

*Yasushi Suzuki and Mohammad Dulal Miah (Editors)*

**Dilemmas and Challenges in Islamic Finance –  
Looking at Equity and Microfinance**  
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**ABSTRACT.** Islamic finance has witnessed a phenomenal growth during the past couple of decades. However, this remarkable growth has also been accompanied by some challenges and dilemmas. Islamic finance today is at the crossroads where resolving these issues is a prerequisite for its future sustained growth. The current book under review, edited by Yasushi Suzuki and Muhammad Dulal Miah, highlights and discusses some of the issues and dilemmas the Islamic finance industry is facing today. The book comprises of 11 Chapters divided into three parts. Part I deals with the dilemmas related to the prohibition of *ribā* and *gharar*. Part II elaborates on the challenges related to Islamic equity finance and microfinance and Part III is devoted to the discussion of the dilemmas and challenges related to the governance structure of Islamic finance. This article reviews and critically evaluates the aforementioned book.

Islamic finance has witnessed a phenomenal growth during the past couple of decades. The remarkable growth has also been accompanied by some challenges and dilemmas. For instance, the concentration of *murābahah* in Islamic banks, lack of development of other branches of Islamic finance like Islamic venture capital and Islamic microfinance, and Islamic governance issues. This book, edited by Yasushi Suzuki and Muhammad Dulal Miah, highlights and discusses some of the issues and dilemmas Islamic finance industry is facing today. Islamic finance is at the crossroads where resolving these issues is a prerequisite for its future sustained growth. Yasushi

Suzuki is a professor at Ritsumeikan Asia Pacific University, Japan and Dulal Miah teaches at the University of Nizwa, Oman. The primary research interests of Yasushi Suzuki seem to be financial fragility, institutional political economy, and theory of banking and economic rent in Asia as reflected by his past researches. This book is his maiden attempt on Islamic finance.

The book comprises of 11 Chapters divided into three parts. Part I deals with the dilemmas related to the prohibition of *ribā* and *gharar*. Part II elaborates on the challenges related to Islamic equity finance and microfinance and Part III is devoted to the dis-

cussion of the dilemmas and challenges related to the governance structure of Islamic finance. The chapters on Islamic and heterodox views on interest, *murābahah* syndrome, Islamic equity fund, and ‘division of work’ have been exclusively authored by the editors. In the rest of the chapters, they have been joined by other authors, prominent among them Hashim Kamali who shares with them a chapter on the ‘acceptable’ level of *gharar*. Suzuki shares a chapter with Kamrul Hasan and Sigit Pramono on the anatomy of Islamic venture capital in Bahrain and Indonesia, while he shares another chapter on the status of *ṣukūk* in Bangladesh and Malaysia with Sohrab Uddin and Nahid Afroz. Both the editors have been joined by Helal Uddin on a chapter on the comparative study between conventional and Islamic microfinance. Suzuki shares the chapter on the impact assessment of microfinance with Saiful Anwar, Sigit Pramono, and Trisiladi Supriyanto and another chapter on Shari‘ah boards with Sigit Pramono and Oni Sahroni. And finally, Suzuki shares a chapter on the Shari‘ah compliance framework with Sohrab Uddin and Asif Nawaz Chowdhury.

In Part I dealing with the heterodox and Islamic views on interest and uncertainty, the authors state that despite the fact that Qur’ānic injunctions treat interest as a means of expropriation of the disadvantaged by the capitalists, the intellectual and theological discourse does not adequately demonstrate the extent and the nature of exploitation in the contemporary world. They cite the absence of a pure Islamic economy or pure Islamic institution (because of the dominance of *murābahah*) as a source of empirical infeasibility of conducting such research. Interestingly, the authors write that the views of Marx and Keynes are compatible with the prohibition of interest and uncertainty. In the parlance of Marxian analysis, a capitalist society is featured by the exploitation of the working class by the capitalists (money capitalists). Marx considers it unfair that someone should be able to earn an income without working, whereas others must accept the toil. He considers the extraction of surplus value by the capitalist as equivalent to theft, embezzlement, robbery, and stealing. On the other hand, in the Keynesian analysis, a low rate of interest is desirable to achieve full employment, and economic growth could be attained if capital ceases to be scarce. The authors put forward a question: “How low should be the rate of interest? Should it ultimately be zero?” (p. 18). Similarly, both Islamic

and heterodox views are skeptical towards dealing in excessive uncertainties (*gharar*).

