

**Czech University of Life Sciences Prague**

**Faculty of Economics and Management**

**Department of Economics**



**Bachelor Thesis**

**Islamic banking**

**Dana Kudaibergen**

**Supervisor**

**Ing. Petr Procházka, MSc, Ph.D.**

# CZECH UNIVERSITY OF LIFE SCIENCES PRAGUE

Faculty of Economics and Management

## BACHELOR THESIS ASSIGNMENT

Dana Kudaibergen

Business Administration

Thesis title

**Islamic banking**

---

### Objectives of thesis

The main purpose of this thesis is to compare Islamic banking and traditional banking and show the differences between them.

Evaluate and compare financial performances of examples of islamic banks and traditional banks.

### Methodology

Literature review will be done using survey methods, methods of induction, deduction, extraction and compilation. Data will be obtained using methods of data collection. Finally, practical part will be done using methods of both quantitative and qualitative research including selected methods of financial analysis of banking.

**The proposed extent of the thesis**

40 pages

**Keywords**

Islamic banking, banking, deposits, credit, credit rating

---

**Recommended information sources**

Allman, B. (2006). Banking. Minneapolis, MN: Lerner Publications Co.

"Introduction to Islamic Banking and Finance" Brian Kettell, "Islamic Finance: Law, Economics, and Practice" by Mahmoud A. El-Gamal, "Islamic Banking and Finance: An Integrative Approach" Hasan Zubair, "ISLAMIC FINANCE BANKING SYSTEM" Sudin Haron

Mishkin, F. (1998). The economics of money, banking, and financial markets. Reading, Mass.: Addison-Wesley.

---

**Expected date of thesis defence**

2015/16 SS – FEM

**The Bachelor Thesis Supervisor**

Ing. Petr Procházka, Ph.D., MSc

**Supervising department**

Department of Economics

Electronic approval: 3. 3. 2016

**prof. Ing. Miroslav Svatoš, CSc.**

Head of department

Electronic approval: 3. 3. 2016

**Ing. Martin Pelikán, Ph.D.**

Dean

Prague on 10. 03. 2016

### **Declaration**

I declare that I have worked on my diploma thesis titled "Islamic banking" by myself and I have used only the sources mentioned at the end of the thesis. As the author of the diploma thesis, I declare that the thesis does not break copyrights of any their person.

In Prague 10.03.2016

---

## **Acknowledgement**

I would like to thank my parents, who gave me the chance to study here and my supervisor Petr Prochazka for their advice and support during my work on this thesis.

# Islámské bankovníctví

## Souhrn

Tato práce je zaměřena na podrobný výzkum islámského bankovníctví modelu a diskusi o charakteristické rysy islámského bankovníctví od konvenčních bankovníctví.

První část práce je věnována vzniku takového jevu na scéně globálního finančního systému, jako bezúročnou bankovního systému a a analýzu role islámského bankovníctví v globálním finančním systému. V rámci tohoto projektu, termín "Islámské hospodářství" se vztahuje k vědě ekonomiky, způsoby provádění to lidé, vztahy mezi lidmi v procesu výroby a směny zboží, zákonitostí proudění ekonomických procesů v souladu s pravidly Islámu. "Pod pojmem "Islámské hospodářství" označuje standardní ekonomický systém, odlišný pouze tím, že příslušná nauka přičítá k její morální kód podle potřeby k vyvážení faktor systému... Tento zvláštní rys tohoto modelu neruší základní zákony, které platí stejným způsobem v Islámské hospodářství, stejně jako v kterékoliv jiné".

V praktické části byl postaven model sukuk-al-ijara pro ruské organizace. Zde uvidíte, že založený na důvěře besprosentní bankovníctví mnohem jednodušší a ne mnohem dražší, než je společnost vnímá.

**Klíčová slova:** Islámské bankovníctví, mudaraba, sukuk, finance, bezúročné půjčky, podíly na zisku, ztráta, gharar.

# Islamic banking

## Summary

The thesis concentrates on detailed research of Islamic banking model and discussing distinguishing features of Islamic banking from Conventional banking.

The first part of the thesis is devoted to the appearance of such phenomena, on the global finance system stage, as interest-free banking system, and the analysis of the role of Islamic banking in the global financial system. In this project, the term "Islamic economics" refers to the science of the economy, ways of conducting it by people, relationships between people in the process of production and exchange of goods, regularities flow of economic processes in accordance with the rules of Islam. "Under the term "Islamic economics" refers the standard economic system, different only by the fact that the relevant doctrine imputes to her moral code as needed to balance the system factor .... This particular feature of this model does not abolish the basic laws that apply in the same way as in any other".

In practical part was constructed the sukuk-al-ijara<sup>1</sup> model for Russian organisation. Here you will understand that faith-based riba-free banking and finance is much simpler and is not more expensive than it is perceived by public.

**Keywords:** Islamic banking, mudaraba, sukuk, finance, credit, interest-free, profit-loss sharing, gharar.

---

<sup>1</sup> Islamic bond loan

# Table of contents

<b>1</b>	<b>Introduction.....</b>	<b>10</b>
<b>2</b>	<b>Objectives and Methodology.....</b>	<b>11</b>
2.1	Objectives.....	11
2.2	Methodology.....	11
<b>3</b>	<b>Features of Islamic economy and banking system.....</b>	<b>12</b>
3.1	Analysis of the impact of interest on loans to the economic welfare.....	12
3.2	Establishment of the Islamic system of credit institutions.....	14
3.3	Religious principles and legal framework of Islamic banking.....	16
3.4	Profit and loss sharing mechanism of Islamic banking.....	16
3.5	Research of Islamic economic model.....	17
3.5.1	Primary distinguishing features of Islamic economic model from Traditional economic model.....	17
3.5.2	Basic tools and the organization of the Islamic banking system as a method of formation of Islamic finance.....	20
3.6	Islamic banks in the modern global financial system.....	24
3.6.1	The place and role of Islamic banks in the global financial system.....	24
3.6.2	Prospects for development of Islamic banks.....	25
<b>4</b>	<b>Construction of the Islamic bond lend for Russian company.....</b>	<b>30</b>
4.1	Construction of the bond lend on the basis of the product – sukuk-al-ijara.....	31
4.1.1	Feasibility study of the realization of borrowing.....	31
4.1.2	Sukuk-al-ijara.....	32
4.1.3	Loan options of sukuk-al-ijara.....	34



4.2	Assessment of the effectiveness of the products.....	34
4.2.1	Assessment of the issuer’s effectiveness .....	35
<b>5</b>	<b>Conclusion.....</b>	<b>47</b>
<b>6</b>	<b>References .....</b>	<b>50</b>
<b>7</b>	<b>Appendix.....</b>	<b>51</b>

### **List of tables**

Cash flow report.....	36
Profit and loss account.....	38
Table 3.....	39
Cash flow statement.....	40
Profit and loss statement.....	42
Cash flow for the sukuk-al-ijara investors.....	45

# 1 Introduction

Global financial and economic crisis in 2008 that hit the society, showed how unstable the present economic system. There is no secret already that such phenomenon was born in the banking sector and in the sphere of credit.

Interest in the Islamic banking system, is caused largely by the fact that the current global financial system, which is based on the theory and practice of Western economists, is increasingly faltering and generates global crises. Until recent time, the theory of the Islamic economic model attracted only scientific interest in the Western world among a narrow circle of scientists. Nowadays, however, the Islamic economic model, its structure, and mechanisms are relevant, since only in Islamic countries are now seeing growth of GNP and economic upswing.

Actuality of Islamic economy in general and the banking system in particular gathers pace, current financial situation in the world makes a growing number of economists and politicians to think about necessity to find new principles and tools. Moreover, in some Western countries such as the United States of America and Great Britain, Islamic banks got wider expansion.

The attention of many experts had drawn methods of banking in countries where the official religion is Islam. According to the norms of Islam to give and to take any percentage is strictly prohibited, but Islamic banking exists and shows significant growth rates, while the traditional banks hardly experiences the crisis. Islamic banks were created with respect not only for Muslims, but for Christians and Jewish.

# **1 Objectives and Methodology**

## **2.1 Objectives**

The purposes of this work are to make out the basic principles of Islamic banks to determine the characteristics of the Islamic economic system, to assess the place and role of Islamic banks in the global financial system, to compare Islamic and Conventional banking systems and evaluate and compare financial performances of examples of Islamic banks and traditional banks. In accordance with the purpose the following tasks defined:

- Identify the features of the Islamic economic system and Islamic banks;
- Consider the tools of the banking system;
- Consider the way the integration of Islamic banks in the global financial system;
- Compare Islamic and Traditional banking systems..

## **2.2 Methodology**

While the topic was researched there were used comparative method, analytic method, synthesis method, study of books, statistical publications, and articles.

