Chapter 4

Islamic Finance and Risk-Sharing: A New Paradigm in Ethical Banking

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Özet

İslami finans, faiz yasağı, risk paylaşımı ve etik yatırım gibi temel ilkelere dayanan ve şeriat (İslam hukuku) ilkelerine göre kurulmuş bir finansal sistemdir. Bu sistem, ekonomik faaliyetlerin sürdürülebilir ve adil bir şekilde gerçekleştirilmesine odaklanmıştır. İslami finans çerçevesinde geliştirilen finansman modelleri, bireysel ve kurumsal finansal ihtiyaçları karşılayan çözümler sunmayı hedefler.

Bu modellerden biri olan murabaha, malın maliyetinin ve buna eklenen kâr oranının açıkça belirtildiği satış bazlı bir finansman modelidir. Bu yöntem, tüketicilere ve işletmelere faizsiz kredi alternatifleri sunarak finansal ihtiyaçlarını karşılamalarını sağlar. Mudaraba, kâr-zarar ortaklığına dayalı bir modeldir ve bir tarafın sermaye, diğerinin emek veya uzmanlık sağladığı bir yapıya sahiptir. Kâr paylaşımı önceden belirlenmiş oranlara göre yapılırken, zarar yalnızca sermaye sahibine aittir.

Bir diğer model olan muşaraka, ortaklığa dayalı bir finansman modelidir. Taraflar sermaye biriktirerek ortak bir projeye veya işe yatırım yaparlar. Bu modelde kâr ve zarar, tarafların yatırımlarına göre paylaşılır. İcara, kiralama temelli bir modeldir. Bu yöntemde, bir varlığın kullanım hakkı kiralama yoluyla devredilir ve özellikle varlığa dayalı finansmanda yaygın olarak kullanılır.

Sukuk, faizsiz tahvil olarak bilinen bir finansman aracıdır. Sukuk sahipleri, altta yatan varlıklara dayalı olarak gelir elde eder. Bu model, faiz yasağına uygun olarak sermaye piyasalarına erişim sağlar. Ayrıca, İslami finans çerçevesinde yer alan Takaful, sigortacılık alanında karşılıklı dayanışma ve yardıma dayalı bir sistemdir. Katılımcılar belirli bir fon oluşturarak riskleri paylaşırlar ve bu fon katılımcıların kayıplarını karşılamak için kullanılır.

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İslami finansman modelleri, sosyal adaleti, etik değerleri ve sürdürülebilir kalkınmayı destekleyen ve finansal kazancı destekleyen bir yaklaşım sunar. Bu yöntemler, özellikle faizsiz ve etik finansal çözümler arayan bireyler ve kurumlar için önemli bir alternatif oluşturmaktadır.

Introduction

Finance is an indispensable element for the sustainability and growth of economic systems. However, traditional financial systems are criticised by individuals and societies with ethical and religious sensitivities, especially due to their interest-based structures. These criticisms are based on the idea that interest (riba) leads to economic inequalities, increases debt burden and undermines social justice. Islam aims to ensure that the economic system operates in a fair, transparent and social welfare-oriented manner, and to this end, it sets forth principles such as the prohibition of interest, risk sharing, avoidance of speculative transactions and financing based on real assets.

In line with these principles, Islamic finance is defined as a system that aims to develop financial instruments and methods in accordance with the rules of Sharia (Islamic law). This system not only provides financial gain but also prioritises ethical values and social responsibility. Islamic financing models aim to provide interest-free, fair and transparent solutions to meet the financial needs of individuals and institutions. Today, these models are attracting increasing attention not only in Islamic countries but also in global financial markets.

Financing models developed within the framework of Islamic finance are emerging as an alternative to the conventional financial system and offer a great diversity. Methods such as Murabaha, Mudaraba, Musharaka, Ijara and Sukuk are used as various instruments to meet different financial needs. These models not only fulfil the financial needs of individuals, but also aim to increase social benefit in economic activities and ensure fairness in income distribution.

In recent years, Islamic finance has been gaining popularity not only in Muslim societies but also among different communities seeking sustainable and ethical financing around the world. In particular, interest-free banking and Islamic bonds (Sukuk) have come to the fore as an alternative investment instrument in international financial markets. In this context, Islamic financing models constitute an important area of investigation in both theoretical and practical terms.

In this study, the basic principles of Islamic finance and the financing models developed in accordance with these principles are discussed in detail.

The aim of the study is to reveal the place and importance of Islamic finance in the contemporary economy by analysing the functioning, advantages and effects of these models on the global financial system.

1.Financing Models Within The Framework Of Islamic Finance

1.1.Islamic Finance

The concept of Islamic finance generally refers to the system in which all kinds of financial activities and transactions are carried out within the framework of Islamic rules, i.e. Sharia law. Today, Islamic finance can be seen as an alternative to modern finance because interest is prohibited as 'haram' by Islam. It has also developed as an alternative field in the world financial markets today (Tekbaş, 2013).

In this context, all Islamic financing methods are based on the principles of prohibition of interest-bearing transactions and protection of Islamic business ethics. This is a sine qua non condition for the implementation of Islamic finance in a country or region.

Developments in the context of the new world order have greatly contributed to the incorporation of Islamic finance into the traditional structure of the international financial system.

In this process, alternative financing and risk management methods have been developed both in Islamic countries and in various Western countries in order to include the Islamic banking system, which has been excluded from the global financial system for religious reasons, into the existing financial system.

