

The Future of Islamic Finance in India

Mohammad Hussain Khatkhatay, popularly known as M. H., the Managing Director of the India's erstwhile largest Islamic Financial Institution, the Barkat Investment Group, has been instrumental in almost every major Islamic financial activities in the country. From the establishment of Modern Educational Social and Cultural Organization (MESCO) 1958, Bait-un-Nasr (BUN) 1973, Barkat 1983, Federation of Interest Free Organization (FIFO) 1986 to the establishment of Al-Baraka Finance House in 1989, it has been a journey full of events. The man who built a financial empire is now the helpless spectator of the falling all these one by one. First it was Barkat Group in May 2000 and now the BUN, which is almost at the door of liquidation. MH explains to Shariq Nisar, the tragic events of Barkat and its ramifications on the Islamic financial activities in the country.

Having an academic background of B. Tech in Metallurgical Engineering and M.B.A. in production. Why did you choose the field of Islamic finance?

By the time I had finished my MBA in 1973 I had already made up my mind to make the switch from Engineering to Finance and Management. Islamic Finance was then a natural progression. One factor, which did make me inclined to working in the financial field rather than in other areas of benefit to the community was that I was struck by the wide charm in this field between mere assertions by Muslim leaders and writers and the stark reality. For instance, I remember having read, somewhere in the mid sixties in an old magazine issue of the fifties, an article by Dr. Hamidullah about the feasibility of Islamic Banking. I could not help feeling that we could do with some practical constructive work in preference to mere discussion and self-glorification. This was the spur that led me to decide to implement the Islamic injunctions in the finance area.

Your Barkat Investment Group has been one of the highly successful Islamic Finance Company in India in 1980s and till mid 1990s. What do you think are the main reasons that led to the collapse of the Barkat?

Apart from the obvious and immediate cause being the sustained recession in the real estate market (in which we had a heavy exposure) and the vagaries of the stock market, I think we can account for the following:

- a) Failure of management in not taking care to diversify as well as not paying sufficient attention to mismatch in tenures of assets and liabilities.
- b) Weak capital structure due to high gearing.
- c) Lack of institutional support infrastructure (absence of financial support on Islamic basis).
- d) The crisis period coincided with a period of very rapid changes in the regulatory framework imposed by the government, which led to cutting off some Islamic options, which could have eased our situation.
- e) Management philosophy being oriented more to growth (to provide a palpable justification for the feasibility of Islamic Banking), rather than a more cautious income orientation.
- f) One may also add, that the self-imposed restriction on not engaging in *Murabahah* and the difficulties in engaging in profit-sharing business led us to painting ourselves into the corner of real-estate investment. This was, however, again a management failing as the same should have been anticipated by some serious analysis.

I personally interacted with few depositors, who blamed to your adamant attitude of not seeking help from the conventional financial institutions. Moreover, you never opted for the Murabahah financing, which is allowed in the Shariah and practiced by Islamic financial institutions the worldwide.

What you have stated is true. As far as dealing in riba is considered, that cannot be condoned in any circumstances and I am satisfied that we stood our ground and did not compromise on it. As far as *Murabahah* is concerned, we started with the idea that if we are attempting an Islamic alternative, let us be sincere in it. There were already so many people doing the same conventional financing under Islamic names. Then if we were getting into Islamic finance, there was no point in replicating the same practices of dubious authenticity. But once we got into a crisis I doubt going in for *Murabahah* would have helped. It was already too late.

Why did you prefer liquidation? Has it brought any solace to the beleaguered community?

Let me clarify that we did not voluntarily take Barkat into liquidation. We tried for two and a half years to keep it afloat. It was finally taken over by the authorities when some investors lost their patience and went to the police. In fact for us the period of struggle before the closure was the most trying and stress-filled and yet we did not adopt the easy way out.

Regarding the letter, certainly not. If anything, it has only increased their loss. For one, the intervention of the authorities dried up the non-funding income from the Islamic bank, I mentioned.

At that time we had several proposals in the pipeline, which could have materialized and generated income in millions. Infact, we received Rs. four million from a completed deal after the Barkat was closed and the money was deposited with the court when it came through. If we had been allowed to continue, more people would have got repaid to a greater extent. As things stand, for the last two years no investors are being paid and as and when properties are sold they will fetch even less than they would have done if Barkat was still a going concern. This is unfortunately how things happen in such situations.

Why did you not approach the Islamic Financial institutions of other countries to save your organization?

We did, we wrote to Islamic Development Bank (IDB) and also to some other Islamic banks abroad as well as some other institutions and well-placed individuals. We did receive some help from some individuals but nowhere near what was required. One Islamic bank too helped us indirectly by paying us lucrative fees for arranging some financing deals between them and Indian businesses. The regret is that these deals were structured as *murabahah* and involved a compromise on our part though our participation was not direct and our involvement was in a situation of extreme crisis.

Barkats' parent organization Bait-un-Nasr (BUN) is also reported to be facing a lot of difficulties.

Yes, BUN is in trouble. It is closed though not yet taken over by the authorities. It will be a pity if it too folds up. BUN crisis was brought on by distorted media reporting. Though it was indirectly linked with Barkat, at the time of the run on it, it had a healthy liquidity position. At the time it was hit it had an asset base of about Rs. 150 to 160 millions and a

daily cash collection of Rs. 1.2 to 1.5 millions. With the infusion of Rs. 30 to 40 millions it can be revived with a bold and dynamic team with vision.

It will be sad if BUN goes under. Unlike Barkat, which was based on profit and loss sharing investment, BUN is based on small deposits and small shareholders numbering almost half a million, mostly with an average stake of about a thousand rupees or less. It was being run on a no-profit-no-loss basis.

One other reason why BUN needs to be saved is that unlike almost all other substantial loans operations on interest-free basis. Such as the Muslim funds in the north, it did not make compromises with *Shariah* principles. It is also the only institution to have tried to scientifically work out its costs and link charges to costs. It had a developed HR department, a proper performance evaluation system with remuneration levels linked to performance and a planned management hierarchy. Its accounts were also computerized to a fairly high level, mostly using in house talent.

It is alleged that you had put all your eggs in one basket?

It is not an allegation it is the truth. However, being wise by hindsight does not help. On the other hand, as I mentioned in passing, insufficient analysis and attention to investment strategy in the absence of the *murabahah* option and the difficulties in profit and loss sharing investment, falsification of accounts, high investigation and monitoring costs and hostile taxation/laws (taxing equity investment heavily while exempting debt, and unlimited liability of partnerships) also prevented us from reducing dependence on what had been a solid investment option (barring a few short lived downturns) over the previous half century in India ; real estate.

What is the future of Islamic finance in the country?

A difficult one, I think we have missed the bus. It is the eighties and nineties that were the best and most opportune period for Islamic finance in India. It was during this period that the government threw open the fields of mutual funds, banking and insurance. Regulations have also been made more stringent and thresholds have been raised. Then, many niche areas, which were accessible earlier due to compatibility with Islamic requirements, are now, due to changed regulatory conditions, either closed to us or will now involve bigger compromises with Islamic stipulations. The political climate too has turned more unfavorable to Islamic banking. Also, since in the earlier phase of liberalization, things were in a flux, on the whole the bureaucracy and the entire polity was more open to new ideas.

Of course I am still optimistic and hope for a new dawn. Only, it will require greater efforts, much larger capital and more dedication.