ISLAMIC
MODEL OF FINANCE
a case study of islamic investment management company, calicut, kerala

INTER UNIVERSITY CENTRE FOR ALTERNATIVE ECONOMICS
University of Kerala, Kariavattom Campus

ISLAMIC MODEL OF FINANCE -
A Case Study of Islamic Investment Management Company, Calicut, Kerala

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Dr. Sunija Beegum N.

CERTIFICATE

This is to certify that this report "Islamic Model of Finance – A Case Study of Islamic Investment Management Company, Calicut, Kerala" is a record of bonafide work carried out by Dr. Sunija Beegum. N, under my supervision. No part of this report has been submitted for the award of any degree or diploma of any university.

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Dr. Sunija Beegum N.

EXECUTIVE SUMMARY

Islamic finance seeks to ensure that financial practices and their accompanying legal instruments comply with Islamic law (*Shariah*). Islamic financial transactions cannot include the interest payment at a predetermined or fixed rate; rather, the Qur'an stipulates profit-loss-risk sharing arrangements, the purchase and resale of goods and services and the provision of financial services for a fee. Of the two prime principles of Islamic financial system; one is that it is based on philosophy of risk sharing - both lender and the borrower share the risks as well as the returns that are incurred from the project. Second, it lays considerable emphasis on making socially responsible investment, by not making investment in sectors which are considered to have negative impacts on the community. In practice, Islamic scholars have developed products that resemble conventional banking products, replacing interest rate payments. The major financial services or instruments of Islamic finance are *Mudaraba, Musharaka, Murabaha, Ijara, Isthisna, Salam, Quard al hasan* and *Sukuk*. In many countries Islamic banks are functioning simultaneously with conventional commercial banks. There are around 300 Islamic banks throughout the world grown at a pace of 15-20 per cent annually with estimated assets of $ 270 billion. Islamic financial services continue to show strong participation in various regions including GCC countries, ASEAN, South Asia and western countries. In India though interest-free financing is provided in a limited manner through NBFCs and cooperatives, Committee appointed by RBI recommends that measures be taken to permit the delivery of interest-free finance on a larger scale, including through the banking system. Kerala, one of the states with mounting deficits cannot foster economic development with state funds alone. Government of Kerala is looking forward with alternative modes of financing for meeting an assortment of requirements of the state. It is of great advantage for Kerala towards broadening its potential to become a favoured investment destination for Middle East and Southeast Asian investors looking for *Shariah* compliant investments. The study throws light into the nature of Islamic financial practices and financial performance of an Islamic financial venture capital company, *Secura* in Calicut, Kerala. Two-tier *Mudarabah* model is the basic theoretical model used by Islamic financial institutions to structure venture capital. *Secura* provides agency services for fee come under *wakala* of Islamic contracts and *ijarah* or leasing. It develops joint venture properties which will be leased first and sold out later and it will share the profit or loss. Indicators of profitability of the Company show that it upholds a favourable level. The average Return on Assets stood at 15% and Return on Equity is 21% during 2009-2013. Liquidity ratios presents that the liquidity position of the Company is good. It maintains a laudable level of current assets so that it can boost up the confidence of investors of the company. It completed four real estate projects successfully and managing four ongoing projects. The risk and solvency indicators such as Debt Equity Ratio, Debt to Asset Ratio and Equity Multiplier show consistency during the five year period. The study underline that Islamic financial institutions have high potential in Kerala and it provides an alternative financing model.

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INTRODUCTION

Islamic finance seeks to ensure that financial practices and their accompanying legal instruments comply with Islamic law (*Shariah*). Islamic or *Shariah*-compliant banking products are financial transactions that do not violate prescriptions of the *Qur'an*. *Qur'an* prohibiting interest says "Those who devour usury will not stand except as stands one whom the evil one by his touch hath driven to madness. That is because they say: 'Trade is like usury.' But Allah hath permitted trade and forbidden usury. Those who after receiving direction from their Lord, desist, shall be pardoned for the past; their case is for Allah (to judge). But those who repeat (the offence) are companions of the fire, they will abide therein (forever)" (2:275). Specifically, Islamic financial transactions cannot include the interest payment at a predetermined or fixed rate; rather, the *Qur'an* stipulates profit-loss-risk sharing arrangements, the purchase and resale of goods and services and the provision of financial services for a fee.

Of the two prime principles of Islamic financial system; one is that it is based on philosophy of risk sharing - both lender and the borrower share the risks as well as the returns that are incurred from the project. As such it discourages fixed returns in terms of predetermined interest rates known as riba and favours profit and loss sharing (PLS) model. Second, it lays considerable emphasis on making socially responsible investment, by not making investment in sectors which are considered to have negative impacts on the community. Shariah compliant contracts cannot create debt, while provide for a sharing of risk and responsibility between the involved parties. Islamic finance is based on equity, whereas the conventional banking system is debt-based. Islam is not against the earning of money, but it prohibits the earning of money through unfair trading practices and other activities that are socially harmful in one way or another, which is why predetermined interest or *riba* is forbidden. This edict springs from the Islamic belief that wealth should not be hoarded but put to productive use so that others can share in its benefits. Islam does not allow uncertainty in contracts. Speculation or gambling is unacceptable, which weighs against insurance and dabbling in futures and options (Angelo M, 2012).