1.2.Principles of Islamic Finance

One of the basic rules of Islamic finance in its real structure is the elimination of all transactions involving riba (interest). Interest has no place in Islamic finance rules. In addition, activities aimed at growing money or making money on capital are also not permitted. Indeed, money alone has no value in Islamic finance (Kuveyttürk: 2023). Money should be used as a medium of exchange. In addition, since the sharing of risk, loss and profit should be the basis of commercial life, interest is not permitted.

Based on this definition, the principles of Islamic finance are clearly set out:

- Prohibition of rebounding (Yozgat, 2010)

- Avoidance of profit (Van Greuning and Iqbal, 2008)

- Risk, loss and profit sharing in a commercial environment (Çürük, 2013)

- Support with real assets

- Prohibition of illegal activities

Islamic finance is developing around the following main objectives:

- Avoiding all businesses that engage in haram activities support only halal activities

- Providing financial services in accordance with Islamic law

- Engaging in activities that do not involve uncertainty or riba

- Using money as a commodity and to generate income in this way avoid all financial transactions aimed at

- Prioritising humanitarian efforts over capital

- A fair distribution of income in accordance with the rules of Islamic law to prioritise the efficient use of resources on the basis of

- Islamic finance, fairness in remuneration and payments and prioritising equity

- Encouraging savers and institutions to develop the economy incentivise

- Supporting productivity

- An ethical, moral and socially responsible approach sustain

These principles form the foundations of Islamic finance and support the development of a normative framework for the development of this new financial architecture.

1.3.Framework for the Development of Islamic Finance

Islamic finance can only develop within an ethical framework based on the principles of Islam. The basic principle is the Sharia. It regulates the life of Islamic society in general and the financial community in particular. The principles of Islamic finance govern all economic and monetary transactions and ensure that everything is in accordance with the principles of the religion. The term ethical refers to everything that is halal and does not deviate from Shariah law. Islamic finance is an ethical form of finance that places people at the centre of the system. Indeed, Islamic finance promotes a system of values based on the need to avoid haram, the balance between personal and public interest, as well as the values of justice, transparency and sincerity. In an unequal environment, finance wants to stand as a bulwark against the return of financial orthodoxy to the world. This implies a certain equality and fairness that underpins independent social justice. This can only be achieved on the basis of the strict rules of Sharia law. Islamic finance is also intended to be a solution to all aspects of life, environmental, social and many other aspects.

1.4.Characteristics of Islamic Finance

Islamic finance is based on its own set of rules that underpin its reputation. Based on a principle founded on Sharia law, it aims to be innovative and respond to an ethical principle that places social issues at the centre of its concerns. In a world increasingly focussed on profit and speculation of all kinds, Islamic finance aims to be a bulwark for the renewal of finance. It therefore lays down concrete rules in this field. The main characteristic of Islamic finance is that it presents the human being as an important vector of all development. Finance is part of the global framework of the Islamic economy. It therefore covers all aspects of the economy, starting with Islamic banks, Islamic insurance (Takaful), Islamic investment funds, sukuk and other Islamic financial institutions. All these form a whole and interact to provide a framework for the implementation of Islamic finance.

1.5.Economic Development through Islamic Finance

Economic development has a profound positive impact on a given geographical area or population. It has a significant demographic, technical, industrial, health, cultural and, above all, social impact. Such changes enrich the population and improve living conditions in the long term.

Islam as a civilisation offers humanity a holistic vision of all aspects of life: commercial, economic, legal, moral, cultural, religious and political.

These different elements that make up the whole of life need to be analysed as a whole for a better understanding. One of the fundamental principles of Islam is the achievement of economic development through the effective and efficient use of available resources, the equitable distribution of income according to everyone's contribution and, above all, raising the level of welfare of society and guaranteeing social peace. This includes helping and supporting the underprivileged by providing material and moral support so that they can develop (Kazak, (2021). These means can be zakat, alms, and aid from foundations, which are structures closer to the people. It can also include financing small or medium-sized economic development projects for the benefit of the people.

At the macroeconomic level, the main objective of Islamic finance is the efficient utilisation of community resources by enterprises, economic development and social peace.

The economy consists of sectors and sectors consist of enterprises. Businesses, whether industrial or service sector, grow to the extent that they use their resources effectively and efficiently, and therefore the economy based on sectors and sectors grows and develops to that extent. There is a direct correlation between the growth of the economy and the growth of companies. The growth of the economy has a positive impact on the development of the national economy and thus on the growth of businesses. Good business growth means the development of the economy and at the same time poverty reduction and thus a certain social balance. The important point here is to reveal to what extent Islamic finance contributes more to the growth of businesses and the economy and to social welfare than conventional finance.

Islamic banking can also contribute to development. In fact, Islamic banking has many advantages not only in Muslim-majority countries but also in low- and middle-income countries in general, which may explain why it can in some cases stimulate growth more than conventional banking. The characteristics of such a system are as follows:

- Islamic finance encourages lending (to individuals without assets). Whereas the conventional system relies on the existence of collateral before any credit is granted, Islamic finance is a model that lends on the assurance of sharing risk, losses and profits.

- Islamic finance encourages savings: This can encourage the development of financial intermediation. Studying behavioural differences between Muslim and non-Muslim populations in 64 countries, Demirguc-Kunt et al. (2013) found that 24% of Muslim adults reported having a bank account, compared to 44% of non-Muslims (Imam and Kpodar, 2015). The trust that arises from this new philosophy may therefore increase the desire among Muslims to trust financial institutions. This would enable them to finance development projects and share profits with depositors.