### **3. Features of Islamic economy and banking system**

#### **3.1 Analysis of the impact of interest on loans to the economic welfare**

At the expense of levying percent, money welfare state increase rapidly over regular intervals, i.e. they have an exponential (growth rates are constantly accelerating) dynamics of growth, which explains why there were difficulties with the monetary flows at regular intervals in the past, why are they appearing now. In fact, the interest on the loans can be regarded as a cancer of the social structure.

The period of time required for doubling the size of the invested sum of money in the collection of 3% per year - 24 years, at 6% - 12 years, at 12% - 6 years. Even at 1%, the percentages stipulate an exponential dynamics of growth with a doubling in about 70 years.

The impact of interest rate mechanism on the monetary system is determined by its partial covert. Most people think that they pay interest only when they take money on credit, and if the payment of interest is not desired, simply not to take money on credit is enough. However, this is not so, because the price of each product that we pay includes an interest portion. This percentage varies for goods and services, purchasing by us in accordance with the value of invested capital. Few examples, typical for the German economy, illustrate this difference. The share of interest payments on loans (capital expenditure) retained for garbage collection is 12%. In this case, the share of interest is relatively low, as are the costs for expenses for wage are prevailing. The situation changes for the price of drinking water and sewage system, where payment of interest as part of the cost is already 38 and 47%. For fees for use of social housing flats, this part is already 77%.

Unwanted features of interest banking can be summarized as follows:

- Transactions based on a percentage, violate the principle of fairness of economic system. According to the standard lending system, the borrower must pay a prearranged percentage of the loan, even in case of carrying losses. Even if you had earned income, the percentage of the loan can be a burden if it exceeds the rate of profit.

- The instability of the system based on a percentage, in a result of failure leads to bankruptcy that result the loss of productive capacity and unemployment.
- A system based on a percentage, is focused more on security than on growth. Since the banks have obligations to their investors, they are more interested in safe return of loans and interest on them. This leads to the fact that banks limit their borrowers to large companies or such organizations or individuals who have proven themselves to be sufficiently safe. This excessive focus on the safety of funds hampers the growth, because this system separates the cash flows from a large number of potential entrepreneurs, whose efforts would increase the gross national product.
- The interest system is not an incentive for innovations, especially for small businesses. Small businesses are reluctant to use new production methods using borrowed funds, as they need to ensure the payment of interest and principal debt, regardless of the results.
- Banks with percentage system are only interested in preserving their capital and receive interest. Interest in funded by them enterprises is limited only in the profitability of companies, in respect to their ability to generate cash flow, which would provide for interest payments.

Over the past thirty years, the financial and banking sector of economics, both individual countries and entire regions periodically experience acute crises convey in a sudden increase in the number of insolvent banks, investment and insurance companies. Mass crises of financial and banking systems occurred in the past, for example large-scale crisis of the "Great Depression" period in the United States of America.

Just before the last decades such crises have historically represented a singular phenomenon.

If the majority of researchers of financial and banking crises agree that the objective factor contributing to their mass character, is a deepening process of globalization of financial activity, so attempts to identify and theoretically justify the other objective factors of "insolvency", affecting the financial and banking systems have not yet been brought significant results.

In recent years, Muslim experts of the economy and banking carefully considered possible ways of replacing percent. Muslim economists have developed models of interest-free economic system, and analyzed the impact of the abolition of interest on the economic growth, the establishment of resources and distribution of income.

Substantiated the theoretical basis for the organization of modern banking on an interest-free basis.

The concept of interest-free banking is no longer a purely theoretical category. In the past two decades there has been created, on the interest-free basis, several Islamic banks in different parts of the world. Three Islamic countries, Pakistan, Iran and Sudan have attempted to eliminate the percentage in a scale of entire economics.

### **3.2 Establishment of the Islamic system of credit institutions**

Creation of Islamic banks due to the policy of social and economic revival of the traditions of Islam, which is carried by Egypt and the countries of the Arabian Peninsula. The birth of Islamic banking in the 1960s in Egypt wasn't noticeable event, but more than half of a century, the world is watching the process of steady and rapid development of this industry. With annual growth rate of 15-20%, Islamic banking has expanded its horizons across the world and has its offices in more than 75 countries.

Islamic Golden Age 1940-1950-ies attracted serious attention to socio-economic and political dimension of Islam and the idea of an Islamic banking system - that is, a system in which there wouldn't be borrowing rate.

One of the first modern scientists, who explicated the theory of Islamic economic model, became Anval Ikbar Qureshi in the book "Islam and theory of interest" in 1946. He proposed to build relationships between the Islamic bank and the client on the basis of partnership. However, he did not give a clear definition of partnership, offering to provide the capital from one side, and work - is another, while the gains and losses were assigned to both.

In 1947, Sheikh Mahmoud Ahmad in his book "Economics of Islam" repeated the same point of view with a proposal for the establishment of Islamic banks as stock companies with limited liabilities. He believed that the placement of the client's capital may be carried out on the principle of partnership.

The authors responded later - Mohammad Uzayr (in 1955), Irshad (in 1964), Al-Arabi (1966) - also saw the main principle of Islamic banking - Mudaraba.

In 1968 Siddiqui published a book with detailing narration of the theoretical basis of Islamic economics and legal framework of the Islamic financial intermediation. According to proposed by him banking model, which is based on Mudaraba and Musharaka, Islamic banking operations were divided into three categories: services rendered for the commission and other types of fixed payments, the financing scheme "Mudaraba" or a partnership and services provided free of charge.

Early experiments with Islamic Banking took place in Malaysia in the middle of 1940s, in Pakistan in the late 1950s and Egypt was established Mit Ghamr Savings Bank (MGISB), it became the first Islamic bank in the Arab world, and Nasser Social Bank 1971.

By the initiative of the Government of Egypt creation of Islamic credit institutions started in 1964, and then it was continued thanks to a joint initiative of Egypt and Pakistan at the meeting of foreign ministers of Islamic states. Subsequently, the leaders, well-known public figures and business leaders of the Arabian Peninsula were joined to this process. An avowed leader in the field of Islamic banking has become the seventh Saudi prince Mohammed Al-Faisal Al-Saud. In 1978 on his initiative it was created the International Association of Islamic Banks (IAIB), whose primary purpose was the spread of Islamic banking principles in Muslim countries and the provision of technical assistance to national Islamic banks. At the initiative of IAIB it was founded the International Institute of Islamic Banking and Economics, to carry out research and training functions, and in 1981 set up an international financial non-governmental organization "Dar Al-Mal Al-Islam" (DMI) to support private enterprise on the basis of Islamic principles. After the formation of IAIB were created "Islamic Bank of Bahrain" in Bahrain and "Qatar Islamic Bank" in Qatar (1979). National Islamic banks have subsequently been discovered in more than 20 Muslim countries. Islamic credit institutions also operate in non-Muslim countries such as - Luxembourg, the US, the UK, and Bahamas. By the end of the 80's there were opened more than 100 Islamic credit institutions. In developing countries, these institutions serve a relatively large share of the credit market. "Islamic Development Bank" is a specific credit institution, which was created by the governments of Saudi Arabia, Kuwait, the United Arab Emirates and Libya.

The Bank is engaged in financing of major projects and the development of inter-state trade. Its capital - 15.4 billion USD ten times higher than equity capital of Saudi commercial banks and it almost does not attract monetary resources through deposit operations.

### **3.3 Religious principles and legal framework of Islamic banking**

The specificity of Islamic economics lies mainly in the fact that the basis for its implementation and operation cannot be contrary to the prescriptions of the Quran and the Sunnah of the Prophet Muhammad, and totally accord with them.

Islamic economic doctrine based on the principles of equitable distribution of wealth in society, social justice, prohibits the imposition of a fixed percentage of the loan. Justice is a priority objective of economic activity. The Islamic understanding of this is not only a moral, but also the adequate economic category. Credit institutions operating according to economic principles of Islam, do not charge a fixed percentage of loans and use the principle of joint participation in the profits of the credited economic activities and a fair distribution of risk between all the participants of passive and active operations of the credit institution. At the same time, Islam strongly encouraged trade and business activities.

Modern Islamic scientists also emphasize that the Islamic bank should be involved in activities aimed at the implementation of socio-economic problems - such as the eradication of poverty, the equal distribution of wealth and income, creation of work places - and the model of participation in the profit and loss account could not be better suited for all these tasks.

### **3.4 Profit and loss sharing mechanism of Islamic banking**

In the pre-Islamic era, funding was based either on the principle of *riba* or models *Mudaraba* and *Musharaka*. Since Islam forbids "*riba*" - usury - lawyers of early Islamic period have carefully studied the properties of *Mudaraba* (a special kind of partnership where one partner gives money to another partner for the purpose of investing in a commercial enterprise) and *Musharaka* (joint equity venture in which investors invests together and share the resulting profit or loss in accordance with the size of the share of each member) and developed a thorough legal basis of the different legal views on these two types of financing, so that they are fully compatible with the Shariah. The abundance of legal opinions on these



two types of funding laid the foundation for the modern theory of Islamic banking. These two principles laid the modern theory of Islamic banking.