In practice, Islamic scholars have developed products that resemble conventional banking products, replacing interest rate payments. The major financial services or instruments of Islamic finance are *Mudaraba, Musharak, Murabaha, Ijara, Isthisna, Salam, Quard al hasan and Sukuk.*

a. Mudaraba or profit-sharing is a profit and loss sharing contract between two entities namely Islamic financial institution as an investor and an entrepreneur as second entity. Profits are shared between the two entities according to proportions agreed in advance. In case of loss, Islamic financial institutions bear the loss and entrepreneur sacrifices his efforts.

b. Musharaka or equity participation is similar to that of Mudaraba, but only difference is that bank is not the sole investor for entrepreneur. Two or more partners together contributes for the investment in a specific project. Profits are shared as per the agreed proportions in advance. While, loss sharing is limited to capital contributions made by various partners.

c. Murabaha or cost-plus financing is a type of cost plus sale contract. Under this arrangement customer asks the Islamic financial institution to purchase an asset for him and sell the same to him on deferred basis. Bank accrues profit by charging predetermined amount above the actual asset cost. Amount of instalments are non-negotiable.

d. Ijara are almost identical to leasing contracts in conventional banking, in which the lesser gets periodical return from the lessee against the use of an asset. Financial as well as operation lease are permissible. Ownership risk of the assets is borne by the investor, while maintenance and operational expenses are borne by customer.

e. Istisna or construction financing is a type of enterprise contract in which the customer asks the Islamic financial institution to make or build a specific product for him as per the specifications. The institution would sale the asset to the customer on deferred basis.

f. Salam is a deferred delivery contract: A sale contract wherein the price is paid on the spot, but the delivery of the goods is deferred. – It is essentially a forward agreement where delivery occurs at a future date in exchange for spot payment of price.

g. Qard-al-hassan is an interest-free loan given for social welfare or for short-term bridging finance.

h. Sukuk is a plural form of word Sak, which in simplest terms is a Shariah complaint Bond. Sukuk is a certificate of investment comprising of ownership claims in the pool of assets. It is one of the forms used for raising funds and is vital vehicle for re-source mobilization, in public or private sector (Hafizi et.al, 2010).

Types of Islamic financing institutions include banks, venture capital firms, private equity firms and investment banks and micro financial institutions. In many countries Islamic banks are functioning simultaneously with conventional commercial banks. There are around 300 Islamic banks throughout the world grown at a pace of 15-20 per cent annually with estimated assets of $ 270 billion. Islamic banking has thus increased its penetration in many countries, crossing the threshold of 15 per cent as a share of banking system assets in 10 countries (Iran and Sudan with a full-fledged Islamic financial sector, Bangladesh, Brunei, Kuwait, Malaysia, Qatar, Saudi Arabia, the United Arab Emirates and Yemen). However, Islamic finance assets are still concentrated in the Gulf Cooperation Council (GCC) countries, Iran, and Malaysia. The growth of Islamic banking, in particular outperformed conventional banking over the past decade (IFSB, 2014).

An increasing number of commercial banks around the world are considering the possibility of offering interest-free financial products. An interest-free window is simply a window within a conventional bank through which customers can conduct business utilizing only shariah compatible instruments. The products offered are safekeeping deposits which stood at the liability side of the bank and relevant trade-finance products on the asset side. In many countries this reflects bank's desire to offer services to a growing population interested in shariah products. However they are also motivated by the wish to tap the growing pool of international investors.

International bodies including the Islamic Financial Standards Board (IFSB), the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI); and the International Islamic Financial Market (IIFM) have issued standards to cater to the specifics of the Islamic finance industry.

Scope of the Study

Islam offers a rich set of instruments and unconventional approaches, which if implemented in true spirit, can lead to reduced poverty and inequality. Policy makers emphasise that Islamic instruments can promote financial inclusion by improving regulatory and financial infrastructure to promote enabling environment. Economic development and growth along with social justice are the foundational elements of an Islamic economic system. The motivation of economic activity should be to meet one's own needs and also contribute to the good of the society (Siddiqi, 1968). As establishing justice is one of the primary goals of Islam, an Islamic economic system would endeavour to eradicate all forms of inequity, injustice, exploitation, oppression and wrongdoing (Chapra, 1992).

Private financing institutions with high interest rates become the latest money venture in many countries and amass more than what stipulated originally. Conventional financial institutions give credit only on the basis of adequate collateral securities with rate of interest. Islamic financial institutions either in form of banks or Financial Companies promotes investment opportunities for promoting talented poor and the micro and small enterprises that lack collateral. The absence of collateral security limits the availability of finance for strategic purposes such as higher education, construction of house, start-ups and further more. Islamic banking is crucial to helping Islamic countries which have remained largely under banked and therefore also underdeveloped to catch up. It also helps developing countries with minority Muslim populations to benefit from an alternative source of financing and deepen their financial sectors. Islamic banks also appear to be complements to, rather than substitutes for conventional banks (IMF, 2010). Shariah-compliant products are not only very attractive for segments of the population that demand financial services that are consistent with their religious beliefs but also for addressing the financial problems of non-Muslims too.

Islamic modes of financing have its own merits such as financial sector stability and asset creation. Islamic financial institutions can promote financial sector stability for various reasons. It prohibits rate of interest and certain types of derivatives such as futures, forwards and options due to risks of loss that go beyond the original investment. Financial sector stability may be increased by raising the proportion of equity modes of financing relative to debt (Buiter and Rahbari 2015). Hasan and Dridi (2010) show that during the years immediately after the crisis of 2008, Islamic banks were more resilient and achieved higher credit and asset growth than conventional banks. As a result, Islamic banks were assessed more favourably by rating agencies in the post-crisis era. The present study based on an Islamic financial company in Kerala has its relevance since Government of Kerala is willing to tap the investments from the Middle East region & NRI's through Islamic Finance route.