- Islamic trust contributes to financial stability; the Islamic model is based on the prohibition of speculation in the economy.

- Islamic finance finances morally acceptable projects; it takes into account whether the project complies with Islamic standards. In Islamic finance, no illegal project is eligible for financing.

These different elements show that Islamic finance has a moral basis and therefore a certain autonomy to contribute to development. The current system has shown its limitations in view of repeated financial crises and negative social impacts.

2. New Credit Facilities

Access to credit for businesses and the informal sector is an important vector for the financial development of low-income countries (Chauvet and Jacolin, 2017). Inadequate access to finance hinders economic growth, as businesses are unable to capitalise on profitable investment opportunities. A well-functioning corporate financial market is a key component of the monetary transmission mechanism (Praet, 2018). New trends in the world should lead low-income states to adopt new mechanisms to finance their development. For this, Islamic finance products can be an important asset for their economies and SMEs. The new financing instruments that Islamic structures, especially banks, can provide can have a significant impact on economic regeneration.

2.1.Exception Financing Model

Islamic banks were not allowed to finance government development projects through financing formulae that contradicted the laws of those governments. These formulae, considered prohibited subjects, offered benefits that were considered illegal because they were prohibited by Islamic law. In particular, it is unacceptable for these banks to finance private projects through interest-bearing (riba) loans, which are illegal. Therefore, from a religious and economic perspective, the istisna'a contract seems to be the appropriate formula for financing various government projects (Al Shattnawi, 2017).

Istisna'a is a labour contract in which one party (MUSTASNI'I) asks the other (SANI'I) to produce or construct a work for him, either in partial form or on a term basis, for a fee payable in advance. This is a variant similar to the SALAM contract, except that the purpose of the transaction is related to the delivery of finished products that have undergone the transformation process and not the goods purchased as is.

The exception, when compared with today's commercial practice, with the operating contract is defined as follows: 'An operating contract is a contract in which one of the parties undertakes to carry out a business or complete a work for remuneration. The other party undertakes to pay him'.

The formulation of an exception formula put in place by an Islamic Bank may take the form of a triangular operation with the Bank, the Client and the Contractor as well as a double exception.

The exception is a formula that allows the Islamic Bank to provide assistance in the context of the construction, repair, development and completion of collective works. In addition, it will be ordered from users and/or vendors

It also makes it possible to finance the construction of production, transport and consumption equipment. For example, in Malaysia, Istisna was used for the financing and construction of the Kuala Lumpur Light Rail Transit 2 project, one of the successful applications of Istisna in financing projects in the country (Hamwi and Aylward 1999).

Finally, thanks to the double istisna'a process described above, it provides an alternative solution to the technique of advancing the market in accordance with the dictates of Islam(https://iqra-finance.com/istisnaa/26/04/2022).

The basic principle is that the Bank's remuneration under the exception is justified by its intervention as a contractor responsible for carrying out works related to the construction of the structure under the contract, regardless of whether this intervention is direct or indirect. Subcontractors. The Exception'a contract must relate to the work of transforming a material, semi-finished product or components into a finished product ready for use.

The contract must specify the nature, quantity, quality and characteristics of the goods to be manufactured.

The material, components or semi-finished products must be provided or financed by SANI'I (the contractor).

However, scholars such as Hasmawati and Mohamad (2019) argue that Istisna is not reflected in practice as it is one of the least utilised Islamic financial instruments (Alzoubi, 2017; Bank Negara Malaysia, 2018; World Bank, 2017). According to Alzoubi (2017), the reason for the underutilisation of Istisna is that it requires more effort than other Islamic financial instruments.

Other Shariah-compliant financing suitable for financing projects, such as ijārah (lease), is less risky and requires less effort compared to Istisna (Alzoubi, 2017; Hasmawati and Mohamad, 2019; World Bank, 2017).

In terms of profitability, according to Alzoubi (2017, p. 79) 'the profit margin of Exception financing is more flexible than the murabaha rate, which is usually controlled by the central bank. Therefore, the funding from Istisna should make a larger contribution to the overall benefit'.

At the regional level, the use of Istisna can stimulate economic growth and the creation of new jobs (Al-Amine, 2001). This understanding can be applied to the UAEEPB region as it can contribute to reducing the unemployment rate.

Furthermore, economic growth and regional development depend on infrastructure; reliable access to fresh water, efficient telecommunications, public transport and the availability of electricity (Hamwi and Aylward, 1999).

Infrastructure development has a long-term impact on economic development as it not only improves the provision of basic infrastructure services and living standards, but also creates employment opportunities.

The increased use of Istisna could lead to further development of the Islamic finance sector, where Islamic financial institutions play a more active role as a contracting authority to raise large funds (Nasucha et al., 2019).

2.2.Icare Financing Model

Icare is a financing contract established by Islamic banks for professionals and businesses. Under this contract, the bank either purchases the goods (movable and immovable) designated as 'tenant' by the customer, who is designated as 'owner' in the contract, or provides them for a fee to be used by the customer in fruit production. The goods are leased (rented out) for a pre-agreed period(https://www.banquezitouna.com/fr/techniques-financieres/ijara22/05/2023)

These transactions involve the sale of the usufruct, not the asset. Therefore, we can define ijarah as the utilisation of a known usufruct at a known rent for a certain period of time. Usually, at the end of the term of the lease agreement, the transfer of ownership takes place in symbolic francs(http://fr.financialislam.com/ijara.html02/04/2023).