In 1985, Chopra suggested that the concept of Islamic banking, based on the same principle of participation in the profit and loss account. Innovative in his approach was to promote the idea of an Islamic financial institution as primarily an investment institution. His understanding of the banking system in common with the ideas expressed earlier by other scientists and provides a fertile ground for the conclusion of agreements on share participation in the profit or loss between the bank and the client. Further, he claimed that Islamic banks should serve primarily to the interests of society, not an individual or group of individuals. Thus, its role - to focus on the security of social welfare, not just seek to maximize profits.

All kinds of relationships (including economic) between people in terms of Islamic law are considered as an agreement or a contract, by which is meant the existence of rights and obligations of the parties in the various types of relations with the priority of Sharia law.

### **3. 5 Research of Islamic economic model**

#### **3.5.1 Primary distinguishing features of Islamic economic model from Traditional economic model.**

The Islamic financial system has a clear social orientation with the priority of moral and ethical principles. Islamic economics is regarded by scientists and theologians of the Muslim East since the heyday of Caliphate and understood as part of the social system, the laws of which have been identified the divine plan and transferred to humanity through a series of prophets: Abraham, Moses, Jesus and in the final teachings of the prophet Muhammad about the universe. In this understanding, Islamic economics has another name - "tawhid economy" (from the Arabic "tawhid" -monotheism). Social orientation suggests the main purpose of economic development - social justice in the distribution of the results of economic activity. The method of achieving this goal is the development of the economy and economic growth. At the same time, theologians and economists emphasize the special role of

Islamic ethics and its inherent ability to protect business operations from abuse and lawlessness. All economic categories, such as money, capital, profit, wealth, production, viewed through the prism of moral norms and values of Islam guidelines.

-The important role of "governorship" concept, according to which the owner of any commercial value and social value of the resource is not the owner, but attorney of the true owner - Allah. "It is assumed, therefore, that the more wealth or resources available for disposition for a specific person, the greater his responsibility as commissioner of the Most High, including for ensuring wealth and society growth as a whole."

- An important aspect is that the deputed resource to a person must not to be idle and turn into hoarding of cash. To struggle this, during the time of Prophet Muhammad purely economic mechanism was applied - inactive assets were levy a special tax for the benefit of the poor, which is called in Arabic "zakat".

- Prohibition of a series of actions, called "gharar" in Arabic, which means "danger", "misleading", "jeopardize". Under gharar means conducting purchase and sale transactions of goods, which are not available, and the production of which is expected in the future; purchase and sale of securities without disclosing the real asset that serves as the content of the securities; commodity buying and selling without exhaustive specification; transaction without specifying the exact price; transactions with non-specific indication of the timing of execution of agreements.

It is worth pointing out that in the global economic system, all the above elements, understood as "gharar" allowed and commonly used without any restrictions. This phenomenon is explained by the spirit of adventure inherent in Western economic tradition. However, Sharia does not deny the risk, but on the contrary, the risk is encouraged in the sense that both parties entering into economic relations realize the loss and do not claim their compensation at the expense of each other. However, Sharia prohibits pointless risk, therefore, "gharar" is interpreted as unnecessary risk, because it is impossible to calculate possible losses.

- Another term associated with "gharar" - "meysir" (in Arabic - "Gambling"). The prohibition of gambling in the Islamic economic model narrows down to two basic understandings:

1. Receiving of income arising as a result of coincidences. Such income is prohibited because its production doesn't related to the production and using of labor. An example is the casino game.

2. The global understanding of "meysir" as one of the distinguishing features of modern capitalist economy. According to Zhuravlev A., "meysir" is understood as a cross-border migration of huge cash flows for the purpose of own funds of expanded reproduction without the production of real wealth, both tangible and intangible. The Asian crisis of 1997-1998 clearly demonstrated the negative impact on the global economy. The most successful player in the exchange markets George Soros admitted as a parasitic role of the currency markets: "I made a fortune through the financial markets and, nevertheless fear today that uncontrolled capitalism and spreading of market values on all spheres of life threaten the future of our open and democratic society... Today, the main enemy of the open society - is no longer the communist but the capitalist threat".

- Money is regarded as a service, technical tools and cannot be traded.

Seeking to attain a goal to create an economic system, which is based on fairness and justice, Islam believes that money cannot accumulate value by itself, as in case when they are lent at interest. In addition, charging interest on debt by lender or by borrower is defined as profit without production efforts.

The Islamic economic system recognizes private property, based on personal labor, and public - state and cooperative. The basis of productive activity is considered work, but not capital. According to Islam, the property of any person belongs to Allah, the inviolability of private property was raised to the level of integrity and value of life. Deprivation of anyone's property is unacceptable, except of extreme cases, provided by full-length payment, fair compensation.

Thus, based on the precepts of the Quran and the Sunnah, the specificity of Islamic economics is as follows:

- The owner of any good is attorney of a true owner - Allah;

- Islamic finance has a strong social orientation;
- Islamic economy is based on the moral principles outlined in the Quran and Sunnah;
- Resource should not be inactive and turn into hoarding cash;
- The prohibition of financial transactions which mislead counterparties;
- The prohibition on making a profit, which not associated with use of labor and production.
- Money - is a tool, and not an object of sale;
- The prohibition of usurious interest;
- Recognition of both private and public ownership of the resources of production;
- The main productive activity is labor rather than capital;
- Private property is inviolable, as mediated by Allah's property.

### **3.5.2 Basic tools and the organization of the Islamic banking system as a method of formation of Islamic finance**

The Islamic economic system of banks performs the same function as in the traditional Western - compensation for the negative factors of the financial markets: spatial and temporal unevenness of supply and demand, distortion of information. The function of banks is to ensure the work of national payment systems and financial intermediation.

It is notable that the interest-free banking system has its ethical roots in Christianity, where it had existed until the era of the Crusades. Thomas Aquinas taught that "interest undermines the stability of money as a measure of value by giving a monetary value of the proposal, different from the nominal value and depending on the time factor ...". In the 1545 in England was revised a law forbidding taking an interest, and to treating it as usury; usury was defined as inflated interest rate, and low interest rates were "legalized". Out of three Abrahamic religions (Judaism, Christianity and Islam) only Islam completely forbids interest without modifying original prescriptions. The prohibition of usury written in the Torah: "Do not lend upon usury to your brother nor silver, nor bread, nor anything else that can be lent upon usury". Treating these statements for their own purposes, rabbis and theologians permitted the charging of interest from representatives of other nationalities and religions.

The first and the main distinguishing feature of instruments of Islamic banking from the Traditional banking is its fundamental disagreement with the work of the western bank of the financial intermediation.

In the role as a financial intermediary, any bank accumulates funds of depositors, which are currently not used by their disponents, and forms at their expense liabilities in the financial source for those individuals and businesses that are experiencing a shortage of funds. Thus, for the role of an intermediary bank must be able to compensate costs and be rewarded for work.

In the traditional economy, the bank makes a profit from the difference in interest rates; on the one hand by charging a higher percentage from borrowers, and on the other, giving a low percentage for investors.

The Islamic model process is slightly more complicated. The depositor and the borrower, in effect, act as agent and principal, respectively. In Shariah this form of contract called "Mudaraba" and represented as a partnership in profit. One side, the owner of money, brings capital to any enterprise, contribution of the second party ("mudarib" - agent) is in its physical, mental labor or management activities, thanks to which the company is realized. The Bank is the intermediary between the investor and the borrower as well, as the real estate agency is an intermediary between the seller/landlord of property and the buyer/tenant. If the company fails for reasons beyond the control of the borrower (mudarib), the investor bears losses as Shariah believes that spent energy, time, physical and nervous energy of the second side is not less important than the money lost. However, this does not mean that mudarib doesn't bound by obligations in relation to losses. He can be brought to account if his direct fault in incompetent actions, negligence and so forth will be proven. The gained profit as a result of the successful implementation of the project is divided between the bank, the borrower and the investor in the proportions that were installed as a result of agreements with mutual agreement of the parties.

The second distinguishing tool of Islamic banks is displayed in the conduction of active operations in the form of gratuitous loans, which in Arabic is called "card al-Hassan", which signifies a loan issued from the good feelings, compassion, merci, gratis aid, if it is

obvious for the lender that the borrower is wittingly not in a position to repay. In this case, means are provided as a voluntary or mandatory donation.

“Card al-Hassan” can also be picked out as an interest-free loan to government or organization for implementation of public projects such as construction of roads, plants, and vitally important objects.

The third important tool of Islamic banking is forming of liabilities. Investments in Islamic banks can be two types – “Card-Hassan” and “Amana” (“amana” literally means “a thing put in storage”, but in practical context – function or action over trustee storage. Depending on what form are created obligations "card hassan" or "aman", poste restante, a resource base of the bank or banking system is creating. If there are taken investments of the "aman" system as the basis for the formation of the bank's liabilities for the subsequent crediting, the bank is obliged to provide 100% provision for these investments. The client also has the right to determine whether the bank has the right to invest his funds in any investment project or not, that is incomprehensible to the Western banking system.