Growth in India

Around half of all the literature on Islamic finance in the world produced in the first half of the twentieth century, was in Urdu by Indian writers, the rest being either in English or in Arabic. The first book in English was published in India is Islam and the Theory of Interest by Anwar Iqbal Qureshi of the Usmania University, Hyderabad in 1946. Maulana Hifzur-Rahman Seoharvi and Syed Manazir Ahsan Gilani also wrote on the on the subject in 1942 and 1947 respectively. Other writers include Mazharuddin Siddiqui, Mohammad Hamidullah and Yusufuddn Mohammad. During 1950s and 60s Maulana Abul Aa'la Mawdudi had published many articles. Muslim society had introduced many region based institutions to help the poor people in the form of interest free loans and to introduce saving schemes and to utilize their funds on productive activities. Some of them are registered in the form of co operative credit societies, nonbanking financial companies and some are as financial and charitable societies. The institution registered in the form of NBFCs and co-operative societies has taken important steps. They were mobilized savings and provide interest-free loans for thousands.

India is the second largest Muslim populated country having Islamic financial institutions in the form of Islamic investment and financial companies registered under Companies Act, Islamic co-operative credit societies under State Co-operative societies Act; Islamic financial societies under Charitable Societies Act and unregistered interest-free self help groups. The growth of Islamic Financial Institutions in India is a post-independence phenomenon. Muslim Funds were established mostly in North India during the 1960s. In South India its expansion started during 1970s. The institutions except Islamic investment and financial companies are non-profit earning undertakings. Lack of awareness about the concept of Islamic finance is a major hurdle among both Muslims and non-Muslims in India.

Some asset management companies like Taurus Mutual Fund and Tata Mutual Fund offer equity schemes that are *Shariah* compliant. These funds are marketed as 'Ethical funds' so as to make them attractive to non-Islamic investors as well. These funds do not invest in companies associated with alcohol, tobacco, gambling and pork products. They also don't invest in companies that profit from charging interest. Also, there are portfolio management schemes which follow *Shariah* rules in their selection of stock. A study on 1000 companies listed at the National Stock Exchange (NSE) found that 335 companies qualified on shariah parameters. Market capitalisation of the qualifying stocks was 61 percent of the total market capitalisation of the NSE listed companies. Surprisingly, the growth in market capitalization of shariah compliant stocks was found to be more impressive than the growth in market capitalization of non-shariah compliant stocks (Shariq Nizar, 2005).

The existing statutory regime provides enough leeway to follow the law and Shariah at the same time. Thus, it is possible to carry on financing activity based on Shariah by constituting;

(i) A co-operative credit society or a non deposit accepting Non-banking financial institution or

(ii) A trust or a company registered with SEBI operating as Domestic Venture Capital Fund or

(iii) A Foreign Venture capital Fund, registered with SEBI or

(iv) Run *Takaful* business (Islamic Insurance as a co-operative Society where the cover is available to members only) or

(v) Open an Islamic window in a conventional bank without awaiting any change in the existing laws and regulations and without contravening any of the existing Laws or Regulations (Khurshid Najmi, 2007).

A high powered committee by Reghuram Rajan (2008) suggested interest free banking as a part of financial sector reforms. In 2015, RBI recommended to allow Islamic banking windows at conventional banks to offer shariah complaint finance vehicles to explore the potential of Islamic finance. It also suggested that it can be offered through non-banking channels such as investment funds and lending co-operatives (Report of the Committee on Medium-term Path on Financial Inclusion, December, 2015).

Kerala and Islamic Finance

Interest-free Institutions started functioning in Kerala after the turn of 1970s. According to TK Hussein (2008) 360 interest free institutions were functioning exclusively under INFACC (Interest Free Association's Coordination Committee) in Kerala. During 1990s Islamic finance industry developed with diversified products and services. It is also noted that many social and religious organizations promoted interest free ventures in the last decade. Muslim organizations including *Jama at e Islamic Hind, Kerala Nadvathul Mujahideen, Samastha Kerala Jamiyyathul ulama,* and *Muslim Service Society* are important among them. Islamic financing services are practising in Kerala in the form of financial companies. Some of them are conducting equity finance or *musharakah,* cost plus financing or *murabaha,* deferred payment and deferred delivery or *isthisna,* agency services or *wakalah.*

The major Islamic financial companies in Kerala are *Secura* (2009), Alternative Investment and Credits Limited (2001) and *Zirva* Business Solutions (2009). Government of Kerala also collaborate with an Islamic financial company called *Cheraman Financial Services* (2013) which got NBFC status from RBI.

Statement of the Research Problem

Finance is the backbone of every economic activity in the world. Kerala, one of the states with mounting deficits cannot foster economic development with state funds alone. Government of Kerala is looking forward with alternative modes of financing for meeting an assortment of requirements of the state. It is of great advantage for Kerala towards broadening its potential to become a favoured investment destination for Middle East and Southeast Asian investors looking for *Shariah* compliant investments. It also boosts up public investments especially in meeting ever escalating needs in infrastructural sector projects such as airports, bridges and power-generating facilities. In the agricultural sector, Islamic finance could help break the cycle of debt and interest payments which often hampers the economic progress of farmers and smallholders. The rise in demand for infrastructural development in industrial and agricultural sector of Kerala can be addressed through Islamic finance institutions. Hence an in depth study of an Islamic finance institution will give an insight into the nature of Islamic financial practices that promote entrepreneurship and infrastructural growth and thus development. It also confer information into the nature of working of Islamic financial services which boost up awareness about various Islamic finance and leads to further materialization of such institutions. A thriving study on the financial performance of the institution is a motivating factor for exploiting potential of this alternative financing model.

