amro, Citibank, Chase Manhattan and JPMorgan are opening "Islamic windows", Islamic sub-divisions, pension and hedge-funds, striving to involve funds of growing Islamic population of Europe, USA and other countries (Yakupov L., Shlyahin D., accessed on 11.5.2016).

At present time Islamic banking system is considered throughout the world as perspective. In fig. 1 is presented the dynamics of values of index S&P BRIC SHARIAH INDEX. This index include stocks of largest and most liquid companies of Brasilia, Russia, India and China that correspond Shariah standards and are trading on stock exchanges of developed markets - at Hong Kong Stock Exchange, London Stock Exchange, NASDAQ and NYSE. Index demonstrates stability of quote and weak liability to economic crises.

**Figure 1**  
**DYNAMICS OF INDEX S&P BRIC SHARIAH INDEX**



Definitely, to invest in accordance to oneself spiritual values is not always super-profitable. Nonetheless, every year in the world grows the number of religious funds, then excess profitability is not the most important thing for investor.

**Table 1**  
**S&P BENCHMARK SHARIAH INDEXES (S&P Dow Jones Indices, 2015)**

| Index Name                | Index Change |        |        |        |
|---------------------------|--------------|--------|--------|--------|
|                           | Stock Count  | 1-Year | 3-Year | 5-Year |
| S&P Global BMI Shariah    | 4.201        | -1.7%  | 7.5%   | 5.3%   |
| S&P Global BMI            | 11,803       | -3.9%  | 5.9%   | 4.0%   |
| S&P Developed BMI Shariah | 3.154        | -1.0%  | 8.4%   | 6.3%   |
| S&P Developed BMI         | 8.647        | -2.6%  | 7.5%   | 5.4%   |

In 2015 all indexes of considered group demonstrated decrease connected to worsening of political and economic indexes. Reduce of oil prices seriously impacted many classes of assets in region. However, Islamic indexes in mid-term and long-term dynamics show more growth than traditional indexes, which is the evidence of their investment attractiveness.

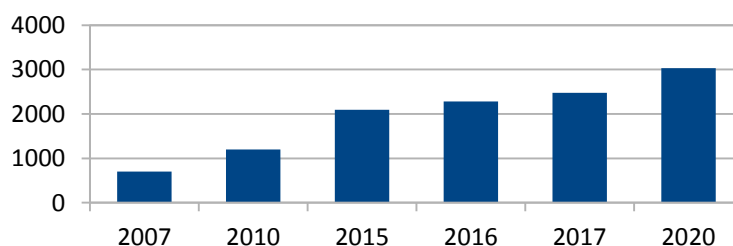
Let's consider major economic indexes of effectiveness of Islamic finance market. In result of conducted research we detected the following positive moments of development. In 2014 total assets of Islamic commercial banks in the world increased up to nearly 1 trillion

800 billion USD. Total assets of Islamic economics - mostly these are countries of Arabian league, and also Turkey and Iran - exceeded nearly 2.5 trillion USD. Annual increments of assets of Islamic banking is approximately 17-18%, this is more than increments of the global banking system approximately 10-fold.

Capital profitability of first twenty of Islamic banks is 12.5%, of traditional banks - 15%. Interesting that as soon as Islamic banking started to develop, such large financial institutes as JPMorgan, City, HSBS Bank (PP), Barclays Plc., Lloyds bank, Bank of America, Dutch Bank started to Islamic subsidiary structures only in order to use those free funds that were directed from countries of Persian Gulf. Islamic financing was chosen by these large finance institutes due to stability of system itself, and also economical and political stability of Islamic centers, such as London, Malaysia, Dubai. Market of Islamic financing annually grows for 15-20% average.

By forecasts of experts in 2018 is anticipated increase of profitability of owner capital us Islamic banks up to 15%, and general growth of assets - up to 15-16%. I.e., assets of Islamic financing annually increase for 15-16%, rate of growth substantially exceed similar index in traditional global system. Today 40% of Islamic banking assets belong to Islamic banks of Iran, 16% - KSA, 8% - Malaysia, 5% - UAE and 2% - Turkey (Institute of forecasting and settlement of political conflicts, accessed on 18.1.2016).

**Figure 2**  
**FORECAST OF DYNAMIC OF ISLAMIC FINANCES IN THE WORLD, MIL. USD**



### RESUME

Products of Islamic banking and finances arose interest not only of scientists, but of practicing too. One thinks that Islamic principles of financing in Russia have a good perspective as a source of financing of innovation projects, because direct investments are one of basic forms of Islamic financing. Others note a need in Islamic banking products, first of all, from small and medium business. Experts from Russia center is Islamic economic and finances estimate potential demand for Islamic financial services as approximately 60 billion RUB. The majority of experts note that real substantial demand for products of Islamic banking and finances is still not formed in Russia. Similar conclusions are made about ethical finances in general too, including funds of all types and so called "green" bank. Formation of demand will take time. Nevertheless, with taking into account foreign experience, it can be said that expansion of ethical finances in Russia, emerging of alternative ethical and "green" banks is a perspective of nearest years.

## CONCLUSION

Using of experience of Islamic banking, oriented to development of real sector of economic, would be useful both Russian bank and non-bank structures. First of all, this would give an opportunity to attract investments from countries of Near East and to use investment potential of Islamic population of our country more completely.

What is preventing the development of Islamic banking in Russia? The answer is simple - the major reason is in weak development of legislation basis on issues of Islamic finances. At development of law environment should not be forgotten about creation and development of international financial center, infrastructure for investors (Ziyazetdinov A.P., Rudaleva I.A., 2016, accessed on 11.5.2016). It is necessary to make correspondent amendments into legislation related to functioning of Islamic financial institutions, peculiarities of estimation of their assets, taxation, drawing of statements (legislatively approve systems of zakyat, realize Islamic laws on property and heritage, introduce appropriate land reforms with limitation of existing estates size and normalizing hiring system, create institute fir regulation of state and private monopolies and business corporations, accept necessary laws and create institutes on environment protection, implement statement system (al-hishah) and law basis for consumer interests protection, accept a corresponding monetary and fiscal policy for stabilization of prices, cancel interest on all types of financial operations). In order to control activity of Islamic companies should be created national external Shariah board that will monitor activity of subordinate organizations.

Without waiting for legislation to change, in some regions of Russia separate bank are implementing in practice Islamic instruments that can be applied in frames of current legislation. For example, branch of OJSV CB "Ellipse bank" - bank "Vostok-Capital" in Ufa propose financing of purchasing of permanent assets by "ijara" mechanism - analogue of leasing operation. In Dagestan are issued interest-free debit cards. In Tatarstan is acting investment company "Umart-finance" that specializes on provision of finance services corresponding to Islamic law. It proposes direct investments, leasing services and investment deposits. In Moscow is opened investment company LLC "UIFC "Ash-Shams Capital" that proposes to invest funds in accordance of Shariah standards and specializes on management of collective investments. First ethical fund in Russia - Islamic ethical fund "Halal" - was registered in 2007 (Batayeva B.C., 2013, p.270). Fund is not large, composition of its portfolio comprises stocks of Russian companies traded on united stock exchange MICEX-RTS. Functions of Shariah board of this fund are conducted by LLC "Zam-Zam+" from Kazan specializing on Islamic economic consulting services.

## CONFLICT OF INTERESTS

Authors confirm that above provided data do not contain conflict of interests.

## ACKNOWLEDGEMENTS

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## END NOTE

1. Composed by materials <http://us.spindices.com/indices/equity/sp-bric-shariah-index>
2. By materials of leading advisory companies estimations.

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