In addition to "mudaraba" in the Islamic banking system, there is another tool created for the same purpose - "musharaka" (from Arabic - partnership, participation). In the case of using "Musharaka" the capital can be carried in by both the client and the bank itself. Gains and losses are apportioned between the bank and the customer in accordance with their respective shares of the financing of the project. Here, the bank is not only a mediator but also as a partner.

"Murabaha" (from Arabic - resale, stock exchange speculation) – is another tool peculiar only to Islamic banks. It is used for crediting customers' purchases. Bank buys raw materials or equipment on behalf of the client, and subsequently resells it by installments, but at a higher price. The difference is stipulated in advance.

"Ijara" - is one of the most common operations of Islamic banks. "In fact, this is an agreement about leasing. The bank buys the property, such as an aircraft or equipment, and delivers them to the leasing of a potential buyer. In some cases, this operation can be classified as the leasing contract of purchase and sale, according to which the client has the right to redeem the property during the validity of leasing contract". Islamic bank can't lend movable and immovable properties, if using by the tenant is supposed for purposes prohibited by the

Shariah, such as: the organization of the drinking establishments, sale of alcohol, a Western-style bank placement (in case of real estate lease), etc.

The condition of Islamic law is bounded with the contract "Ijara" in case of a hire-purchase, i.e. financial leasing, non-compliance of which entails "gharar". From the point of view of Shariah lease and purchase of property - are two related to each other but at the same time highly different transactions. Turning them into one contract would lead to ambiguity and create a situation of "gharar". Therefore, two contracts are negotiated separately from each other, and with the payment of rents in the amount of value of the property, including the bank's share, proprietorship passes to the customer - contract of sale is executed.

"Salam" - is a tool allowing, typically large industrial enterprise, quickly get working capital for the purchase of means of production to customers. In this case, the bank carries significant risks as essentially gives the customer money in the debt, and the debt can not be the subject of the contract; the customer actually sells, and the bank buys non-existent goods. Therefore, the structure of "Salam" at first sight falls under the concept of "gharar" but Sharia demonstrates "the ability to be flexibly applied to the real needs of the economy, taking into account the peculiarities of the production cycle, in particular in sectors with a pronounced seasonality in demand for working capital. Since this is a physical product to contract output, the degree of "gharar" deemed irrelevant in view of the high probability that under conditions of time limit, goods will be present".

"Istisna'a" - is a type of contract offered by Islamic banks, for a modern large-scale industry. Bank in this transaction acts as a general contractor in the construction project, which will be given to a potential customer, a construction company acts as a subcontractor who undertakes to complete the project within a specified time and for a certain price for the final customer.

"Muzaraat" (from the Arabic can be translated as "share-cropping"). Historically, that under "muzaraat" understood the agreement of a person to cultivate the land of another for a certain percentage of the value of arable land. Nowadays, this concept received a broader, modern sense - providing of working capital on the basis of profit sharing by two parties.

"Musakat" - is a tool that is used to conclude a contract for a short-term financing of the agricultural sector.

"Tavarak" - is a sales contract under which the buyer acquires goods on credit and sells it to another person for cash, but at a lower cost. The purpose of this transaction is to obtain cash, rather than commercial profit.

It is clear that this set of tools, based on the precepts of Islam, ensures the stability of the Islamic society as a whole, and each member of this society in particular. The user of Islamic banking services gets more opportunities in the implementation of the financial transactions and operations, rather than in the traditional banking system.

The moral system, which effects on the inner consciousness of person, making him aware of the nature of the trust resources, and provides the criteria, necessary for their effective and equitable allocation and distribution.

At the conclusion of the chapter one can be said that the Islamic financial system has some potential for sustainability during economic shocks and crises. However, Islamic banks offer a wide range of instruments for the implementation of a wide range of services, making them competitive in the global banking system. All Islamic financial system toolbox prevents the occurrence of the crisis, both in the financial system, and in society. Resources should not be left out in the cold, for example, turning into the treasure, as well as sent to the speculation, but should be used efficiently for the benefit of society, to create real added value, to increment mass of goods and services, but not the money supply.

## **3.6. Islamic banks in the modern global financial system**

### **3.6.1 The place and role of Islamic banks in the global financial system**

At present, Islamic financial institutions operate in more than 75 countries around the world. The largest concentration is in the historically conditioned the Middle East and Southeast Asia (Malaysia and Bahrain - are the largest centers), as well as in Europe and the United States.



Regardless of whether we are talking about the development of Islamic banking in the Islamic financial system and the global financial system at the present stage, we cannot ignore the globalization processes that have an undeniable impact on any financial system existing in any country in the world. In an attempt to explain the global changes the modern science offers a variety of concepts and approaches to the concept of globalization.

The explanations K. Ohmae, "contemporary globalization means a new era, a distinctive feature of which is that people everywhere have increasingly become dependent on orders prevailing on the world market (K. Ohmae, 1992)." There is no doubt that Islamic banks falls under the influence, such as those that operate on the historically conditioned territory, and banks abroad.

Of no small importance in development of Islamic banks is the fact that the ruling elite in most countries, spreading Islam, are often subject to political and economic pressure from the West and forced to develop the economy of their countries, taking into account the global situation.

The development of Islamic banks in different regions of the world is also associated with the peculiarities of the different models of economic behavior of the peoples according to their social, cultural and religious identity. In table 1 (see. Appendix 1) are the most common models of economic behavior in the world. "The Islamic world is slowly but steadily intrudes in the northern hemisphere. This is confirmed not only by the expansion of the financial sector, but by active process of migration of the population of Islamic countries to developed non-Islamic countries. Considering such globalization indicator as labor migration, it should be noted that Europe - England, Germany, France and other countries - experienced the strong migration and cultural influence of the Arab world previously, where is now very strong position of Islam, nowadays Islamic financial institutions are beginning to seep into the financial scope of the European countries". Therefore, Islamic finance products in different countries will be required to varying degrees.

### **3.6.2 Prospects for development of Islamic banks**

Some aspects and regulations of the Islamic banking system allow it to successfully confront the circumstances that led the Western financial system to the crisis.

Creation in 1975 of the Islamic Development Bank and Dubai Islamic Bank was the beginning of the official development of Islamic banks. Today, the principles of the Islamic banking system is successfully used not only in Muslim countries but also in Europe and in the United States. Many Western banks are open and maintain a so-called "Islamic windows" (bank branch, engaged in the provision of services according to Shariah) for the provision of such services, which exist in parallel with a standard set of services in these banks.

Today, there are about 300 large Islamic financial institutions managing the portfolio of assets, estimated at about 500 billion US dollars. In the East, the main centers of Islamic banking are Malaysia and Middle East countries, in the West thus center is the UK. This fact is the result of the UK's financial infrastructure and the desire of the government to bring the system of laws and legal rules to a level that will allow Islamic banks to operate successfully along with the traditional banking system.

In its development the Islamic banking system faces the following major challenges today.

**Staff.** Expansion of existing financial institutions and the creation of new ones in connection with the development of Islamic banks creates a need for qualified personnel. Current possibilities of educational institutions, engaged in the education of specialists in the field of Islamic finance, is unable to meet this need. In this regard, Islamic financial institutions should focus on the education of its own staff. For the success of this mechanism is necessary to have a well-established HR function, fiscal stimulus, healthy and attractive work environment.

**Competition.** Despite of the growing interest in Islamic banks, it is still at an early stage of its development. Access to markets is associated with increasing competition from traditional banks, have begun to offer Islamic banking products (by opening the "Islamic windows"), the transformation of traditional banks in the Islamic and the appearance of new players in the market. The current drop in oil prices and the reduction of temporary free liquidity also affects on opportunities for Islamic banks to compete with the traditional Western financial markets.

**Excess of liquidity.** The lack of an effective alternative to traditional interbank foreign exchange market, operating in accordance with the principles of Sharia, resulting in serious

difficulties in liquidity management by Islamic financial institutions. Limited opportunities for investment, according to the principles of Islam from the banks, in turn, lead to unreasonably high value of assets.

**Management of risks.** Work in accordance with the principles of Islam, exposes Islamic financial institutions to additional risks. Such risks include the risk of compliance with the principles of Sharia, legal risks, and so on. Taking into account the expansion of the Institute of Islamic banking system, the function of risk management in Islamic financial institutions must ensure not only the management of these risks, but stable development of the industry.

**Standardization.** At the moment, there are no common standards of financial reporting and the regulatory framework for Islamic financial institutions. As a result, in some countries they are working in accordance with AAOIFI standards (Accounting and Auditing Organization for Islamic Financial Institutions), while in others they use the standards prescribed by traditional financial institutions.

The presence of a special legislative framework - a guarantee that the experience of Islamic banks and Islamic branches - "windows" will not remain completely marginalized. Such database does not exist in Russia. But the example of the law, if not authorizing the establishment of Islamic banks, or at least does not prohibit it, can serve as the United Kingdom.