Zamir Iqbal (1997) elaborates the factors which paved the way for expansion of Islamic finance such as rise in current account surpluses of oil exporting countries, introduction of broad macro economic and structural reforms in the form of liberalisation of capital movements, privatization and the global integration of financial markets. The study briefs out the principles of an Islamic financial system and basic instruments of finance.

Mumtaz Hussain et.al (2015) discussed various principles and products of Islamic banks and suggests measures to enhance financial stability of the Islamic financial systems, such as strengthening the supervisory and regulatory frameworks including comprehensive prudential standards, a robust liquidity infrastructure to facilitate both liquidity risk management at Islamic banks and help conduct monetary operations by central banks. Promoting the soundness and resilience of Islamic banking, particularly in times of distress, would require instituting a Shariah-compliant financial safety net infrastructure.

Mahmoud Mohieldin (2012) discussed the potential of Islamic finance in recent years in various countries. A meaningful development of the practice of Islamic finance will require abandoning the mechanical emulation of conventional instruments and packaging them as seemingly Islamic financial instruments. Investments in human capital and research and innovation are also necessary to facilitate the development of Islamic finance solutions and products to respond to economic needs and financing requirements.

A study by Samad and Hassan (2000) assessed inter-temporal and interbank performance of an Islamic bank. They examined banking features such as liquidity, profitability, risk and solvency, and community involvement of Bank Islam Malaysia Berhad (BIMB for 1984 to 1997 using financial ratios. The study concluded that BIMB was relatively more liquid and less risky compared to a group of 8 conventional banks and yet not popular among Malaysians.

Thorsten Beck et.al (2010) made a comparative study in 22 countries with 397 conventional and 89 Islamic banks. The empirical estimations show little significant differences between Islamic and conventional banks. The tentative conclusion of the cross-country, cross-bank comparison of conventional and Islamic banks is therefore that either opposing effects of Shariah-compliant banking cancel each other out or that the differences between these two models are smaller than often assumed. However, there are certainly regulatory and supervisory challenges for countries that see an increasing entry of Islamic banks, and suggest that conventional banks that operate in countries with a larger share of Islamic banks are more cost effective but less stable.

Maher Hasan and Jemma Dridi (2010) made a comparative study on the effects of the Global Crisis on Islamic and Conventional Banks using bank-level data covering 2007–10 for about 120 Islamic and conventional banks in eight countries (Bahrain, Jordan, Kuwait, Malaysia, Qatar, Saudi Arabia, Turkey, and the United Arab emirates). The study focused on changes in four key indicators: profitability, bank lending, bank assets, and external bank ratings. Islamic banks maintained stronger credit growth than conventional banks in almost all countries. This suggests that Islamic banks market share is likely to continue to increase and those Islamic banks made a greater contribution to macroeconomic and financial stability by making more credit available.

Muhammd Ghous (2003) studied nature and composition of Islamic financial institutions in India. It also analysed socio economic performance of selected institutions and identify its problems and prospects. It reveals that the institutions have acquired necessary economic strength and fulfilled prudential norms of international standards. However they need to increase their operational size so that they can become more competitive by reducing their operational cost and by increasing overall earnings. The study emphasises the need for developing standardised and innovative products to enhance their business.

Pawandeep (2008) made a SWOT analysis on the future potential of Islamic banks in India. Islamic banking has good prospects in India from a development point of view. It presently faces many challenges that have to be addressed. This require a dedicated effort of a strong committee with unbiased stand from economic and secular perspective and recommend changes to be brought in Banking Regulations Act for introduction of Islamic banking in India.

Yash Majeethia (2014) explored the possibility of funding infrastructure in India through Islamic financial instruments. The methodology consists of estimating infrastructure funding requirements in India, understanding development and status of Islamic finance in global context, exploring basics of Islamic banking system along with its various financial instruments especially Sukuks as well as identifying challenges and the way forward. In order to introduce an Islamic financial system in county like India, it is required to set up institutions which can be capable to furnish the requisite skills to the professional under the guidance of Islamic financial scholars.

Dr.Shanmugam Munuswamy (2014) made a study on the awareness, perceived problems, suggestions, and willingness to accept Islamic finance among College Teachers in Chennai in India. It was found that there is a significant difference between Muslims and non-Muslims in the awareness, suggestions and willingness to accept. However, there appeared to be a similar opinion of the perceived problems. This may be because of the lack of knowledge about Islamic finance. On the contrary, while analyzing the same variables among the three religious groups such as Hindu, Muslims, and Christians, it was found there exist a similar opinion on the willingness to accept Islamic finance. It can be inferred that both Muslims and non-Muslims in India are generally not aware of the benefits of Islamic finance. However, they are willing to invest after knowing the benefits.