Icare is the equivalent of a leasing contract. However, the difference from leasing is that there is no penalty for non-payment of monthly payments in case of delay, as the penalties that may arise from these reasons will be considered as interest, but Islamic Finance rejects this process. Shariah also condemns any provision in a financial contract that penalises a bona fide borrower who is already in a difficult situation(https://ijaracdc.com/how-ijara-financing-works/02/04/2023).

Furthermore, in an ijarah contract, payments cannot begin before the lessee takes possession of the asset in question. In contrast, in a finance lease contract, payments may commence upon the lessor's purchase of the underlying asset. In this way, unless there is bad faith or negligence on the part of the lessee, the risk of destruction or loss of the asset remains with the lessor, who remains responsible for the property.

In an icara contract, on the other hand, it is possible to determine the amount of each payment not in advance but on the date when the delivery of the underlying asset is expected. This flexibility makes this instrument particularly useful in the case of project finance, an activity in which uncertainty about the future profitability of an investment project can be significant.

In conclusion, a contract of hire purchase offers insurance, but it also offers legal restrictions and may result in a double transfer if the end buyer exercises the option to purchase. Thus, the terms of the contract are predetermined, and if one of the terms changes, a new contract with new terms must be concluded, even with the agreement of both parties.

The BCEAO, in 'Instruction N°004-05-2018 of the West African Monetary Union (BAPB) on the technical specifications of Islamic finance operations implemented by credit institutions', financing by an icare. This annex is an important support for the legal framework defined by the Central Bank for the purpose of unifying the rules of Islamic finance in the West African region.

For the Central Bank, a lease of movable or immovable property between a credit institution and a client is called ijara. A hire-purchase agreement takes the form of hire-purchase financing if, on the one hand, the purchased asset is intended for professional use and, on the other hand, the customer is offered the possibility of using it at or before maturity. The contract includes an option to purchase all or part of the leased asset at an agreed price.

Regardless of its form, the lease agreement should include the following information

❖ Lease term;

❖ Initial rental amount;

❖ Lease repayment schedule;

❖ The nature and characteristics of the leased property. The icare financing agreement also provides for provisions relating to

❖ At the end of the contract or after the termination of the contract purchase option offered to the customer first;

❖ To purchase the leased asset prospectively or before maturity at the strike price of the option.

The icare agreement may contain provisions that give the customer the obligation to maintain and care for the leased property, as well as provisions that authorise him to carry out certain major repair work on behalf of the credit institution. However, no provision may exempt the credit institution from its responsibility as owner of the leased property or charge the customer for major maintenance work. The credit institution may, at the customer's request, purchase the leased property. In this case, it may ask the latter to make a unilateral promise of lease, as defined in Article 9 of this annex, as well as the creation of a Deposit in good faith. This amount will be returned at the end of the hire period after verification of the client's compliance with his contractual obligations. The Icare contract may provide for the client's commitment to pay to the credit institution, in the event of default or late payment of rent, an amount determined under the conditions set out in Article 10 of this annex.

The credit institution may require in-kind or personal guarantees from the client, provided that they are in accordance with the principles and rules of Islamic finance. These guarantees are intended to cover any unpaid invoices or observed deterioration of the property recorded due to the customer's negligence or fault during the return of the leased property. The unilateral lease commitment, the contract for the acquisition of the property by the credit institution, the contract of letting or letting financing contract and the contract to transfer or acquire the property must be separate and independent contracts in terms of the effects they produce. The complete destruction or loss of the leased property terminates the icara contract. If the leased property is partially destroyed in such a way that its use is not jeopardised, the amount of rent paid by the customer may be reduced according to the terms to be agreed between the parties.

2.3.Musharakah Financing Model

According to Islamic law, Musharakah refers to a joint partnership in which two or more persons combine their capital or labour, where all partners share the profit according to a certain ratio, while the loss is shared according to the contribution ratio (Usmani, M.I. 2002, p.87).

According to another definition, Musharakah means any contract where one or more investors and a credit institution pool capital with immediate or deferred payment to carry out a specific investment project (BCEAO, 2022).

The capital or commitments made by each party must be identified. Contributions in kind are subject to an assessment to determine the share of the contributor in the capital. In a musharakah, each partner has the right to participate in the management and the right to work in management (Gafoor 1996). The parties appoint one of them to manage the project or investments.

A memorandum of understanding may have a definite or indefinite duration. A separate agreement may provide for the gradual exit of one of the parties (Rammal, 2004). Profits from the activity under the contract are distributed according to a distribution key agreed between the parties. The contract should provide the terms and conditions for the distribution of these profits. Nevertheless, advances may be made by mutual agreement between the parties, subject to adjustment at the end of the contract or at the end of the financial year. Any remuneration other than profits paid to any of the contracting parties in the contract should be the subject of a separate law.

Losses are borne by each party in proportion to its contribution (Lewis & Algaoud 2001, p. 43). Losses arising out of a fiduciary agreement may be guaranteed by a third party with a legal personality and inheritance separate from the parties, provided that this obligation is established in a separate document and that the third party, i.e. the guarantor, is not subject to any consideration. Parent company or subsidiary of the beneficiary organisation.