**Adherence to Sharia.** Adherence to the principles of the Sharia is the main condition for operation of Islamic banks. This issue is directly connected with the problems of education of qualified personnel and management policies described above. Islamic schools are not able to meet the demand for skilled workers growing number of Islamic financial institutions. Differences in the interpretation of the provisions of Sharia also cause a need for qualified personnel to work out a common position on the mechanisms of operation of Islamic banks products.

According to the principles of Sharia, the deal, as a rule, must be backed by real assets, i.e. asset must exist, be owned by the seller and have a specific description.

These facts suggest that the Islamic banking system is a complex mechanism that has yet to pass certain stages in its development. However, despite the existing problems, it is

therefore an institution that has proved its worth and the ability to work during the global financial crisis.

As can be seen, the introduction of work based on the principles of Islamic banks has allowed Islamic financial institutions for the most part to avoid the risks and problems that have led Western financial community to the crisis. This statement is confirmed not only by theoretical studies but continued even in crisis conditions the global expansion of Islamic financial institutions and the spread of Islamic banking products.

Islamic banking encourages development of economics by providing funds for the purchase/production of tangible assets. Following its principles minimizes speculative securities transactions, such as those that led to the mortgage crisis in the United States.

Under these circumstances, Institute of Islamic banks is thus an alternative source that can provide the business community capital needs and financial resources. We should not forget the fact that the Islamic financial institutions tend to allocate funds for a particular project and the purchase of a particular asset. This fact gives us confidence that the funds will not be aimed at stopping so-called "current holes", existing in banks and enterprises. On the contrary, they will be directed to the real sector, thereby stimulating economic development. In the current economic downturn it should be given particular importance in terms of both economic development in general, and from the point of view of the creation of new industries and provide jobs for the population.

Considering the serious problems with the involvement of debt financing on the European and American markets, and still vacant niche of Islamic banking in the CIS countries, the horizons of this institution are very promising. The main benefits of this development in the context of the current crisis and the decline in production volumes can be:

- stimulating the activity of enterprises by attracting free financial resources available to the Muslim countries, to finance investment projects;
- supporting of development of financial institutions through the development of new products and improving their liquidity with the active co-operation with foreign Islamic institutions;

- further development of business by attracting new investors who have denominational preferences in relation to the technology of the banking operations.

On the basis of the studied material it's possible to offer several options for the development of Islamic banks in the global financial system.

- 1) Islamic banks, entering the worldwide process of globalization will continue to spread to a large number of countries and will operate in the structures of the economies as alternative elements of credit and financial system. At the same time, you must consider the impediments to their development in the form of a negative attitude towards the Islamic financial institutions and for Islam in general by politicians of a number of non-Muslim countries, as well as the world's elite, which owns the major financial institutions of the world and make their profit from the realization of the interest system and capacity the money, not provided by real property. However, during the evolution of this process, globalization becomes positive component in the form of alternative financial capabilities as individual consumers of banking services and states in general. As a result of this scenario, the dominant role of the western financial system will be maintained, therefore, the development of Islamic banks will be slow, and the global economy will be a subject of various types of the crisis.
- 2) The second option involves the development of the financial situation of the collapse of the world financial system as a result of inflation of the so-called "bubble" of the money supply, in which the economies of most countries of the world will fall. In this case, the international community can resort to new financial models and use as a basis in the development of the Islamic financial system, realizing the error of the first. However, the development of this option is unlikely, since world powers such as the United States may give up its military power for the struggle for the restoration of global hegemony, which will lead to the aggravation of the situation and the disastrous consequences, after which it will be impossible to assume further development of not only the

economy but also the situation in the world in general. That is why this option is the most negative and unpredictable.

- 3) In the course of globalization, the dominant role of Western countries in the global economy will rise in line with other countries. Multipolar economic space involving numerous economic relations between countries will be formed. In this situation, Islamic banks will also get a good dynamics of development and will serve as an alternative to the banking market. The development of the world economy in this way is possible in the case of reducing the influence of the United States and the international banking elite on the global economy. Developing countries will gain the opportunity to develop themselves, ceasing to be a raw material appendage of the postindustrial countries.

#### **4. Construction of the Islamic bond lend for Russian company.**

At the moment in Russia there is an opportunity to raise funds for financing the projects of commercial organizations is extremely limited. In particular, this fact concerns the development of small and medium-sized businesses in the country. Companies related to mentioned segment of the market, are unable to effectively communicate with private investors in connection with

- Inability to cover expenses, required to bring the company's shares on the stock market;
- High risks associated with small-sized companies;
- High risks, associated with opaque structure of ownership and other factors.

In fact, the only option to attract funding for such companies is to attract funds through bank loans. However, financing through the loan is quite expensive, resulting in significantly increased costs for attracting and servicing debt, and, consequently, reducing of profitability. From our point of view, the solution to this problem for a group of small and medium capitalization companies may be offered by Islamic financial technologies that provide access

to relatively cheaper financing instruments. When using these tools to the company issuing imposed fewer requirements compared to classical financial instruments. Also, the use of financial instruments, built by using Islamic financial technology provides access to the personal savings of the Muslim population of Russia as these instruments comply with the essential requirements of Sharia law. To test the validity of this hypothesis, as well as the effectiveness of this instrument for Russia, it will be modeled a loan sukuk-al-ijara, which will be held for the financing of medium-sized company, any industry. After building a financial model for such loan financial results will be analyzed, obtained by a company as well as investors, and conclusions will be made.

## **4.1 Construction of the bond lend on the basis of the product - sukuk-al-ijara.**

Construction of sukuk-al-ijara will be carried out in several stages:

- Feasibility study of the realization of borrowing.
- Scheme description of construction of sukuk-al-ijara.
- Analysis of the main parameters of sukuk-al-ijara.

### **4.1.1 Feasibility study of the realization of borrowing.**

ABC Company will apply to the airline industry. This sector has been chosen for the following reasons:

- The continued need for additional financial resources within the framework of significant volumes of expenses for maintenance of the fleet and infrastructure;
- The ability to obtain the most representative results of the analysis of the attraction of financial resources;
- Difficulties in attracting funds by using classical bonds. It should be noted that most of these companies raise funds through bank loans.

The funds raised during the placement of this loan will be used for the implementation of ABC Company's development program.

As part of this program, the ABC plans to expand the geography of its presence, maintain and expand the position in existing segments, modernize technology and exploitable equipment.

For the implementation of strategic plans of development, there was processed a scheme of measures to equip a technical base, the acquisition of additional equipment, introduction of new technologies, implementation of maintenance programs and, most important, there is a direct saving an existing database.

In this regard, the financial resources, attracted by this loan, will be used for the following activities:

- overhaul of the existing production facilities;
- expansion of production capacity (through the acquisition of new ones);
- the creation and development of the repair material and technical base;
- formation of first-aid set;
- funding settlements for purchased raw materials.

Also, the implementation of these measures ABC company should maintain production program on existing direction. This will maintain the required production volumes, as well as reach a certain of its growth, and reduce production costs through more efficient use of new technologies and production capacities.

#### **4.1.2 Sukuk-al-ijara.**

Product life cycle is divided into several stages:

- Stage 1 - Organization of SPV. Conclusion the necessary contracts;
- Stage 2 - Placement of SPV shares among investors;
- Stage 3 - The performance of obligations under contracts of 1 and 2 stages, investment activity;
- Stage 4 - Termination of obligations under Phase 1;
- Stage 5 - The elimination of the SPV.

Let's consider each step separately.



### **Stage 1 - Organization of SPV.**

ABC Company will initiate the process of creating SPV in the form of an open joint-stock company.

The sole shareholder of the SPV is the Company ABC, is as a contribution to the charter capital transfers property to ABC, which puts via SPV balance at below market value (in this case, the discount is 5%). The company's charter as a main activity stops providing property leasing also provides the possibility of investing in collective investment institutions free cash flow. On the whole volume of the transferred assets in the SPV leasing contract in which the lessor is the SPV, and lessee company ABC. Under this contract the size of the leasing Payment is defined as follows:

$$\textit{Lease payment} = \textit{Depreciation} + \textit{Transport fee} + \textit{Property tax} + \textit{Profit}$$

### **Stage 2 - Placement of shares among investors SPV**

Placement of SPV shares through an investment bank, companies and agent network through direct purchases of these securities by investors.

### **Stage 3 - The performance of obligations under contracts of 1 and 2 stages, investment activity**

As part of its activity SPV will receive lease payments according to the contract signed on the 1st stage. These funds will be accumulated in the SPV's assets in the form of free cash balances, SPV that will be placed in institutions or collective investment for greater reliability in the deposits of commercial banks in order to obtain additional income. Also SPV will be obliged to repay their securities upon request of the holder.