Muhammed K Palath (2011) made a study on the impact of interest free microfinance society functioning in *Maranchery Panchayath* (local self body) of Kerala called "*Thanal*". It analysed the impact of this institution on the poor and marginalized class through sample survey. The working of the institution increased saving habit of people in coastal area. Loans are mainly used for the living expenses and emergency needs. It pointed out weaknesses such as very small portion of loans create self employment. Lack of government support and professional approach will affect the expansion.

Ameer P A (2013) studied about the effectiveness of a micro financial interest free organisation in meeting financial and non-financial services of the rural poor in *Alappuzha* district of Kerala. Results show that household income, expenditure on children's education, housing conditions, drinking water source, consumption of nutritious food, expenditure on clothes, spending on food items and ownership of household asset had increased significantly due to the influence of invested money. The findings also indicate that there is great potentiality of interest free micro financing to cater to the needs of the poor as well as poorest of the poor.

The literature on Islamic finance mainly focus on theoretical background elaborating the principles and methods of financial practices, welfare impact of Islamic financial institutions, potential of the industry in various countries and its sustainability and financial performance. The studies related to Islamic finance in India are very few and concentrate on exploring the potential of the industry and its economic performance. A study at all India level (Ghous, 2003) reveals that the institutions have acquired necessary economic strength and fulfilled prudential norms of international standards. However there were no further studies pertaining to performance of Islamic finance institutions in India. A detailed study on Islamic financial companies is not undertaken in Kerala also. The studies undertaken in Kerala dealt with the impact of interest-free micro financial enterprises only. The potential of Islamic finance in Kerala can be understood only through undertaking more studies in this area. So, the present study will be a significant one in this area. It attempted to make an in-depth analysis of an Islamic financial company which will reveal that Islamic financial institutions are viable alternative financing models for Kerala.

Objectives of the Study

1. To study the concept of Islamic finance and its underlying principles and instruments
2. To study the Islamic financial practices and underlying instruments of '*Secura*', an Islamic Financial Company
3. To assess the financial performance of the Company

Methodology

The study is based on primary and secondary data. Primary data on working of the company and its financial practices are elucidated through interview method. The sources of secondary data include reports of World Bank, International Monetary Fund, Indian Institute of Islamic Studies and various Islamic Financial Institutions. Annual Financial Reports, Brochures, Manuals and Publications of the Company are used for analysing profitability, liquidity and credit performance of the Company. Ratio analysis is used for analysis. One of the widely used and powerful tools is ratio or index. Ratios express the numerical relationship between two or more things. This relationship can be expressed as percentages, fraction or proportion of numbers. Accounting ratios are used to describe significant relationships, which exist between figures shown on a balance sheet, in a profit and loss account, in a budgetary control system or in any other part of the accounting organization. The analysis also reveals whether the company's financial position has been improving or deteriorating over time. Ratios can be classified into three broad groups on the basis of items used: (1) Profitability Ratios (2) Liquidity Ratios and (3) risk and solvency ratios. The major statistical technique used for the study is the arithmetic mean and standard deviation. Diagrams and graphs are used for presenting statistical data.

Company's financial statements are the major documents used for the study. Financial statements generally refer to two basic statements: the Balance Sheet and the Income Statement. "Balance sheet is a summary of a firm's financial position on a given date that shows

Total assets = Total liabilities + Owner's equity." The income statement (profit and loss statement) reflects the performance of the firm over a period of time.

The major Profitability Financial Ratios used for analyzing profitability are Return on Asset (RAO), Return on Equity (ROE) and Profit Expense Ratio (PER). The formula for calculating these ratios are

(i) Return on Asset (ROA) = Profit after tax/ total asset

(ii) Return on Equity (ROE) = Profit after tax/ equity capital

(iii) Profit Expense Ratio (PER) = Profit/Total Expense

The major liquidity ratios used are Current Ratio (CR) and Current Asset Ratio (CAR)

(i) Current ratio = Current asset (CA) / current liability (CL)

(ii) Current Asset Ratio (CAR) Current Assets /Total asset

Risk and insolvency ratios used are Debt Equity Ratio, Debt to Total Asset Ratio and Equity Multiplier.

(i) Debt Equity Ratio (DER) = Debt/equity capital

(ii) Debt to Total Asset Ratio (DTAR) = Debt/total asset

(iii) Equity multiplier (EM) = Total assets /shareholder's equity

Chapter Framework

The study is presented through five chapters. Chapter 1 provide introduction, review of literature and methodology. The concepts and practices of Islamic finance are presented in the second chapter. Third chapter provide the working of the company and fourth chapter analyses the financial performance of the company. Chapter five gives conclusion of the study.

Chapter 2

ISLAMIC FINANCE – AN ALTERNATIVE MODEL

One of the forms of capitalism, which has been flourishing in non-Islamic societies, is the interest-based investment. There are normally two participants in such transactions. One is the Investor who provides capital on loan and the other Manager who runs the business. The investor has no concern whether the business runs into profit or loss; he automatically gets an interest (*Riba*) in both outcomes at a fixed rate on his capital. Today the world economic system based on interest has resulted in concentrating the wealth in the hands of selected few creating monopolies and widening the gap between the rich and the poor. In contrast Islam encourages circulation of wealth and regards its role as important to an economy as the flow of blood to our human body. According to materialistic economics, livelihood is the fundamental problem of man and economic developments are the ultimate end of human life. While according to Islamic economics, livelihood may be necessary and indispensable, but cannot be the true purpose of human life (Usmani, 2002).