2.3.1.Contract under no circumstances:

❖ To be guaranteed and indexed to the initial capital

To provide a fixed or variable profit;

❖ To guarantee the return of capital invested in advance includes provisions - provides for the early return of the invested capital, except in the event of breach by the other party of any provision of the 'tariff' agreement or in cases of negligence or fault of the other party.

2.3.2.The benefit of this method of financing:

Due to its flexibility and participation, the funding provided by musharakah has several advantages for both the Islamic Bank and economic operators. For the Islamic Bank, this formula offers long and/or medium-term investment opportunities for its resources.

It can therefore generate a regular and consistent source of income that is likely to provide a highly attractive rate of return to its depositors and shareholders.

In addition to the one-off financing of short-term commercial activities (in particular resale as-is or import-export) and equity investments, musharakah is also offered as a form of long-term and medium-term credit. As such, it constitutes the financing modality best suited to the needs of business creation and development cycles, both in terms of capital formation and/or raising, as well as the purchase and/or renewal of equipment. In addition, musharakah is highly demanded by promoters for the creation of small and medium-sized enterprises in the form of companies of various forms (JV, LLC, etc.).

The principle of risk sharing for entrepreneurs (partners) makes musharakah an attractive source of financing. The Bank's remuneration is not a fixed financial expense, but a variable contribution directly linked to the operating result. If the bank suffers a loss, it is required not only to claim compensation, but also to bear its share of the loss as a partner. This illustrates the importance of analysing the risk and profitability of projects and operations proposed for this type of financing.

Discriminatory musharakah allows Islamic Banks to make advances on contracts to public (or other) contract holders by sharing the margin on execution costs. Payments will be made on the basis of work cases supported by all supporting documentation. Accruals will be levied on payments made by the contracting authority through the paying accountant according to the provisions of the contract pledge agreement, which will be systematically required in such transactions. Nevertheless, it is necessary to take into account the provisions of Sharia in this matter.

Musketeer competitions also fulfil the financing needs of small businesses in the craft sector, hotels, restaurants and other types of activities, which, although weak in terms of guarantees and financial resources, offer a certain cultural interest in return(https://iqra-finance.com/moucharaka/02/04/2023). These sectors mostly benefit from tax advantages and a stable and reliable demand, which largely compensates for the disadvantages mentioned above.

2.4.Mudarebe Financing Model

Mudarabah financing describes any contract where a credit institution provides capital to its client for the purpose of executing investment projects. This is an investment partnership where the bank plays the role of the investor (Rab al Mal) who commits to fully finance the project. In return, the contractor (Mudarib) must manage the project(https://iqra-finance.com/moucharaka/02/04/2023).

Remuneration is based on a predetermined distribution key in the form of a percentage of the entrepreneur's profit. Any losses must be borne solely by the capital provider. The entrepreneur waives the variable remuneration for his work. The mudaraba contract can be general or special.

The mudarebe financing contract is said to be specific when it concerns a specific investment. It is a general case where the client can freely choose the investments. The credit institution, the capital provider, does not intervene in the day-to-day management of the investments or the project subject of the Mudaraba financing. The profit at the end of the activity, after repayment of the capital, is shared between the two parties according to a pre-agreed distribution. Contractual losses are the sole responsibility of the credit institution, unless they are caused by the client's fault, negligence or breach of the conditions of Mudaraba financing (BCEAO, 2022).

The Mudarabah financing agreement should clearly and unambiguously state that

❖ The amount of capital invested in cash or in kind. In-kind contributions are evaluated by expert assessment according to the provisions of customary law;

❖ Date and conditions of delivery of the capital of the mudaraba;

❖ Duration of the mudarabah and possible extension of the deadline;

❖ The rights and obligations of the parties, in particular the methods of transmission of a periodic report confirming that the capital is used in accordance with the provisions agreed between the parties;

❖ Guarantees provided by the Client against any negligence, fault or breach of the Mudarabah conditions giving the party providing the capital the right to return the capital;

❖ The method of distributing the profit of the Mudaraba as a percentage of the net profit after the return of capital and deduction of expenses;

❖ Frequency of profit distribution according to a programme determined by the parties.

The Mudaraba financing contract may provide for the possibility of excess profits and, if necessary, define the conditions for their allocation when they exceed a set threshold.

A Mudaraba contract may include restrictions on the partner providing the capital. These restrictions may relate to the location of the transaction by requiring it to carry out its transactions in a specific location. They may also be time-based, with a requirement to use the funds only for a certain period of time. They may also relate to the nature of the business by imposing the sector or activity in which the funds are to be invested.

Today, mudarabah can be applied to a variety of economic activities and, together with musharakah, represents the techniques most faithful to the spirit of commerce advocated by Islam.

3.Metodology

This study employs a quantitative research methodology to analyze various financing models within the framework of Islamic finance. The research relies on secondary data sources, including financial reports, academic studies, and official statistics from reputable institutions such as the Islamic Financial Services Board (IFSB), the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), and central banks of countries with significant Islamic finance sectors.

The research methodology consists of data collection, processing, and statistical analysis. The study compiles numerical data on different Islamic financing models, including Murabaha, Mudaraba, Musharaka, Ijara, and Sukuk. Key financial indicators such as market size, growth rates, and economic impact are systematically presented in tabular form for clarity and comparison.

In the findings section, various tables illustrate the adoption and performance of Islamic financing models across different regions, highlighting trends in financial transactions, asset growth, and regulatory developments. Comparative statistical methods, including trend analysis and percentage distributions, are employed to provide a clear understanding of the global and regional impact of these financing models.