### **Stage 4 - Termination of obligations under Phase 1**

At the conclusion of the lease agreement, concluded on 1 stage sukuk-al-ijara SPV exercises the option, issued in its favor by the ABC, that is, will carry out the sale of assets at a predetermined price in the option. Also SPV will repay the securities placed in collective

institutions investment. Upon completion of these transactions on the SPV's balance sheet will remain cash and shares repurchased during the SPV operation.

### **Stage 5 - The elimination of the SPV**

In the final phase of the sukuk-al-ijara, initiated SPV liquidation procedure, the results of which securities holders SPV receive a share of the society, which will consist of the value of assets + accrued income of the SPV during the activity.

During operation of the SPV will be external monitoring to ensure interest held by Investment Bank D, which was brought by the ABC for these purposes.

#### **4.1.3 Loan Options of sukuk-al-ijara.**

To perform the planned production now and development programs needed to attract funding 300 mln. czk. For these purposes it will be modeled product sukuk-al-ijara. The amount of funding, attracted by this product will be equal to 300 000 000 czk. Number of securities issued by the SPV, will be equal to 3 000 000 par value of 100 czk. In order to reduce transaction costs for data Securities provides centralized storage. Term of circulation is equal to 48 months. According to this product there are planned in the periodic payments amount of 3.25%, however, there is the possibility of repayment of the securities, issued by the SPV, at any time and the amount without any restrictions. Formally, the software for this product is not available, however, the actual security is transferred to the ownership of assets of SPV, on the balance sheet at below market value. Distribution of this product should be administered via the agency network of Investment Bank D (due to lack of feasibility of the product using the exchange mechanism), with the possibility of attracting additional agents.

#### **4.2 Assessment of the effectiveness of the products**

Evaluating the effectiveness of the product to be studied viewed from the perspective of the issuer and the investor separately. The result of assessment will be the comparison of products - sukuk-al-ijara and banking products - and a decision on the advisability of raising funds using sukuk-al-ijara. For simplicity of the assessment it is assumed that:

- Costs related to the emission of sukuk-al-ijara is 15 000 000 czk (including costs on SPV organization, marketing campaign, placement securities, etc.);
- The discount rate is 10% and won't change for 4 years;
- The average rate of return by investing in collective institutions investment during 4 years is equal to 10%;
- Lease payments arising under the lease agreement,
- are fully covered by the profit of the company ABC;
- During the specified period of 48 months repayment of 100% of the securities of SPV does not happen;
- Assets transferred to the SPV, by the company ABC are lands and production facilities.

#### **4.2.1 Assessment of the issuer's effectiveness**

Evaluating the effectiveness of the loan to the issuer will be built on analysis of forecasted cash flow and profit and loss account. At Table №3 presented the forecast cash flow for the period 2013-2015, 2012 is taken as zero.

Analysis of the predicted cash flow was carried out on the basis of assumptions that revenue growth will be 5% per year, the cost of growth - 5%, other costs will be 3%. This assumption is based on the fact that the costs will be reduced due to more efficient use of available resources. As it shown in Table №3, when the loan is used as a tool to attract funding for the implementation of operations the planned program for the issuer in the form of the costs borne costs debt service, the additional costs for the property tax,

Table 1

Cash flow report, millions czk (for sukuk and ijara)						
Indicators	2011	2012	2013	2014	2015	Total
						2011-2015
Operating activity	4067	4263	4473	4694	4925	22423
Cash inflow	4000	4200	4410	4862	4862	22103
Revenue	67	63	63	63	63	320
Depreciation	3765	3897	4084	4277	4479	20502
Cash outflow	2500	2625	2756	2894	3039	13814
Cost price	1000	1030	1061	1093	1126	5309
Other expenses	144	137	147	158	169	755
VAT payable to the budget	99	84	99	112	125	518
Income tax	22	21	21	21	21	106
Transport tax	0	0	0	0	0	0
Total, cash low from operation activity	302	366	369	417	446	1920
Investment activity						
Cash inflow	0	300	0	0	0	300
Realization of shares in SPV		300				
Cash outflow	0	300	0	0	257	557
Acquisition of assets	0	300	0	0	257	557
Total, cash flow from investment activity	0	0	0	0	-257	-257
Financial activity						
Cash inflow	0	0	0	0	0	0
Cash inflow from the bond placement	0	0	0	0	0	0
Cash outflow	0	110	95	95	95	394
Expenditures on attraction	0	15	0	0	0	15
Leasing payments	0	95	95	95	95	379
Paying off bonds	0	0	0	0	0	0
Payment of interest on bonds	0	0	0	0	0	0
Total, cash flow from financial activity	0	-110	-95	-95	-95	-394
Net balance of cash flow	302	257	294	322	95	1270
Net balance of cash flow cumulative	302	559	853	1175	1270	

Discounted cash flow	302	233	243	242	65	1085
Discounted cash flow cumulative	302	779	779	1021	1085	

but will reduce the tax base for income tax and VAT, and, consequently, the amount payable to the budget of income tax.

In carrying out the assumptions, the issuer keeps a positive balance in cash flow and its stable growth during the borrowing period. It is also important to note that the discounted cash flow at the current moment is about 1 billion CZK.

This table represents the forecasted profit and loss account using sukuk-al-ijara loan. In accordance with the findings it is clear that the effect of raising funds through the issuance of sukuk-al-ijara not affect adversely on the financial results of the issuer's company.

Table 2

Profit and loss account, mln. czk. (for ijara sukuk)						
Indicator	2011	2012	2013	2014	2015	Total 2011-2015
Total revenue	4000	4200	4410	4531	4862	22103
Cost of services (excluding expenses attributable to the prime cost)	2500	2625	2756	2894	3039	13814
<b>Gross profit</b>	<b>1500</b>	<b>1575</b>	<b>1654</b>	<b>1736</b>	<b>1823</b>	<b>8288</b>
Costs attributable to the cost (not including lease payments and expenses for attraction):	1000	1030	1061	1093	1126	5309
Expenses for attraction	0	15	0	0	0	15
Leasing payments	0	95	95	95	95	379
Taxes	22	21	21	21	21	106
Property tax	22	21	21	21	21	106
<b>EBITDA</b>	<b>478</b>	<b>414</b>	<b>477</b>	<b>528</b>	<b>582</b>	<b>2480</b>
Depreciation	67	63	63	63	63	320
<b>EBIT</b>	<b>411</b>	<b>351</b>	<b>414</b>	<b>465</b>	<b>519</b>	<b>2160</b>
Interest expense	0	0	0	0	0	0
<b>Profit before tax</b>	<b>411</b>	<b>351</b>	<b>414</b>	<b>465</b>	<b>519</b>	<b>2160</b>
The cumulative profit before taxation	411	762	1176	1641	2160	5151
Tax on profits	99	84	38 99	112	125	518
<b>Net profit</b>	<b>312.61</b>	<b>266.84</b>	<b>314.60</b>	<b>353.26</b>	<b>394.33</b>	<b>1641.64</b>

The load on the issuing company, due to the execution of expenditure obligations under the lease payments, allowed maintaining an average the annual growth in profits at the level of 7% per year.

Let's forecast cash flow for the case when the company-issuer will fund planned programs using a bank loan for comparison. Assume that the interest rate on bank loan will be 20%, all other fees and maintenance costs amount to 2%. The bank receives property as collateral-issuer Company. Repayment of the loan will be equal to annuity payments under with the following schedule:

Table 3

Annuity payment		The interest rate on lending and expenditure on service		
	120.3		22%	
Year	Main debt	Interest	Rest of repayment	
0	300	0	0	0
1	54.30603405	66	245.6939659	
2	66.25336154	54.05267251	179.4406044	
3	80.82910108	39.47693297	98.61150332	
4	98.61150332	21.69453073		0

This method is most effective for the company as the load on repayment is distributes evenly. The effectiveness of this repayment also confirmed by the forecasted cash flow.