In conventional economies, the capitalist is compensated for the use of his or her capital with interest, and the entrepreneur with profit. In an Islamic economy, however, since interest is prohibited, the capitalist and the entrepreneur begin sharing the profits. But there is a further complication: since profits are generated by taking risks, this means that risks are also shared. Since some risks inevitably lead to losses, this means that losses too must be shared. As a result, the economy changes its character, and what can be called a "share economy" emerges. In this way, the sharing of risks, profits, and losses is the most essential trait of an Islamic economy. As opposed to capitalist system Islamic system advocates that the reward for capital is not the interest but the profits and losses and risk (Murat Cizakca, 2013).

Islamic finance is as old as Islam itself and constituted an inseparable part of an entire economic system. An Islamic financial system is one which complies with *Shariah* or Islamic law. Islamic commercial jurisprudence are derived from the *Quraan*, *Sunnah* (sayings of the Prophet), and legal reasoning by *Shariah* scholars, and in their entirety constitute the basis for Islamic finance (Ahmed and Kohli 2011). Islamic Financial system offers a variety of religiously acceptable financial services to Muslim communities. It reconciled with secular financial system to provide an alternative for non-Muslim clients seeking ethical investments and greater risk diversification.

This chapter discusses the principles and major instruments of Islamic finance and provide an overview of current status of Islamic financial markets in the world. It also gives the status of Islamic financial institutions in India as well as Kerala.

2.1. Principles of Islamic Finance

Prohibition of Interest

Arabic term *Riba* is a synonym for the term interest used in conventional banking operations. *Riba* means charging predetermined additional amount on a loan extended based on length of credit period. In the *Quran*, there are several verses that condemn riba', which literally means "increase, addition and surplus". *Riba* or interest is prohibited in Islam through the following Quranic versus.

- *Surah Al-Rum* "That which you give as interest to increase the peoples' wealth increases not with God; but that which you give in charity, seeking the goodwill of God, multiplies manifold." (30: 39)
- *Surah An-Nisaa* "And for their taking interest even though it was forbidden for them, and their wrongful appropriation of other peoples' property. We have prepared for those among them who reject faith a grievous punishment (4:161)"
- *Surah Al-i-'Imran* 3:130 "O believers, take not doubled and redoubled interest, and fear God so that you may prosper. Fear the fire which has been prepared for those who reject faith, and obey. God and the Prophet so that you may receive mercy (3:130)"
- *Surah Al-Baqarah* 2:275 "Those who benefit from interest shall be raised like those who have been driven to madness by the touch of the Devil; this is because they say: "Trade is like interest" while God has permitted trade and forbidden interest. Hence those who have received the admonition from their Lord and desist may keep their previous gains, their case being entrusted to God; but those who revert shall be the inhabitants of the fire and abide therein forever."
- "God deprives interest of all blessing but blesses charity; He loves not the ungrateful sinner." (2:276)

In a *Hadees* (sayings of Prophet) reported from Jabir: The Prophet may curse the receiver and the payer of interest, the one who records it and the two witnesses to the transaction and said: "They are all alike [in guilt]" (Muslim, Tirmidhi and Ahmad). Siddiqi, (2004) reported that unanimous view of Muslims throughout history remained is any excess charge in a contract of loan is *riba* and bank interest has no exception. *Islamic Fiqh Academy* (IFA) Jeddah of OIC representing the collective wisdom of *Shariah* experts is of the view that any increase stipulated in a contract of loan irrespective whether consumption loan or productive loan is *Riba* and prohibited in Islam.

Islamic scholars have also tried to provide a theoretical basis for the ban, in terms of ethics and economics. The prohibition of interest is based on the assumption that there can be no gain without risk-taking. Divine prohibition of usury, which is a common feature of the three monotheistic religions, does not, in fact, prohibit every return on capital or trade. Its purpose is to protect the weaker contracting party. Some scholars state that, since capital does not have a stable value over time and space, its price cannot be fixed ex ante but must take account the actual economic benefits the debtor has enjoyed upon its usage. Therefore, there must be a link between the results of the usage of capital and the amount paid for it (Angela D, 2013). In an interest-based system, the major criterion for the provision of credit is the creditworthiness of the borrower, whereas, in an Islamic financial system, it is the productivity of the project that is more important. This encourages the channelling of credit to productive projects.

Risk Sharing

In the Islamic financial system, debt security is eliminated and therefore, suppliers of funds become investors instead of creditors. The provider of financial capital and the entrepreneur share business risks in return for shares of the profits and losses. In Islam, it is profit rather than interest that is closer to its sense of ethics and fairness. The concept of profit involves the idea of sharing the risks of both gains and losses, and symbolises entrepreneurship and wealth creation. This risk-sharing principle is implemented through a series of contractual arrangements. Under the Islamic system of economy, if a man wants to lend his money to a businessman for being invested in business, he will have first to decide clearly whether he wishes to lend this money in order to have a share in the profit, or simply to help the businessman with his money. If he means to earn the right to a share in the profit by lending his money, he will have to adopt the mode of "partnership" or that of "co-operation". That is to say, he too will have to bear the responsibility of profit or loss - if there is eventually a profit in the enterprise, he shall have a share in the profit; but if there is a loss, he shall have to share the loss too. On the other hand, if he is lending this money to another person by way of help, then he must necessarily regard this help as no more than help, and must forgo all demand for a "profit". He will be entitled to get back only as much money as he has lent out. Islam considers it not only unjust but also meaningless that he should fix a rate of "interest" and thus place all the burden of a possible loss on the debtor (Usmani, 2002).

