

Research Article

## **A Study on Prospect and Problems of Islamic Private equity capital Investment in India.**

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### **ABSTRACT**

Islamic Private equity capital investment is interest free investment with Shari'ah compliant, based on profit sharing as per agreed ratio of Islamic instruments. The Islamic private equity capital investment plays a vital role for the economic development of a country. The main purpose of this paper is to find out the prospect of Islamic Private Equity Capital investment through the Islamic co-operative society, Islamic financial Institution and Islamic Bank established in India with Shari'ah compliance as per the RBI directives 1997. This paper covers the economic development and to help the people of India through the IPEC investment. It also cover the role of the Reserve Bank of India for the establishment of Islamic banks in India with shari'ah compliance. This paper sort out the problems of IPEC investment and establishment of Interest free Islamic Bank regulation by the RBI. As per the census conducted in 2011, there are 172.2 millions of Muslim people living in India. At present India is the largest Muslim population outside Muslim-majority countries. In India the Islamic Private Equity Capital is relatively a new concept and finds its origin back less than a decade. The findings of this papers shows that the Islamic Banking if established will be more popular than the conventional banking for the economic growth through Islamic Private equity capital investment in India. This will help to develop the society by giving interest free loan to the people both the Muslim and the non-Muslim through the application of Islamic instruments(partnership agreement) mudarabah, musharakah, murabaha, Ijara, etc with the compliance of the principle of Shariah.

**KEYWORDS:** IPEC, MSCS Act-2002, Islamic Instruments, Islamic Bank, Shari'ah Law, RBI Directives 1997, Halal, Riba.

### **1. INTRODUCTION**

In this era Islamic Private Equity capital is booming and flourishing. India is the most prospective country for establishment of Islamic bank for the growth of Islamic private equity capital for the economic development of the country. In Islam receiving and giving interest is forbidden. The concept of Islamic private equity finance is based on the principle of Shari'ah compliant. According to Islam haram activities are not allowed. Hence, halal products and activities are only allowed for investment in Islamic private equity capital investment.

For Islamic private equity capital investment, the Islamic bank acts as the mediator as fund manager as the Islamic bank collect fund or deposit form the depositor and invest it in to the business attached with halal activities with agreed profit sharing ratio with the entrepreneur maintaining the Shari'ah compliant. The fund invested by the Islamic bank and other financial institutions in to the entrepreneur is termed as Islamic private equity capital investment. The investor of Islamic private equity capital (depositors) will get the share of profit from Islamic bank in place of interest given by the conventional bank. In Islam interest or riba is fall within the preview of haram activities so it should not be considered but the share of profit is a halal income which is allowed in Islam. The investment in Islamic private equity capital is developing through the Islamic banks and other financial institutions by way of interest free loan given to the entrepreneur with maintaining the principle of Shari'ah. The objectives of the Islamic bank and other Islamic financial institutions are to provide financial facilities to the investee in accordance with the Shari'ah compliance for the socio economic development by increasing the welfare for the mankind. But the conventional banking are based on the principle of receiving and giving interest or riba which is especially prohibited in Islamic Shari'ah. The amount loan given by the Islamic bank is known as the amount of Islamic private equity capital if these are invested in the business engaged in halal activities with maintaining the Shari'ah principle.

India is the largest Muslim minority population in the world (17.2 millions). The demand for the halal investment in Islamic private equity capital is very high. The Islamic banks and other financial institute can satisfy the demand of the Muslim people in India by the IPEC investments. But India is a sovereign, republic and secular country hence, it avoids the specific demand for a particular cast and is not willing to create the separate regulation for the Islamic bank. Due to this reasons the Islamic bank has not yet established in India till date. In many non-Muslim country is allowing the private equity capital investment by opening the separate Islamic window in the conventional bank with Shari'ah compliance. This also need separate regulation for opening the Islamic window. Hence, it is not also allowable in India till date.

## **2. SCOPE AND PROSPECTS OF IPEC INVESTMENT IN INDIA.**

It is to be noted that that the venture capital investment started in India in the year 1972 and it is included in SEBI in the year 1995. But it achieves the remarkable growth for investment about 1.8 billion US dollar in 2004 to 22 billion US dollar in 2007 within a very short period of time. According to 2011 the number of venture capitals included in stock exchange is 280. Hence, it is expected that this type of remarkable growth will also be achieve in case of Islamic private equity capital Investment too provided the separate regulation for Islamic Banking is needed. This can be proved that there can be ample scope for Islamic private equity capital investment in India.

