

NEWSLETTER

Shariah Newsletter of GA Skylight Berhad

ISLAMIC FINANCE

Written by Fatin Filzah

Hi, Assalamualaikum everyone! Hope everyone doing well.

So, last month, we only sharing for Shariah Newsletter for product and event. This month we will share about advantage of Islamic Finance. Over the years, Islamic financing has grown at a rapid pace globally and is now a market worth more than \$3.5 trillion. In Islamic finance, which adheres to Islamic law (Shariah), offers several distinct advantages over conventional finance.

Here are some of the key benefits:

Advantages of Islamic Finance

RISK SHARING:

The principle of risk-sharing (Mudarabah and Musharakah) means that both the lender and borrower share the risks and rewards of investment. This encourages a more equitable distribution of wealth and reduces the risk of financial bubbles and crises.

PRINCIPLE OF FINANCIAL JUSTICE ASSET-BACKED FINANCING:

Islamic finance transactions are backed by tangible assets or services, providing more stability and reducing the risk of speculation. This is in contrast to some conventional financial products that can be highly speculative and disconnected from real assets.

ETHICAL INVESTMENT:

Islamic finance prohibits investment in industries considered harmful or unethical, such as alcohol, gambling, and tobacco. This ensures that funds are used in ways that are considered morally and socially responsible.

SOCIAL AND ECONOMIC JUSTICE:

Islamic finance emphasizes fairness, transparency, and justice. Contracts must be clear and devoid of any excessive uncertainty (Gharar), ensuring that all parties fully understand the terms and conditions, which helps prevent exploitation and fraud.

PROHIBITION OF INTEREST (RIBA):

Charging or paying interest (riba) is prohibited in Islamic finance. Instead, financial institutions earn profit through equity participation, leasing, and trading, which aligns more closely with the performance of the underlying assets or businesses.

PROMOTION OF FINANCIAL INCLUSION:

Islamic finance can be more inclusive, offering financial services to those who might avoid conventional banks due to religious reasons. This helps to bring more people into the formal financial system, fostering economic growth and development.

These advantages make Islamic finance an attractive option for investors and institutions seeking ethical and stable financial practices, as well as for those looking for inclusive financial services that align with their religious beliefs.

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While Islamic finance offers numerous advantages, it also comes with certain disadvantages and challenges.

Here are some of the key drawbacks:

Disadvantages of Islamic Finance

LIMITED PRODUCT RANGE:

The range of financial products available in Islamic finance is often narrower than in conventional finance. Some complex financial instruments available in conventional finance have no Shariah-compliant equivalents.

HIGHER COSTS:

Structuring Shariah-compliant financial products can be more complex and costly. This complexity often results in higher administrative and operational costs, which may be passed on to consumers.

LACK OF LIQUIDITY:

Islamic financial markets can suffer from lower liquidity due to the limited number of participants and the restricted range of instruments available for trading. This can make it harder for institutions to manage liquidity and for investors to quickly buy or sell their assets.

REGULATORY CHALLENGES:

The regulatory framework for Islamic finance is still developing in many parts of the world. This can lead to uncertainties and inconsistencies in the application of Shariah principles, making it difficult for Islamic financial institutions to operate smoothly.

SHARIAH COMPLIANCE RISK:

Ensuring compliance with Shariah principles requires constant oversight and consultation with Shariah scholars. Differences in interpretation among scholars can lead to uncertainty and variability in the products and services offered by different institutions.

LIMITED AWARENESS AND UNDERSTANDING:

There is often a lack of understanding and awareness of Islamic finance principles among both potential customers and conventional financial institutions. This can hinder the growth and acceptance of Islamic financial products and services.

These disadvantages highlight the complexities and challenges that come with implementing and operating within an Islamic finance framework. However, many institutions are working to address these issues through innovation, education, and regulatory development to make Islamic finance more accessible and competitive.

See you guys on next newsletter about another topic! Assalamualaikum