Prohibition of Speculative Behaviour

Speculative transactions are deemed to involve a type of unjust increase prohibited by the Quran. The underlying motivation is to ensure a fair correspondence between the expected benefits and obtained benefits of both parties to a contract. All activities that contain elements of uncertainty, such as commercial transactions in which there is uncertainty about an asset or its price, are covered by the prohibition of *gharar* (uncertainty) and *maysir* (gambling) stipulated in the *Quran*. Insurance contracts, futures, forwards and other derivatives also fall under *gharar*, as there is no certainty that the object of the sale will exist at the time the trade has to be executed. Prohibitions under the Quran also include *haram* (forbidden) activities, which are primarily related to tobacco, pornography, arms, alcohol, pork and gambling.

Sanctity of Contracts

Islam upholds contractual obligations and the disclosure of information as a sacred duty. This feature is intended to reduce the risk of asymmetric information and moral hazard. Islam places great importance on preservation of property rights; defines a balance between rights of individuals, society, and the state; and strongly prohibits encroachment of anyone's property rights (Iqbal, 2011). Kahf (1998) identifies some rules related to using one's property. These include balance in use, avoiding waste, using property without harming others (negative externalities) and conforming to the principles of *Shariah* when exchanging property. Ownership of wealth beyond a threshold level entails responsibilities towards others and obligates payment of alms (*zakat*). While commercial transactions are sanctified and encouraged as they preserve and support wealth and posterity (Hallaq 2004), transactions also must support the overall goal of Islamic law, to promote welfare and prevent harm. From the perspective of society this implies that an economy should ensure growth and stability with equitable distribution of income, where every household earns a respectable income to satisfy basic needs (Chapra 1992).

2.2. Islamic Financial Instruments

Islamic Financial Instruments are kinds of financial instruments which are based and designed in compliance with *Shariah* Rules and Regulations. Islamic financing products are broadly classified on the basis of PLS (Profit-Loss-sharing) principle and Sale based principle. The instruments under

PLS mode of financing are *Mudarabah and Musharakah*. The important Sale based Islamic financial instruments are *Murabaha, Ijara, Isthisna, Salam, Quard al hasan and Sukuk.*

2.2.1. Financial Contracts under PLS Principle

Mudarabah

Mudarabah is a profit-and-loss sharing contract in which financier who provides all capital needed for financing a project and other party known as *mudarib* or agent, provides labour and effort. In this contract the proportionate share in profit is predetermined by mutual consent between the two parties but in case of loss only financier bears the capital loss and *mudarib* loss by get nothing in return for his expended time, effort and labour. *mudarabah* partnership is a true profit-and-loss-sharing partnership originally practiced by the Prophet. The Holy Prophet himself has made such an agreement with his wife *Hazrat* Khadijah before their marriage. Since then there has been a complete consensus of opinion on this too among the jurists of Islam (Usmani, 2002). The problem with this partnership, however, was that it was practiced in history usually by two partners: a *rab al-mal* and a *mudarib*. This meant that the capital entrusted to the agent remained quite limited.

A mechanism by which the savings of thousands of people could be entrusted to a powerful agent did not exist in the early history of Islam. The crucial step for this purpose was taken by Dr. Ahmad al-Naggar in 1963. This was the establishment of the first ever Islamic bank in Mit Ghamr in Egypt. This bank was envisaged as a multiple *mudarabah* with hundreds of depositors/ investors entrusting their hard-earned savings to it acting as the *mudarib*, agent. Today, Islamic banks are flourishing all over the Islamic world, even in non-Muslim countries, collecting the savings of hundreds of thousands of Muslims and non-Muslims and channeling them for profitable projects. Islamic banks have transformed Muslim countries from being non-bank societies to banking societies. This modernization of a classical Islamic partnership is not an achievement to be underestimated (Murat Cizaska, 2013).

Musharakah

The literal meaning of *Musharakah* is sharing. The root of the word "*Musharakah*" in Arabic is *Shirkah*, which means being a partner. The *Musharakah* contract was used in the middle Ages to facilitate the joint ownership of property or of a commercial enterprise. It is a contract in which two parties agree on the capital shares that both confer to a project. Both parties are involved in the implementation and management of the project and profits are divided according to the terms agreed in the contract. Meanwhile, losses are allocated in proportion to the capital contributed. Under Islamic jurisprudence, *Musharakah* means a joint enterprise formed for conducting some business in which all partners share the profit according to a specific ratio while the loss is shared according to the ratio of the contribution. It is an ideal alternative for the interest based financing with far reaching effects on both production and distribution (Usmani, 2002).

2.2.2. Sale based Islamic Financial Contracts

Murabaha or Mark-up Principle

Murabaha is selling for the cost price plus a specified profit provided that both the seller and buyer know the cost price. The seller says my cost of capital is one hundred and I sell it it you for a profit of ten. This is permitted and there is no doubt about its legitimacy (Homoud, 1987).

Murabaḥah is a popular *Shariah*-compliant sale transaction mostly used in trade and asset financing. The bank purchases the goods and delivers them to the customer, deferring payment to a date agreed by the two parties. The expected return on *murabaḥah* is usually aligned with interest payments on conventional loans, creating a similarity between *murabaḥah* sales and asset-backed loans. However, *murabaḥah* is a deferred payment sale transaction where the intention is to facilitate the acquisition of goods and not to exchange money for more money (or monetary equivalents) over a period of time. Unlike conventional loans, after the *murabaḥah* contract is signed, the amount being financed cannot be increased in case of late payment or default, nor can a penalty be imposed, unless the buyer has deliberately refused to make a payment. Also, the seller has to assume any liability from delivering defective goods. The mark-up principle is justified on the basis of generally accepted axiom that time may be valued provided it is incorporated in a sale transaction (Saadallah, 1986).