After the financial subprime crises, Islamic private equity capital investment became the main sources of financing for startup business and infant industry in many countries and will meet the growing demand of the Muslim and also non-Muslim in India. The IPEC may plays a vital role over the recent years in terms of the development and design of the innovative products within the preview of the Islamic Shari'ah. Islamic private equity capital investment done through the Islamic banking and other financial institutions are working in various country without earning any interest and is still flourishing rapidly. They are working not only with profitability but also developing the Islamic private equity capitals in terms of values, assets and the number of depositors and entrepreneurs. There is a huge potential demand and good market in India for the Islamic private equity capital which needs the establishment of Islamic banks and

other Islamic financial Institutions. But due to lack of proper regulation in India, this type of interest free banks or Interest free Islamic window in conventional bank will not be possible to implement in the short run. Many foreign banks like City bank, HSBC, Standard Chartered Bank are working with their separate interest free Islamic window in various Muslim and non-Muslim countries in the world which is not possible to open in India for the development and growth of Islamic private equity capital.

Due to the huge demand for IPEC of Muslim people in India the RBI has set up a high level committee with the chairmanship of Mr. Anand Sinha, chief general manager and in-charge of banking operation and development to look in to the matter. The RBI Governor D. Subbarao express his views that due to lack of separate Islamic banking regulation, Islam banking is not possible to establish in India but it may run through the alternative arrangement such as Islamic bank registered under NBFC, GFH and the Co-operative Society registered under the Multi State Co-operative Society Act, 2002. He also express his views that it is not possible to run two regulatory agencies in the same financial institution. Hence, the RBI's attitude for this has not yet finalized.

In the state of Kerala, the Muslim people are interested for developing the Islamic product such as mudarabah, musharakah and murabaha etc. outside the conventional banking for the development of Islamic private equity capital investment. Some financial institute like Cheraman Financial Service, Koche, Taqwaa Advisory and Shari'ah Investment Solution and also many rich people and the workers send their earnings to India those who are from Muslim community are interested to invested in interest free Islamic private equity capital fund which are Shari'ah compliant.

Many trust and co-operative society registered under the Multi State Co-operative Acts, 2002 and they opened their branches in various state in India for giving interest free loan to their registered members only for the growth of Islamic private equity capital investment in India. These society are not allowed to give loan to the non-members of the society. These society are running under the principle of Shari'ah. Some of these are:

- (a) Janseva Co-operative Credit society Ltd. It is registered under the Multi State Co-operative Society Act, 2002 situated in Mumbai and having its twenty three branches in twelve different state in India.
- (b) Al-Khair Co-operative Society Ltd. It is situated in Patna, Bihar and it has thirteen branches in various state of India. It is also registered under the Multi State Co-operative Acts 2002.

All these branches above are providing the interest free loan to the registered members for developing the Islamic Private equity capital with sharia compliance. In this way the Islamic private equity capital investment are growing through the Co-operative society in India.

Beside the above the Gulf Finance house, a Bahrain-based Islamic bank situated in Mumbai has entered in to contract with Mumbai-based Wadhwa Group for Islamic private equity capital investment for the development of real estate with maintaining the Shariah principle. The GFH also enter in to agreement with the ECNM and MITTIC for development of Islamic private equity capital investment through the investment in energy project, IT project and Telecom project in the state of Maharashtra, India.

Many other financial Institution and private banks registered under NBFC Acts are also providing interest free loan and developing the Islamic private equity capital investment in India with Shari'ah compliance. Some these are:

- (a) Al-Ameen Islamic Financial and Investment Corporation (India) Ltd, Karnataka.
- (b) Bank Muscat International (SOAG)
- (c) Al-Falah Investment Ltd., New Delhi.
- (d) Seyad Shariat Finance Ltd, Tirunelveli, Kerala, India.

These are all registered under Non-Banking Financial Companies based and get their licensed as per Reserve Bank of India directives 1997 (RBI) (amendment) Acts, 1997. These are also working for Islamic private equity capital investment in India. These banks are known as Islamic Bank in India as they are working with Shari'ah compliance. These bank are not considering Interest but they are distributing profit to its investor but not interest. The amount of loan given to their entrepreneur is termed as Islamic Private equity capital investment. They are giving loan the entrepreneur with partnership agreement called Islamic Instruments or Islamic Products in the name of Mudarabah, Muashrakah, Murabaha, etc. It is purely on profit basis and avoiding interest.