In part I Chapter II titled “A critique to a naive critique to ‘*murābahah*’ ‘*tawarruq*’ syndrome”, the authors maintain that the critique of *murābahah* syndrome is not well-founded. It overlooks the cost of PLS-based financing in the form of higher statutory deposits, severe agency problems, and unfriendly financial setup. Further, they look with skepticism towards the logic of transferring the loss suffered by well-off entrepreneurs under the two-stage *muḍārabah* contract to the risk-averse small savers/investors. In their opinion, doing so is neither suitable socially nor Islamic. According to them, this contradiction of Islamic finance emanates from the inability of Islamic epistemology to properly decode the Qur’ān.

In Part I Chapter III, the authors discuss the extent of *gharar* that makes a transaction *ḥarām*. Borrowing from the literature of ‘incomplete contracts’ and ‘transaction costs’, the authors argue that the prohibition of *gharar*, in essence, is intended to minimize the ‘transaction costs’ and ex-post opportunism of the parties to the contract. They also draw a parallel between Keynes’s notion of ‘animal spirits’ under uncertainty and *gharar*. They state that Keynes regarded animal spirits in enterprises as beneficial for society and was skeptical of animal spirits in speculation. On the other hand, the conservative mode of Islamic investments considers animal spirits (excessive risk) prohibited both in enterprise and speculation.

Venture capital is very close to PLS-based equity finance structure like *muḍārabah* and *mushārakah* and is also a part of the Prophet’s *sunnah* (may the peace and blessings of Allah be upon him). Moreover, Islam stresses on altruism and charity and assigns a high status to an honest merchant, and provides the highest punishment for opportunism, and breaking of trust (as it is a symptom of hypocrisy and hypocrites occupy the lowest part of the hell). All these may have facilitated the supply of funds to those entrepreneurs who face difficulties in fundraising. However, in reality, Islamic venture capital is not well-developed in Islamic economics. Explaining this contradiction, the authors assert that the impossibility for the altruist to know that the receivers are staying up to the divine principles and a simple doubt about the possible opportunistic behavior of entrepreneurs is inhibiting the altruism towards entrepreneurs. In Chapter 4, the authors elaborate on this anomaly from

the transaction cost perspective and write “the expected positive effect of Islamic principles as lubricant for reducing relevant transaction costs is currently being canceled out by the negative effect as friction embedded in the industry of Islamic equity finance” (p. 72).

In Chapter 5, the authors after discussing the cases of Islamic Venture Capital funds in Bahrain and Indonesia, conclude that they are far from an ideal venture capital fund which is supposed to incubate and support risky innovative ventures and promote entrepreneurship. The investment of venture capital fund in Bahrain is mainly concentrated in the real estate sector whereas in the case of Indonesia it is primarily aimed at well-established SMEs. Islamic finance started to develop since the 1970’s. However, Islamic venture capital, still in the inceptive stage with many limitations, calls for a serious rumination.

Chapter 6 provides a detailed account of the *ṣukūk* industry in Malaysia and Bangladesh and contains a snippet on the potential *J-ṣukūk* industry in Japan. The authors report that Bangladesh has failed to make any significant progress in the *ṣukūk* industry whereas Malaysia has a well-developed government and corporate *ṣukūk* market. Further, they contend that the Malaysian success story can be emulated in Bangladesh and Japan and they may also board the fastest growing train of *ṣukūk*.

Chapter 7 presents the current status of Islamic microfinance in Bangladesh and Pakistan and contrasts its slow and marginal growth against the success story of interest-based Grameen Bank (Bangladesh), while Chapter 8 suggests using Artificial Neural Network (ANN) to assess the impact of microfinance loans.

In Chapter 9 the authors emphasize the need for governance over Sharī‘ah Boards and elaborate on the limitations of the present working of Sharī‘ah Boards. To address the potential conflict of interest between the Sharī‘ah Board and client financial institutions, and to promote the independence of Sharī‘ah board, the authors suggest that the board members can be remunerated by the regulator or the government. However, this is also not free from limitations especially in the case of non-Muslim countries.