Table 4

Cash Flow Statement, in czk (for bank loan)						
Indicators	2011	2012	2013	2014	2015	Total 2011-2015
<b>Operating activity</b>						
<b>Cash inflow</b>	<b>4067</b>	<b>4287</b>	<b>4497</b>	<b>4717</b>	<b>4949</b>	<b>22516</b>
Revenue	4000	4200	4410	4631	4862	22103
Depreciation	67	87	87	87	87	413
<b>Cash outflow</b>	<b>3765</b>	<b>3912</b>	<b>4095</b>	<b>4288</b>	<b>4490</b>	<b>20550</b>
Cost price	2500	2625	2756	2894	3039	13814
Other expenses	1000	1030	1061	1093	1126	5309
VAT payable to the budget	144	154	164	175	186	823
Income tax	99	74	86	98	111	468
Transport tax	22	29	29	29	29	136
<b>Total, cash flow from operation activity</b>	<b>302</b>	<b>375</b>	<b>401</b>	<b>429</b>	<b>459</b>	<b>1966</b>
<b>Investment activity</b>						
<b>Cash inflow</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Cash outflow</b>	<b>0</b>	<b>300</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>300</b>
Acquisition of assets	0	300	0	0	0	300
<b>Total, cash flow from investment activity</b>	<b>0</b>	<b>-300</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>-300</b>
<b>Financial activity</b>						
<b>Cash inflow</b>	<b>0</b>	<b>300</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>300</b>
Receipt of cash loan	0	300	0	0	0	300
<b>Cash outflow</b>	<b>0</b>	<b>120</b>	<b>120</b>	<b>120</b>	<b>120</b>	<b>481</b>
Loan service	0	120	120	120	120	481
Loan repayment	0	0	0	0		0
<b>Total, cash flow from financial activity</b>	<b>0</b>	<b>180</b>	<b>-120</b>	<b>-120</b>	<b>-120</b>	<b>-181</b>
<b>Net balance of cash flow</b>	<b>302</b>	<b>255</b>	<b>281</b>	<b>309</b>	<b>338</b>	<b>1484</b>
<b>Net balance of cash flow cumulative</b>	<b>302</b>	<b>557</b>	<b>838</b>	<b>1146</b>	<b>1484</b>	
<b>Discounted cash flow</b>	<b>302</b>	<b>232</b>	<b>232</b>	<b>232</b>	<b>231</b>	<b>1229</b>



As can be seen from the table 4 for the entire loan period, we can observe a positive cash flow at the company. It is mainly generated by the influx of cash flows from operating activities. When compared with the monetary stream from sukuk-al-ijara financing, the net balance cash flow cumulative loan more than 215 mln. czk., it suggests about greater balance of available funds from the issuing company. This is primarily caused due to large depreciation at the use of bank loans for financing, since the pledge property to ensure it continues to be listed on the balance sheet of a company - the issuer, and therefore the issuing company has the right to carry out depreciation payments. Analysis of the income statement, presented in Table 6, at the financing of the planned programs with the bank loan allows you to maintain steady growth in net profit, but if using sukuk-al-ijara with this growth has averaged 7% per year, while the conventional banking lending to this figure is 5%. The main reason for slowing payment is a load on repayment of the loan and interest, as well as savings on the property tax, which arises when using sukuk-al-ijara, as part of the company's assets were transferred to the SPV. In absolute assessment the effectiveness of the issuer's higher, using Ijara sukuk-al-ijara on 161 mln. czk., which is more than 50% of the amount attracted for funding.

After considering characteristics of sukuk-al-ijara product for issuer, let's proceed to the evaluation of the effectiveness of analyzing product for investors.

The main target audience for the placement of sukuk jjarah are citizens of the Russian Federation, and special attention will be paid to Muslim part of the population. Also, these papers are interest of foreign investors from Muslim countries.

Table 5

Profit and loss statement, czk						
Indicator	2011	2012	2013	2013	2015	Total 2011- 2015
Total revenue	4000	4200	4410	4631	4862	22103
Cost of services (excluding expenses attributable to the cost price)	2000	2625	2756	2894	3039	13814
<b>Gross profit</b>	<b>1500</b>	<b>1575</b>	<b>1654</b>	<b>1736</b>	<b>1823</b>	<b>8288</b>
Costs attributable to the cost price (not including lease payments and expenses to attraction):	1000	1030	1061	1093	1126	5309
Lease payments	0	0	0	0	0	0
Taxes	22	29	29	29	29	136
Property tax	22	29	29	29	29	136
<b>EBITDA</b>	<b>478</b>	<b>516</b>	<b>564</b>	<b>615</b>	<b>669</b>	<b>2843</b>
Depreciation	67	87	87	87	87	413
<b>EBIT</b>	<b>411</b>	<b>430</b>	<b>478</b>	<b>528</b>	<b>582</b>	<b>2430</b>
Interest expense	0	120	120	120	120	481
<b>Profit before tax</b>	<b>411</b>	<b>309</b>	<b>357</b>	<b>408</b>	<b>462</b>	<b>1948</b>
Cumulative profit before tax	411	721	1078	1486	1948	5645
Tax on profits	99	74	89	98	111	468
<b>Net profit</b>	<b>312.61</b>	<b>235.16</b>	<b>271.53</b>	<b>310.18</b>	<b>351.26</b>	<b>1480.75</b>

The main advantages of the simulated loan sukuk-al-ijara are:

- The presence of liquid collateral belonging to investors;
- Getting extra income from investing activities of SPV;

- Absolute liquidity of sukuk-al-ijara: the possibility of redemption at any time, the amount of ransom sukuk-al-ijara from investor will be equal to the share in the SPV, which consists of the cost of transferred property in monetary assessment and added value, obtained by the lease payments and investments of available funds in risk-free instruments, in this model, I would like to use as such a tool - bank deposits;
- Possibility of getting the annual revenue from activities of the SPV in the form of dividends distributed between owners of the SPV;

Such construction of sukuk-al-ijara makes it possible to embody the Islamic finance concepts, under which investors are able to invest in instruments with minimal risks on which there is no discount for profitability.

On described above models sukuk-al-ijara, cash flow was forecasted, which will be received by investors for sukuk-al-ijara during the whole period of treatment.

In the presented model sukuk-al-ijara there are planned dividend payments to Investors, however, these funds can be directed to investments, with the aim to obtain more revenue

Table 6

<b>Cash flow for the sukuk-al-ijara investors, mln. czk.</b>						
Indicator	2011	2012	2013	2014	2015	Total 2011-2015
Initial investments	300	0	0	0	0	300
SPV data						
Assets	-	350	350	350	350	
Revenue		94.67	94.67	94.67	67.67	378.66
Depreciation and amortization (property in leasing)		70	70	70	70	
Property tax		7.70	7.70	7.70	7.70	
Profit		2.53	2.53	2.53	2.53	10
Income tax		0.25	0.25	0.25	0.25	
The amount of dividends to be paid	0	2.27	2.27	2.27	2.27	9
<b>VAT</b>	<b>0</b>	<b>14.44</b>	<b>14.44</b>	<b>14.44</b>	<b>14.44</b>	<b>58</b>
The remainder of unrestrained cash	0	70	70	70	70	280
Redemption of the assets from SPV	0	0	0	0	245	
Income from investments	0	-	<b>7.00</b>	<b>14.70</b>	<b>23.17</b>	
Tax on investment income		-	-	-	5.56	
Net income from investments	0	0	0	0	17.61	

The rate of market return	10%	10%	10%	10%	10%	
Investor's income from dividends						0
The rate of income tax for dividends	9%	9%	9%	9%	9%	0
The amount of tax payable	0	0.20	0.20	0.20	0.20	
Net income		2.07	2.07	2.07	2.07	
<b>Income from liquidation of SPV</b>	-					0
The amount of tax payable	-	-	-	-	21.83	
Net income from the liquidation	0	0	0.0	0.0	520.8	521
The balance of cash flow	-300	2	2	2	523	229
Discounted Cash Flow	-300	2	2	2	357	
NPV	62					

During the analyzed period, investors will receive 4 payments: the first 3 - payment of dividends, 4 - dividend payment + amount received from liquidation of SPV, exclude of tax on profits. During calculating the net present value for the investment of funds by investor in sukuk-al-ijara obtained a positive value, indicating the efficiency of the project. The total capital increase for 4 years will be about 79.8%, so the annual rate of return on a product for the investor will be 19.9%, what is sufficiently attractive for the investor.

Alternative ways of investing for the investor remains direct acquisition of shares on over-the-counter market, contribution to bank deposits and the acquisition of shares of collective institutions investment.

The acquisition of stocks or shares in this company is related with significant risks for the investor, caused by the company's main activity, encumbrance of different obligations, the

small size of the company, as well as significant costs to purchase these shares, as guaranteed the profitability of the investment in this embodiment is not provided to the investor unlike sukuk-al-ijara.

Investing in a bank deposit will provide guaranteed income in 4 years, but the size of this income will be considerably less than the income received from sukuk-al-ijara. For example, assume that the same investors that invested in sukuk-al-ijara, investing 300 mln. czk. in bank deposits. It should be noted that the amount of the deposit is not 300 mln. czk., but will be greatly fragmented, and therefore, they will not succeed the ability to obtain more favorable rates by investing a significant amount of funds. The average rate on such deposit will be equal to 10.4%, with a monthly interest accrual and capitalization of percents. Thus, in 4 years, investors will receive 454.7 mln.czk., that is an income of 154.7 mln. czk., in comparison with investors of sukuk-al-ijara, at about the same risks will get 239 mln. czk.

Investments in collective investment institutions can be much more effective than investments in sukuk-al-ijara, but they are associated with much greater risks for the investor. This practice applies to developing markets, including Russia, within the framework of preservation trends in significant growth of the market and high market volatility, such way comparable risks for collective investment instruments, in my opinion, can be regarded as units of mutual bond funds, with an average growth rate of not more than 15% a year<sup>2</sup>. Investment by purchasing shares of bond funds also less effective, rather than investing via sukuk-al-ijara.