### **3. PROBLEMS OF ISLAMIC PRIVATE EQUITY CAPITAL INVESTMENT IN INDIA.**

The problems for the development of IPEC in India are as follows:

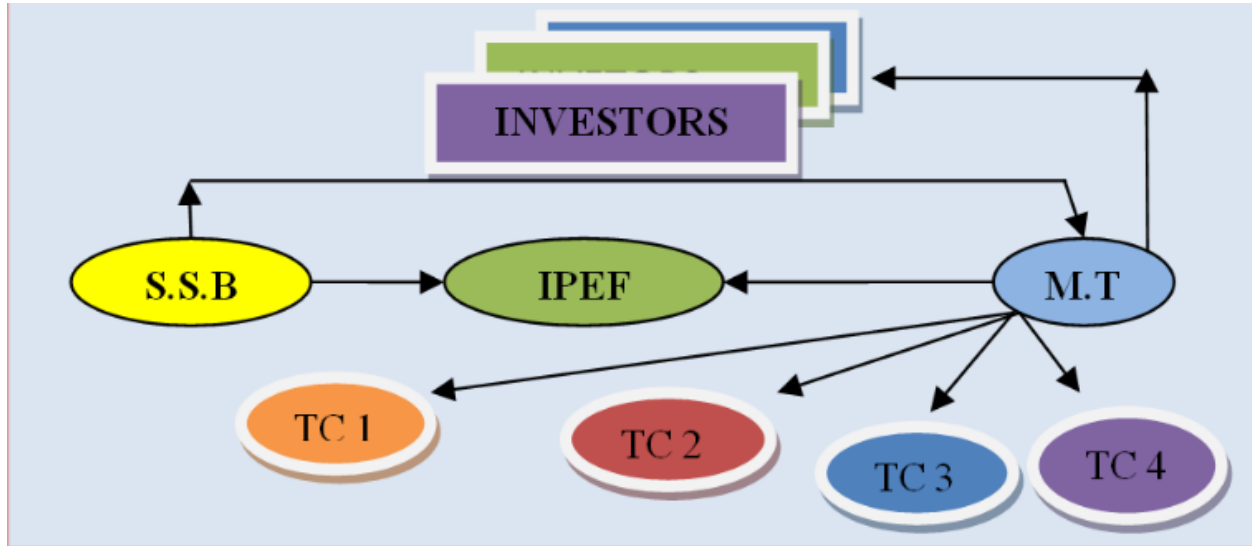
- lack of Shari'ah based legal infrastructure,
- Lack of law and regulation for Islamic bank.
- lack of Islamic Capital Market for IPEC,
- lack of recognized Shari'ah Advisory Board
- lack of Shari'ah compliant management team for management of IPEC,
- lack of sufficient number of Non-Banking financial Institution,
- Lack of motive of the Government for establishment of Islamic Banking and Islamic financial institution in the country with separate regulation.
- Lack of Intention of the Government to follow the Shari'ah Guidelines for investment of Islamic Private equity Capital as the country is secular.
- Lack of permission of the RBI to open Islamic window or Islamic department in the conventional bank.

### **4. OPERATIONAL STRUCTURE OF ISLAMIC PRIVATE EQUITY FUND:**

The rich people are depositing their excess money into the Islamic banks, Islamic financial institutions and Islamic co-operatives (members only) available in the country for a specific period of time with an agreement for profit sharing and without earning any interest or riba (interest) on the amount of deposits. The Islamic banks and other financial institutes will give loan as Islamic Private Equity capital investment to the selected entrepreneurs called Target Companies with their management team (MT) following the Shari'ah principles for halal Islamic products with partnership agreement Mudarabha, Musharakah, Murabaha etc. The management team always invests the fund in profitable target companies attached for the activities which are halal in nature. In halal products. The Shariah Supervisory Board (SSB) sets out the policy of investment and appoint Shariah compliance officer (SCO) for looking after the investments at the target companies (TC) and to verify whether the investment at the target companies is

with Shariah compliant. The investments are made with partnership contract with the Islamic instruments and which are Shariah compliance (Halal Business) in India. The Shariah Compliance Officer and the Management Team will advise the Target Company and report to the SSB regarding the present status of IPE Investment and development of the target company from time to time. The dividend are distributed among the Investors, entrepreneur and the Islamic Bank and financial institution as per deed of agreement with agreed profit sharing ratio.

**The operational structure of Islamic private equity capital investment are as follows:**



Source: Wouters, P. 'Islamic Private Equity Funds', Islamic Finance News, October, 2008.

#### **4.1. Islamic Instruments:**

##### **4.1.i. Mudarabah (profit sharing):**

It is a profit sharing contract. In case of loss, the entire loss will bear by the capital provider. The investee will not bear loss unless his proven negligence.

##### **4.1.ii. Musharakah (Joint Venture):**

It is another type of partnership business contract. Here both the investor and the investee will bear the profit as well as loss if any arise for the business at an agreed profit and loss sharing ratio.