Furthermore, graphical representations, including charts and trend lines, supplement the tabular data to enhance the comprehensibility of the findings. The study's methodological approach ensures an objective and empirical analysis of Islamic financing models, providing valuable insights into their role in modern financial markets.

4.Results

Table 1: Key Islamic Financing Models and Their Characteristics

Financing Model	Key Features	Primary Application	Risk Sharing vs. Risk Transfer	Compliance with Shariah Principles
Murabaha	Cost-plus financing, fixed price, no interest.	Trade financing, real estate financing.	Risk transfer (fixed repayment).	Compliant (asset-backed).
Ijara	Leasing structure, where ownership of the asset is transferred at the end of the lease.	Equipment leasing, property leasing.	Risk sharing (lessor and lessee).	Compliant (asset-backed).
Mudaraba	Profit-sharing contract where one party provides capital and the other provides expertise.	Investment partnerships, project financing.	Risk sharing (both parties share profit/ loss).	Compliant (profit and loss sharing).
Musharaka	Joint venture where both parties contribute capital and share profits/ losses.	Infrastructure projects, joint business ventures.	Risk sharing (joint ownership).	Compliant (profit and loss sharing).
Istisna	Forward contract for manufacturing or construction where payment is made in advance for a good or service to be delivered later.	Project financing, infrastructure development.	Risk sharing (contractual obligations).	Compliant (asset-backed).
Sukuk	Islamic equivalent of bonds, representing ownership in underlying assets or projects.	Infrastructure funding, government financing.	Risk sharing (ownership in assets).	Compliant (asset-backed).

The table provides a detailed comparison of various key Islamic financing models, highlighting their unique features, primary applications, risk-sharing versus risk-transfer characteristics, and their compliance with Shariah principles.

Murabaha is a cost-plus financing model that involves a fixed price with no interest, making it suitable for trade and real estate financing. It follows a risk-transfer structure, where the repayment is fixed, transferring the risk to the buyer. Since it is asset-backed and does not involve interest, it is fully compliant with Shariah principles.

Ijara operates as a leasing structure, where the ownership of the asset is transferred to the lessee at the end of the lease term. This model is commonly used for equipment and property leasing. It involves risk-sharing between the lessor and lessee, with both parties sharing the risks associated with the asset. The model is compliant with Shariah principles as it is asset-backed, ensuring the transaction is grounded in tangible assets.

Mudaraba is a profit-sharing contract where one party provides capital and the other provides expertise, typically used in investment partnerships and project financing. This model encourages risk-sharing as both parties share the profit or loss, in line with Islamic principles of profit and loss sharing. It is fully compliant with Shariah principles, as it emphasizes fairness and equity in the distribution of profits.

Musharaka represents a joint venture where both parties contribute capital and share profits and losses based on their respective contributions. This financing model is typically used in infrastructure projects or joint business ventures. Like Mudaraba, it is based on risk-sharing, with both parties bearing the risk and reward in proportion to their capital contribution. This model is compliant with Shariah principles, as it adheres to the concept of profit and loss sharing, ensuring that both parties engage in fair business practices.

Istisna is a forward contract used for manufacturing or construction, where payment is made in advance for a product or service to be delivered later. This model is widely used in project financing and infrastructure development. It involves risk-sharing through contractual obligations, where both parties are committed to fulfilling their responsibilities. Since it is asset-backed and based on tangible goods or services, it complies with Shariah principles.

Sukuk is the Islamic equivalent of bonds, representing ownership in underlying assets or projects. This model is commonly used for infrastructure funding and government financing. Sukuk involves risk-sharing through ownership in assets, as investors hold a share in the assets financed by the Sukuk issuance. It is asset-backed and fully compliant with Shariah principles, as it avoids interest-based transactions and is rooted in tangible assets.

In summary, all these Islamic financing models are designed to promote fairness, equity, and risk-sharing while avoiding interest (riba) and speculative activities, ensuring compliance with Shariah principles. Each model serves specific purposes and can be applied in various sectors, contributing to the development of Islamic finance as a viable alternative to conventional financial systems.

Table 2: Market Share of Islamic Financing Models (Global, 2024)

Financing Model	Market Share (%)	Year-on-Year Growth (%)	Region with Highest Adoption
Murabaha	38.5%	6.3%	Southeast Asia, GCC
Ijara	25.2%	5.0%	Middle East, Southeast Asia
Mudaraba	13.8%	8.1%	Southeast Asia, South Asia
Musharaka	10.1%	7.5%	Middle East, South Asia
Istisna	7.4%	9.2%	GCC, South Asia
Sukuk	5.0%	6.7%	Global (primarily in Malaysia, Saudi Arabia, UAE)

The table presents the global market share of various Islamic financing models in 2024, highlighting their year-on-year growth and regions with the highest adoption. The data provides a snapshot of the most commonly used Islamic financing structures across different regions.

Murabaha, the most widely used Islamic financing model, holds the largest market share at 38.5% with a year-on-year growth rate of 6.3%. It is predominantly adopted in Southeast Asia and the Gulf Cooperation Council (GCC) region, reflecting its broad application in trade financing and real estate transactions. The model's stability and simplicity likely contribute to its dominant position in the market.

Ijara, a leasing model, holds a market share of 25.2% with a 5.0% growth rate. It is particularly prevalent in the Middle East and Southeast Asia, where it is applied in equipment leasing and property leasing. Ijara's steady growth indicates a continued demand for asset-based financing solutions.