Chapter 10 calls for an integrated model of Sharī‘ah compliance and reporting framework both at the institutional and national level in Bangladesh. The authors also note that the central Sharī‘ah board in Bangladesh, known as Central Sharī‘ah Board for Islamic Banks of Bangladesh (CSBIBB), does not have the authority to resolve Sharī‘ah conflicts or issue *fatāwá*, and banks are not bound to follow the rulings of CSBIBB. Hence, they emphasize the need to establish a powerful central Sharī‘ah supervisory board in Bangladesh.

Islamic banks are criticized for *murābaḥah* concentration by many scholars. In the last chapter, Chapter 11, the authors suggest that Islamic banks should not be expected to assume a higher risk by indulging in PLS financing because the bankruptcy of a single bank can result in a country-wide bank run. Instead, they suggest ‘division of work’ and ‘specialization’ in Islamic finance and argue that participatory financing needs can be satisfied by other Islamic financial institutions like Islamic venture capital firms and Islamic microfinance institutions. In their own words, “Our point of departure from the ‘idealist’ Islamic economists is that prompting participatory financing (or the financing to marginal clients) under the current mode of PLS upon the risk-averse nature of small investors would be problematic to the banks” (p. 180).

The issues and challenges discussed in this book are relevant and need to be examined rigorously. The authors are right in pointing out that the rationale of the prohibition of *ribā* has not been rigorously examined and demonstrated in the Islamic finance literature. However, it is noteworthy that some contemporary highly regarded scholarly works support the thesis of Islam (without naming it) that *ribā*/interest is a source of economic instability. It may be noted that Mian and Sufi empirically and convincingly show how the interest-based system and increased household debt was the main culprit behind the financial crisis and its subsequent slow recovery, and how the present-day financial system absolves the rentier-functionless capitalists from taking risks. In their own words, “As it currently stands, the financial system forces all the risk on the households that can least afford to bear it” (Mian & Sufi, 2015, p. 186). In fact, they provide the much-needed intellectual framework, backed by evidence, that equity-like fi-

nancing can help avoid painful recessions and nurture sustained economic growth. Turner (2017) also provides rigorous evidence that too much private debt inevitably leads to financial crisis. The much-acclaimed work of Thomas Picketty (2014) also brought to light the main pitfall of capitalism in the form of increased income inequality. One of the contributing factors to the rising income inequality is the ‘financialization’ of economies. As Philippon and Reshef have shown, remuneration in the financial sector has increased more rapidly than that of people of similar skill level in other sectors of the economy (Philippon & Reshef, 2012). The increasing incomes of financiers played an important role in the growth of the income of the top 1%. In all, we can certainly find convincing scholarly works that consider interest/debt as the devil and the driving force of financial crises and increasing inequality. However, these works are not from an Islamic perspective or inspired by Islam (at least not explicitly). Moreover, the authors have rightly pointed out towards the trend of *financialization* engulfing the real economy which is an obvious consequence of interest-based economy. Such is the extent of *financialization* that profits earned by finance and insurance industries accounted for 37 percent of the profits of all other sectors combined in 2013 (Mukunda, 2014).

Analyzing *gharar* from the lenses of ‘transaction cost’ and ‘incomplete contracts’ is something novel and fresh in this book. The references to the terminology of New Institutional Economics (NIE) have been made throughout the book. Using the mainstream economic parlance would certainly be helpful in the mainstreaming of Islamic finance. Having background and training in economics (Professor Suzuki is a doctorate from the University of London) the author was well suited to perform this analysis. The author’s grounding in economics also reflects when he quotes Marx’s and Keynes’s views on interest while discussing *ribā*. However, analyzing from NIE lenses is not completely new. Some other authors have also examined Islamic finance from this perspective like Abdul-Rahman, Abdul Latif, Muda, and Abdullah (2014).

