opinion

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Islamic banking will boost a growing economy like ours

Baker Kasawuli Islamic banking

Amid the just-ended electoral process, something huge was happening in our financial sector. The Islamic Finance Act became law and all that is now left is for the Central Bank to issue a regulatory framework to the local financial institutions on its application.

Islamic Banking and Finance is based on the principles of Sharia'h or Islamic Law. The mention of Sharia'h Law among non-Muslims often enlists a certain level of anxiety. I have witnessed this both locally and internationally! It is often seen as wholly synonymous with the brutality associated with groups such as Boko Haram that often selectively invoke this law to defend their despicable acts.

The truth is that Islamic Banking and financial transactions are guided by perhaps some of the most compassionate principles. Some of the key tenets of Islamic Finance are that the lender and borrower should share assets as well as risk; that it should provide contractual certainty and that all the elements in the transaction must be ethical. These principle are the key differentiator between Islamic and convention banking as we know it.

I have numerous clients in the SME sector and all of them attest to the fact that the current relationships they have with their lending institutions could use an injection of most- if not all--of the attributes that Islamic banking offers. Most of our SMEs described the lenders as aggressive and belligerent towards them. They claim that banks behave in a way that diminishes the borrowers' voice and disregards their rights and that in the event of a problem, the banks are always right and the borrowers always wrong. The banks on the other hand claim the borrowers are "crafty and canning". This often plays out across many bank- borrower relationship and points to a broken business relationship.

Islamic Finance offers perhaps the best balm to heal, rebuild and nourish this broken trust. Even the Holy Father Pope Francis -yes the one who recently visited us -- attested to this in one of his most outspoken comments. While addressing new Vatican Ambassadors, the Holy Father called for a worldwide financial reform "along ethical lines—to curb the world of the tyranny of markets and financial speculation".

The Vatican newspaper *Osservatore Romano*, commenting on the global economic crisis, voiced its approval of Islamic Finance noting that the "ethical principles on which Islamic Finance is based may bring banks closer to their clients and to the true spirit which should mark every financial service". *Osservatore Romano* noted for instance that Western banks could use tools like Islamic Bonds known as *sukuk* or collateral, which involves aggregating assets and repackaging them into the form of marketable securities.

Islamic banking offers more than that. It can provide an array of financial products that would help boost an economy that's dominated by small businesses and start-ups. These small entities make a very huge contribution to greater economic growth—look at countries like the US, UK and China. That said, many of our local banks regard these

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entities as "too small" and wantonly characterise them as "start-ups" which they don't finance.

Islamic Banking offers many ways out of this impasse based on the principle of shared return and shared loss. Products like *Musharakah* or equity participation can significantly help entities that often get marked as "Unbankale". *Musharakh* literally means sharing and offers for the equitable sharing of all business related outcomes between the lender and borrower. *Mudharabah* or trustee financing is a type of partnership that brings skills and capital together to conduct business. Islamic financial institutions provide capital to financially weak but skillful people to do business and share outcomes with them. This type of product would be suitable for the artisans of Katwe or Kisenyi, carpenters, pottery, craft making, and florists. *Mudharabah* could also help provide creative financing to enable skillful university graduates set up businesses instead of looking for jobs. Such a product could greatly spur innovations, which like we all know are the stuff that helps grow economies.

Ijara (leasing) would be ideal for the agricultural and manufacturing firms that require heavy machinery and equipment. *Ijara* is a rental contract where the lending institution leases an asset to a client. For example, Dairy Farmers need this type of financing to acquire dairy equipment for milk storage, as do farmers for extensive crop production. At the completion, the *Ijara* asset is either returned to the lender or purchased by the client. *Bai Salam* (Forward Contract) would help financing agricultural needs of farmers. Farmers sell their crops prior to harvesting to the lending institution that then sells onwards to an up-taker at a small mark-up.

Islamic Finance also provides for the *Qard el-Hasan* or a benevolent loan. This is a zero return loan that the Qur'an encourages believers to extend to "those who need them". Generally used for development or social projects, lenders are allowed to only charge a service fee to cover the administrative and transaction costs of the loans.

Conventional banks provide these products in same form. However, there is a huge difference in the detail of how all this pans out. Islamic Banking and Finance prohibits *Riba* (usury/ interest), *Gharar* (uncertainty) and underlines the fact that the lending-borrowing relationship must be based on risk sharing.

Access to capital is very important for the commencement and growth of economic activity. But the form in which capital is provided is of paramount importance. Islamic finance is the embodiment of the type of capital that will help boost a growing economy like ours... it can inspire the new, first time entrepreneurs and provide a helping hand to the existing ones, many of whom are often auctioned off by our banks just as they are about to succeed!

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