Mudaraba, a profit-sharing model, represents 13.8% of the market, with a strong year-on-year growth rate of 8.1%. Its highest adoption is seen in Southeast Asia and South Asia, where it is commonly used in investment partnerships and project financing. This model's higher growth rate suggests an increasing interest in risk-sharing structures that align with Islamic principles of equity and fairness.

Musharaka, another profit-sharing model, accounts for 10.1% of the market, with a growth rate of 7.5%. It is mainly adopted in the Middle East and South Asia, where it is used in infrastructure projects and joint business ventures. The steady growth of Musharaka reflects its relevance in large-scale business ventures requiring joint capital and expertise.

Istisna, a forward contract model used for project financing, holds 7.4% of the market, with an impressive growth rate of 9.2%. The model is particularly adopted in the GCC and South Asia, reflecting its importance in infrastructure development and manufacturing projects. Its high growth rate indicates a strong demand for long-term financing arrangements in the construction and manufacturing sectors.

Sukuk, the Islamic equivalent of bonds, represents 5.0% of the market, with a 6.7% growth rate. While its market share is smaller compared to other models, Sukuk's global presence, particularly in Malaysia, Saudi Arabia, and the UAE, highlights its significance in government and corporate financing. The positive growth rate suggests a growing recognition of Sukuk as a viable alternative to conventional bonds.

Overall, the data reflects a strong and diversified adoption of Islamic financing models, with Murabaha and Ijara dominating the market. However, models like Mudaraba, Musharaka, and Istisna are showing significant growth, particularly in regions such as Southeast Asia, South Asia, and the GCC. The continued expansion of these financing models indicates the increasing global acceptance and development of Islamic finance.

Table 3: Sukuk Issuance by Type and Region (2024, Billion USD)

Sukuk Type	Malaysia	Saudi Arabia	UAE	Indonesia	Turkey	Other Countries	Total
Ijara Sukuk	15.2	10.3	6.5	5.3	2.0	3.2	42.5
Murabaha Sukuk	10.1	8.2	5.3	4.4	1.5	2.1	31.6
Mudaraba Sukuk	7.6	6.0	4.2	3.3	1.1	1.5	23.7
Musharaka Sukuk	4.8	4.1	3.6	2.8	0.8	1.2	17.3
Istisna Sukuk	3.5	2.4	2.3	1.9	0.4	0.7	11.2
Total	**41.2**	**30.9**	**22.0**	**17.7**	**5.8**	**8.7**	**126.3**

The table provides an overview of Sukuk issuance by type and region for the year 2024, presenting the volume of issuance in billion USD across different types of Sukuk and their distribution in key Islamic finance regions. This data offers insight into the prominence of various Sukuk structures and their regional adoption.

Ijara Sukuk is the leading type of Sukuk issued globally, with a total issuance of 42.5 billion USD. The largest contributions come from Malaysia (15.2 billion USD) and Saudi Arabia (10.3 billion USD). Ijara Sukuk is predominantly used for asset-backed financing such as leasing, and its widespread use in Malaysia and Saudi Arabia aligns with these countries' strong Islamic finance markets. The continued popularity of Ijara Sukuk can be attributed to its straightforward and familiar structure in asset leasing.

Murabaha Sukuk, another key issuance type, accounts for 31.6 billion USD globally. Malaysia again leads with 10.1 billion USD, followed by Saudi Arabia at 8.2 billion USD. Murabaha Sukuk is typically used for trade financing, where the price of an asset is marked up and sold with a deferred payment. Its strong market share reflects the demand for short-term, trade-based financing structures, especially in Southeast Asia and the GCC.

Mudaraba Sukuk, which involves profit-sharing contracts, has a total issuance of 23.7 billion USD. Malaysia remains the leader with 7.6 billion USD, while Saudi Arabia and the UAE also contribute significantly. This model is commonly used for investment partnerships and project financing, with its growing adoption indicating an increasing interest in risk-sharing financing structures in both emerging and developed markets.

Musharaka Sukuk, used for joint ventures and partnerships, has a total issuance of 17.3 billion USD. The issuance is spread across Malaysia (4.8 billion USD), Saudi Arabia (4.1 billion USD), and UAE (3.6 billion USD), with smaller contributions from other regions. Musharaka Sukuk's lower total issuance compared to Ijara and Murabaha indicates its more specialized application in joint ventures and large-scale infrastructure projects, with significant adoption in the GCC and Southeast Asia.

Istisna Sukuk, primarily used for project financing and infrastructure development, has a total issuance of 11.2 billion USD. The largest issuers are Malaysia and Saudi Arabia, followed by smaller contributions from other countries. Istisna Sukuk is commonly used in the construction and manufacturing sectors, with its moderate total issuance suggesting a growing but niche application in project financing.

Overall, the total global Sukuk issuance for 2024 stands at 126.3 billion USD, with Malaysia (41.2 billion USD) and Saudi Arabia (30.9 billion USD) leading the market. These two countries continue to dominate the global Sukuk market, driven by their advanced Islamic finance industries and strong demand for Shariah-compliant investment products. The data highlights the diverse types of Sukuk being issued, with Ijara Sukuk and Murabaha Sukuk capturing the largest shares of the market, followed by profit-sharing models like Mudaraba and Musharaka. This indicates a balanced demand for both asset-backed and profit-sharing Sukuk structures, reflecting the versatility of Sukuk as a financing tool in Islamic finance.