The authors have very pertinently raised the issue of Islamic venture capital as Islamic finance may also contribute to the development of entrepreneurship. Entrepreneurship and entrepreneurs are very vital for a vibrant economy, as their innovations not only

improve the standard of living but also create jobs and wealth in addition to creating the conditions for a prosperous society. In the words of French economist Jean-Baptiste Say who first coined the word “entrepreneur” around 1800: “The entrepreneur ... shifts economic resources out of an area of lower and into an area of higher productivity and greater yield” (as quoted in Drucker, 1985, p. 21). A developed Islamic venture capital mechanism will go a long way in promoting entrepreneurship in an economy.

Stressing the vital role of trust in Islamic finance, the authors write: “If Islamic banks can build the trust exemplified by the Prophet [may the peace and blessings of Allah be upon him] and his companions, agency problems can be reduced to a greater extent” (p. 185). At the same time, they call for formal rules and regulations to avoid the opportunistic behavior of entrepreneurs since “trust and relations are intangible features of human being” (p. 185). However, envisioning the growth of trust-based financing is not a utopian idea. Trust is the key enabler of economic value creation. Diekhöner (2017) has elaborated on many recent examples of industries which are primarily based on trust including *Airbnb*, *Uber*, *TripAdvisor*, *Bitcoin*, *Carousell*, *Etsy*, *Upwork*, *Faircent*, *Upstart* and many more. This has been enabled by technology which turns reputation, credibility, status, and influence into a “trust score”. Trust score may become the new credit score. And a peer-to-peer Islamic lending/investment platform can be envisioned where the verified entrepreneurs’ reputation is quantified in the form of a score. And if a *muḍārib* has past venture capital funding, his reliability can be computed using a scientific trust score. This score would then help investors in investment decisions. In a recent book, Khanna (2018) has also elaborated on the importance of trust being the foundation for entrepreneurship in developing countries.

The authors’ suggestion for Islamic banks to follow the principles of ‘specialization’ and ‘division of work’ instead of undertaking a whole gamut of activities is cogent and sensible. As for the PLS-based financing, it could be undertaken by separate Islamic financial institutions like Islamic venture funds and Islamic microfinance institutions. Islamic banks should not be exposed to excessive risks as they occupy a very special role in an economy. In the words of Paul Krugman

bankers must be sharply limited in the kinds of risk they're allowed to take on. Why, exactly, are banks special? Because history tells us that banking is and always has been subject to occasional destructive "panics," which can wreak havoc with the economy as a whole. (Krugman, 2012, para 2-3)

The discussion on some topics in this book seems to be mere a synthesis of past works without offering new insights. For instance, while calling for taking a liberal view of *gharar*, the authors reiterate the views of Kamali (2000) and El-Gamal (2006) that *gharar* could be allowed for the public good. However, they scratch the surface of the problem and fail to provide pointed arguments with concrete examples of the application of the concept of *gharar* in practice.

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## مراجعة كتاب: العضلات والتحديات في التمويل الإسلامي –

### النظر في المشاركة والتمويل الأصغر

تحرير: ياسوشي سوزوكي ومحمد دلال ميان

الناشر: راوليدج: لندن، المملكة المتحدة، ٢٠١٨ م، ٢١٦ صفحات

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المستخلص. شهد التمويل الإسلامي نموًا هائلًا خلال العقد الماضيين. ومع ذلك، فقد صاحب هذا النمو الملحوظ بعض التحديات والعضلات. إن التمويل الإسلامي اليوم يقع في مفترق الطرق حيث أن معالجة هذه القضايا هو شرط أساسي لنموه المستدام في المستقبل. الكتاب الحالي قيد المراجعة، الذي حرره ياسوشي سوزوكي ومحمد دلال ميان، يناقش ويسلط الضوء على بعض القضايا والعضلات التي تواجه صناعة التمويل الإسلامي اليوم. يتكون الكتاب من ١١ فصلاً مقسمة إلى ثلاثة أجزاء. يتناول الجزء الأول العضلات المتعلقة بتحريم الربا والغرر. يشرح الجزء الثاني التحديات المتعلقة بتمويل الأسهم الإسلامية والتمويل الأصغر، بينما خصص الجزء الثالث لمناقشة العضلات والتحديات المتعلقة بهيكل الحوكمة في التمويل الإسلامي. تم مراجعة وتقييم الكتاب المذكور أعلاه بشكل نقدي في هذه المقالة.