##### **4.1.iii. Murabaha (cost plus finance):**

It is a cost plus markup contract among the financial institute, Customer and a third party vender of a particular product. It based on the good faith and honesty. In some cases collateral securities may be taken as guarantee from the customers. The agreed price will be fixed for specific period of time. Penalties may be applicable for late payment.

##### **4.1.iv. Ijarah (leasing):**

This is known as lease agreement. The term Ijara is an exchange transaction for a certain period of time with specific lease rent for the use of assets but the ownership of the assets itself is not transferred.

**4.1.v. Sukuk:**

This is an Islamic bond. It has similar features to that of a conventional bond and securities but they are asset-backed. It is allowed in Islamic Shari'ah.

**4.1.vi Takaful:**

It is an Islamic insurance. This type of insurance is allowed in Islamic Shari'ah.

**4.2. Islamic Banking:**

It is an interest free bank based on the Islamic Shari'ah compliance. It distributes share of profits in lieu of interest on deposits.

**4.3 Shari'ah:**

It is the Islamic unique law comes from the Holy Quran, the Hadith and Sunnah. It aviods interest in any form. Only halal products are allowed as per Shariah.

**4.4 Halal and Haram:**

It is the allowable product select for IPEC investment as per Islamic Shari'ah. It does not include any haram activities. Halal exclude the following:

Gambling, lottery, casinos, riba, interest, trading of human cloning, human fetuses, pornography, speculation and insurance, drugs, tobacco, alcohol, any intoxicant product, pork products, blood etc.

**4.5. IPEC:**

Islamic private equity capital is a form of investment either through Islamic bank or Islamic financial Institutions. This investment is free from receiving and giving interest or riba. As per Qu'ran interest is haram activities so this is forbidden in Islam. IPEC is invested in halal business with partnership business called Islamic product or instruments for example mudarabah, musharakah, murabaha, ijara, takaful, salam etc. profit earned from the business is treated as the return on investment. IPEC investment are of two types such as debt financing and equity financing. It includes ijara contract which is called lease financing. It also includes bond in the name of Sukuk.

**5. OBJECTIVE OF THE STUDY:**

- To find out the growth of the Islamic Private Equity Investment in India.
- To find out the number of Islamic Banking (NBFC), Co-operatives and Islamic Financial Institute in India.
- To find out the performance of IPE investment through Islamic Banks, Financial institution's and co-operatives.
- To find out the problems of the Islamic Private Equity investment in India.
- To give some measures to overcome the problems.

**6. METHODOLOGY:**

The study is basically empirical as well as descriptive in nature, and depends exclusively on the secondary data which show various aspects of the phenomenon in various studies. The data have been collected from the various published sources like books, websites, etc.

Besides the Abstract section, this paper is organized on seven sections. The first section describes the introduction of Islamic Private Equity in India. The second section explains the Scope and prospects of Islamic Private equity Fund in India. The third section sort out the problems of IPEC in India. The fourth section states the concepts of operational structure and procedure of Islamic Private Equity Capital investment, its Islamic instruments, the concept of mudarabah, musharakah, murabaha etc., Islamic banking, the Shari'ah, and the concept of haram and halal income. The fifth section describes the Objective of the study. The sixth section states the Methodology and plan of study and the seventh section discuss about the conclusions and suggestion.

## **7. CONCLUTION AND SUGGESTION:**

The researcher has gain knowledge on IPEC investment in India. This paper shows the Scope and prospects of Islamic private equity capital and sort out the problems to develop the Islamic private equity capital in India. It also shows the procedure laid down for the operation of Islamic private equity capital investment for socio economic development in the country by providing the interest free loan to the people with Shariah compliant. This paper especially shows that how the IPEC investment develop the society through the Co-operative society, Gulf finance house and other Islamic bank registered under NBFC Acts in various parts of India but it does not shows the actual numerical data which can measure the statistical testing. This paper shows the subjective portion of the growth of Islamic private equity capital investment in India. This study also shows the reasons for not establishing the Islamic Banks and absence of RBI regulations and SEBI guidelines which are the barrier for Islamic private equity capital in India.

But if the Islamic private equity capital practiced correctly in India then many people as well as the economy of the country will be benefitted and this will help the young people to increase their earnings and savings for creation of assets and wealth. But the Government should be positive in this regard and liberal for the implementation of Islamic Banking and for creation of separate regulation for Islamic bank for the development of Islamic private equity capital in India. Many non-Muslim county in the world like Thailand, Singapore, Sri Lanka, UK, USA, Philippines, Hong Kong, Japan, Indonesia, Indonesia and many other country have allowed the interest free banking in their country for the development of Islamic private equity capital for their economic growth and development .

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