---

<sup>2</sup> Quotations of Russian units of mutual funds, [http://www.nlu.ru/analysis/fin\\_info/index.php](http://www.nlu.ru/analysis/fin_info/index.php)

## 5. Conclusion

The following tasks have been solved during this research:

The features of the Islamic economic system and Islamic banks, formulated the following conclusions:

- Islamic banks are aimed at the social development of society in general and human beings in particular;
- Has a flexible functioning of the system based on Sharia, which gives the potential for adaptation to the evolutionary processes in the global economy, and the economies of individual countries;
- Islamic banks have a high degree of transparency, which has a positive effect on the economy of the country in which the bank operates; as it is a significant incentive for the cooperation of various kinds of financial institutions with the Bank and to attract investors;
- they suggest wide range of services that are not in the banks of the Western type, which makes Islamic banks competitive in the global financial system;
- Islamic bank has a greater resistance to the financial crisis than Western bank;
- In properly functioning of Islamic banking system it does not cause financial crises, such as those facing the world today.

Considers positive and negative aspects, as well as the path of integration of Islamic banks in the global financial system, the forecast of the prospects of development of the Islamic banking system and made the following conclusions:

- at the present stage, Islamic banks are firmly entering in the international financial system;
- there is conducting an extensive support of the Islamic Development Bank and the Organization of the Islamic Conference of Islamic banks, existing on the territory of member countries of the OIC, as well as Islamic banks in Western Europe, Asia and North America;
- Islamic banks receive support from non-Islamic countries and banks, in particular the IDB, has made significant progress in international cooperation

with one of the largest financial institutions in the global financial system - the International Monetary Fund;

- the most favorable way for the development of Islamic banks and the global financial system in which Islamic banks will get widespread in the world as an alternative to existing traditional banks in a multi-polar world economy without the dictates of economic conditions of the USA and holders of a significant part of global capital;

Negative aspects of the integration of Islamic banks in the traditional system:

- existing theory of Islamic economics mainly engaged by description of how would have to be organized the economic life of society, but is not yet ready to offer a comprehensive analysis of the original really going on processes in this area;
- existing forms of Islamic banking contracts in the majority came from the pre-Islamic trade practices of the Arabian Peninsula. They were recorded in the fiqh (Islamic law) and described it in detail. Subsequently, they were not subjected to any substantial modification. However, in reality they often repeat the forms of banking products and services that exist in the non-Islamic banking world. Thus, there is a substitution of Islamic banking services by non-Islamic;

Of the above problem implies the following - the problem of standardization:

- the problem of risk management is essential. Work in accordance with the principles of Islam, exposes Islamic financial institutions to additional risks (risk in compliance with the principles of Sharia, legal risks) as compared with the general for the banking industry;
- excess liquidity problem comes from the lack of an effective alternative to traditional interbank foreign exchange market, operating in accordance with the principles of Sharia, leading to serious difficulties in liquidity management by Islamic financial institutions.



Products used by financial institutions, in particular banks, based on debt relations are murabaha, salam, istisna and ijara. Debt segment of the stock market, until recently, was represented solely by sovereign obligations. With the development of the world financial system and, in this connection, the need to obtain ever larger competitive advantages on the Islamic market a new product appeared - sukuk - medium-term corporate bond.

The most popular is sukuk-al-ijara - bond, part of building which are leasing relationships. On the basis of this product in Chapter 5 modeling of the bond issue was carried out for the Russian Company on Islamic technologies. As a result of this work it can be concluded that the sukuk-al-ijara is a profitable tool.

Thus, today, the study of "Islamic economics" in general and its capital markets and financial instruments traded on them, in particular, allows to identify alternative forms of funding enterprises.

During the research posed hypothesis was confirmed that the Islamic economy and banks have a solid foundation and prospects of development not only in countries with a dominant Muslim population, but also in non-Islamic countries of East and West.

## 6. References:

1. A. Zhuravlyov (2004). *Islamic finance in modern world. Economic and law aspects*, “Umma”, 2004
2. M. Chapra (1992). *Islam and the economic challenge*. Leicester, (Islamic Economic Series, N17)
3. I. Lipsits (2006). *Economics*, Omega-L
4. G. Soros (1997). *The Capitalist Threat//The Atlantic Monthly*, 1997, № 2 – February//www.theatlantic.com
5. Abdul-Rahman, Y. (2010). *The Art of Riba-Free Islamic Banking and Finance*. New Jersey: John Wiley & Sons, Inc.
6. Amr Mohamed El Tiby, W. G. (2015). *Islamic Finance and Economic Development*. Hoboken, New Jersey: John Wiley & Sons, Inc.
7. El-Gamal, M. a. (2006). *ISLAMIC FINANCE Law, Economics and Practice*. New York: Cabridge University Press.
8. AAOIFI (2003). *Shariah Standards, The Accounting & Auditing Organization for Islamic Financial Institutions*. Manama, Bahrain
9. Abdul Hamid, Norashikin. (2005). *Guide to the Malaysian Bond Market, Rating Agency Malaysia Berhad*. Kuala Lumpur, Malaysia
10. Authorized Financial Institutions list, Capital Market Authority, <http://www.cma.com>
11. Bahrain Monetary Agency. 2002. Annual Report. Bahrain, <http://www.cbb.gov.bh/cmsrule/index.jsp?action=article&ID=135>
12. [www.bo.bdc.ru/2009/8/islam\\_bank.htm](http://www.bo.bdc.ru/2009/8/islam_bank.htm)/26.02.2010.
13. [www.newhorizon-islamicbanking.com](http://www.newhorizon-islamicbanking.com), 26.02.2010
14. IOSCO. 2006. Islamic Capital Market Fact Finding Report. Report of the Islamic Capital Markets Task Force of the International Organization of Securities Commissions, July.
15. Iqbal, Munawar; and Tariqullah Khan. (2004). *Financing Public Expenditure: An Islamic Perspective*, Occasional Paper No.7, IRTI, Islamic Development Bank.
16. Special Report: Islamic Finance Matures And Expands, Standard and Poors, <http://www2.standardandpoors.com>
17. Sukuk issuing report for 2006, <http://www.zawya.com/sukuk/default.cfm?cc>
18. Supreme economic council report, <http://www.sec.gov.sa/>
19. World Federation of Stock Exchange. Annual Report and statistics, 2005

## 7. Appendix 1

**Table 7. Features of the different models of economic behavior.**

Islamic model	Russian model	Anglo-Saxon model	Japan model
<p>1. It is emphasized the advantage of ethical values above the material, economic goods, expressed in the provisions about private property, labor as a source of well-being, sinful of money grubbing, usury and unjust ways of enrichment, the interdependence of the interests of society and the individual, as well as a fair redistribution of wealth in society through the implementation of mandatory and voluntary contributions and payment of various taxes.</p> <p>2. Introduction of ethical</p>	<p>1. In socio-economic terms, Russia acts as a link between the civilizations of Western and Eastern types. In economics, the closest to the eastern type. The huge role of the state as regulator of the economy. The tendency of the population to state paternalism and public assignment forms (education, medicine)</p> <p>2. Church blesses the worldly life, but do not formalize it, there is no rigid rule. Legal issues given to the jurisdiction of the state.</p> <p>3. Economic freedom and independence are secondary importance</p>	<p>1. Tradition of "Protestant capitalism". An active, profit-oriented financial thinking: pronounced individualism, the ban on waste of time, the duty of intensive labor, support for the middle class, saving and increasing funds as a vital duty.</p> <p>2. Investor distinguished by a distinct adherence to risk, greater economic individualism, less state-controlled large companies.</p> <p>3. A person must put</p>	<p>1. The desire for hierarchy, the tradition of loyalty to persons, consisting at the highest level of power; limited labor mobility (lifetime employment system). The desire to promote by the vertical within the company, rather than horizontally (liberal professions); lower adherence to risk.</p> <p>2. Willingness to be a ward.</p> <p>3. Preference by company management personnel interests rather than the interests of shareholders (the "corporation community", "corporation-family"), preservation of employment and remuneration of labor at the expense of dividends, significant payments,</p>

<p>restrictions on the use of the monetary system of loan interest.</p> <p>3. Promotion the organization of the system of direct equity as a result of economic activity.</p>	<p>in relation to the recovery tasks.</p> <p>4. The weakness of private initiative with rather strong collective sentiments.</p> <p>5. The historical course of development led to the underdevelopment of private property, especially on the land, and the absence of the "master on earth"; the dominance of finance capital over industrial.</p>	<p>all his effort to meet their daily, including professional responsibilities in this regard earning money within the limits, set by law, the activities focused on making a profit is the result and expression of virtue and skill in the performance of the call.</p>	<p>remuneration system, in which the size increases with the age of the employee.</p> <p>4. Expressed collectivism, subordinate to the more social than individual, a tendency to self-restrictions (ethics "honest poverty", self-sacrifice in the name of business); high rate of household savings and practicality.</p>
---	--	---	---