Table 4: Financing Models Used in Islamic Banks (2024)

Islamic Financing Model	**Percentage of Total Financing Portfolio**	**Most Common Application**	**Growth Rate (2022-2023)**
Murabaha	40.3%	Trade financing, retail banking, real estate	5.0%
Ijara	25.5%	Leasing, asset-backed financing	4.2%
Mudaraba	14.2%	Investment and project financing	6.5%
Musharaka	10.1%	Joint ventures, business partnerships	7.0%
Istisna	6.5%	Infrastructure, construction, project financing	8.3%
Sukuk	3.4%	Government and corporate funding	10.2%

The table provides an overview of the financing models used by Islamic banks in 2024, detailing their share of the total financing portfolio, their most common applications, and their growth rate from 2022 to 2023. This data highlights the relative prominence of each financing model and its areas of application, as well as the sector's overall growth trends.

Murabaha remains the dominant Islamic financing model, accounting for 40.3% of the total financing portfolio. Its primary applications include trade financing, retail banking, and real estate, reflecting its widespread use in day-to-day financing activities. The model's 5.0% growth rate from 2022 to 2023 suggests stable demand, particularly in trade and retail sectors, which are fundamental to Islamic banking operations.

Ijara, with 25.5% of the total financing portfolio, is commonly applied in leasing and asset-backed financing. This model's 4.2% growth rate indicates steady, moderate growth, aligning with the continued demand for leasing products, particularly in real estate and equipment financing. Its asset-backed nature ensures compliance with Islamic principles, making it a popular choice for Islamic banks.

Mudaraba accounts for 14.2% of the financing portfolio, with a focus on investment and project financing. The 6.5% growth rate from 2022 to 2023 suggests a growing interest in this profit-sharing model, especially in sectors requiring capital and expertise from both parties. The increasing demand for Mudaraba reflects a broader interest in equity-based financing options that emphasize risk-sharing and fairness.

Musharaka is used for joint ventures and business partnerships, representing 10.1% of the financing portfolio. The model's 7.0% growth rate demonstrates strong demand for collaborative business ventures, particularly in infrastructure and large-scale projects. The growth of Musharaka highlights the continuing trend of shared ownership and responsibility in business ventures, with a particular focus on joint capital contributions and shared profits and losses.

Istisna, which is widely used in infrastructure, construction, and project financing, accounts for 6.5% of the financing portfolio. Its 8.3% growth rate indicates an increasing reliance on this model for project-based financing, particularly in construction and manufacturing sectors. The growth of Istisna can be attributed to the continued demand for long-term project financing arrangements, especially in the GCC and South Asia regions.

Finally, Sukuk, representing 3.4% of the total portfolio, is used for government and corporate funding. Despite its smaller share, Sukuk has seen the highest growth rate at 10.2%, suggesting that demand for Islamic bonds is on the rise. This growth can be attributed to the increasing popularity of Sukuk as a viable alternative to conventional bonds, especially in government and corporate financing sectors.

In summary, while Murabaha remains the dominant financing model in Islamic banks, other models like Mudaraba, Musharaka, and Sukuk are showing significant growth, particularly in investment, joint ventures, and funding activities. The steady growth in Istisna also underscores the increasing importance of project financing in infrastructure and construction. This trend reflects the evolving landscape of Islamic finance, where a diverse range of financing models is being utilized to meet the needs of different sectors and industries.

5.DISCUSSION AND CONCLUSION

Today, Islamic finance is gaining importance both theoretically and practically as a financial system developed in accordance with the principles of Shariah, which prioritises the prohibition of interest, risk sharing, ethical investment and social welfare. This system aims to provide solutions to the shortcomings of traditional finance in terms of ethics and justice and contributes to the sustainable realisation of economic development. In particular, interest-free financing models have attracted growing global interest and increased the effectiveness of the Islamic finance system.

Financing models such as Murabaha, Mudaraba, Musharaka, Ijara and Sukuk, which are discussed in the research, stand out as important instruments reflecting the basic principles of Islamic finance. While Murabaha stands out as a sales-based financing model that meets the need for interest-free loans, models based on profit-loss sharing such as Mudaraba and Musharaka offer a fair basis for co-operation between the parties. While Ijara meets asset-based financing needs, Sukuk attracts the attention of global investors by integrating Islamic finance into capital markets. In addition, insurance systems such as Takaful offer an alternative insurance approach based on solidarity and cooperation.

Islamic finance models aim not only for economic gain but also for social justice and the spread of ethical values. These approaches provide a fairer financial system for individuals and institutions, while contributing to reducing economic inequalities and improving income distribution. In addition, encouraging investments that support environmental sustainability demonstrates the compatibility of Islamic finance with the modern world and its inclusive nature.

Today, Islamic finance plays an important role not only in the Islamic world but also as a part of the global financial system. The increase in the number of Islamic financial institutions, especially in regions such as the Middle East, Southeast Asia and Europe, strengthens the impact of this system on global economic dynamics. Instruments such as interest-free banking, Sukuk issuance and Islamic investment funds stand out as alternatives to conventional financial instruments.

As a result, it is seen that the Islamic finance system today has a wide range of applications at both theoretical and practical levels and constitutes an important alternative in the search for an ethical and just economic order. In this study, the basic principles of Islamic finance and the functioning of financing models are discussed in detail and the positive effects of this system on economic sustainability, social justice and global integration are emphasised. Islamic finance has the potential to contribute to the global financial system with further research and innovation in the future.

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