With the rise of Islamic banks pioneered by Dubai Islamic Bank, UAE (1974) and Islamic Development Bank, Jiddah (1975) the practice of Islamic financing principles were initiated. *Murabaha* was shown for the first time in IDB in the year 1976.It was amounted to $50.54 million and it covered 84% of the five Islamic banks in 1984 (Ahmed, 1986). *Murabaḥah* transactions are widely used to finance international trade, as well as for interbank financing and liquidity management through a multistep transaction known as *tawarruq*, often using commodities traded on the London Metal Exchange (LME) (IMF, 2015).

Ijarah

'*Ijarah*' is a term of Islamic Fiqh means 'to give something on rent'. Based on The text of The *Quran* and the *Sunnah* of the Prophet Muhammad, *Ijarah* is one of contract premised by *Shariah* law. It is a contract of exchange of counter values between usufruct and rental. Islamic law permits the lease of certain assets whose benefits can be obtained by the lessee against the payment of certain agreed rental. *Ijarah* is one of the popular contract of financing among Islamic Financial Institutions (IFIs) for many of their financial products such as property financing, vehicle financing, project financing, personal financing and structured products.

In conventional financing usufruct of an asset is transferred to lessee for agreed amounts of rentals whereby leasing ownership may or may not be transferred. Firstly, lessee is not entitled to pay rent under *Ijarah* until asset is delivered for use. Secondly, extra rent cannot be demanded in case of default except a fine if specified in original contract of lease which is not the income of IFI. Thirdly, rent cannot be demanded by IFI during period of major repair. Fourthly, IFI cannot claim further instalments if asset is lost or destroyed therefore all risks of ownership are borne by IFI.

Salam

Salam is a deferred delivery contract: A sale contract wherein the price is paid on the spot, but the delivery of the goods is deferred. – It is essentially a forward agreement where delivery occurs at a future date in exchange for spot payment of price. The Prophet allowed for such transactions to take place to meet the needs of small farmers since they are not able to yield returns until several periods after the initial investment. Under a *Salam* or *Salaf* agreement, a trader in need of short-term funds sells merchandise to the bank on a deferred delivery basis. Payment of the price in full at the time of affecting the contract is a vital condition for the validity of a *Salam*. If both payment and delivery are deferred, the result is a debt-against debt sale, which is strictly prohibited under *Shariah*. The subject matter, price, quantity, and date and place of delivery should be precisely specified in the contract. In the event that the seller can neither produce the goods nor obtain them elsewhere, the buyer can either take back the paid prices with no increase, or wait until the goods become available. Should one of the parties fail to fulfill their contract, the bank will get back its initial investment, but will have to accept the lost profit. To reduce exposure to credit risk, the bank may ask for a financial guarantee, mortgage, advance payment, or third-party guarantee (Rima, 2014).

Istisna

Istisna is a contract in which a commodity can be transacted before it comes into existence. The unique feature of *istisna* or manufacturing is that nothing is exchanged on the spot or at the time of contracting. It is perhaps the only forward contract where the obligations of both parties are in the future. In theory, the *istisna* contract could be directly between the end user and the manufacturer, but it is typically a three-party contract, with the bank acting as intermediary. Under the first *istisna* contract, the bank agrees to receive payments from the client on a longer-term schedule, whereas under the second contract, the bank (as a buyer) makes progress instalment payments to the producer over a shorter period of time.

The UK-based ABC Bank has pioneered a Parallel Phased *Istisna* that mitigates construction risk by breaking down the construction project into several *Istisna*, which allows for staggered financing and lowering the cost of capital. – It financed the construction of an inner-city residential development in Leeds (UK), consisting of 183 residential flats and 72 parking spaces. Modern Buy, Operate, and Transfer (BOT) agreements can also be formalized using *Istisna'*. A government wanting to construct a motorway may enter into an *Istisna* with a builder, who may operate the motorway and collect tolls for a period of time.

Sukuk

The term *"Sukuk"* was first proposed for Islamic financial instruments in the Islamic financial jurisprudence session of Islamic Development Bank in the year of 2002. *Sukuk* means certificates with identical nominal value that after completion of subscription operations evidence payment of a nominal amount mentioned in it by the purchaser to the issuer; and its holder will be the owner of a set of assets or profits arising from assets, or beneficiary of a project or a special investment activity. The returns on the certificates are directly linked to the returns generated by the underlying assets. (Source: AAOIFI).

Sukuk is a certificate of investment comprising of ownership claims in the pool of assets. So, in addition to cash flow, there is also an element of ownership involved in *sukuk*. It is not similar or same as bonds as in case of bonds the issuer is obliged to pay a fixed amount of interest to the investor as agreed in the contract. However, in case of *sukuk* investors, the return on the capital invested depends on the revenue generation by the assets as well as from the proceeds of realization of the assets. Standard & Poor's Ratings Services report (2011) states that the principles of *Shariah* are a good fit with infrastructure spending, and Islamic financing--particularly *sukuk* financing--could play a key role in financing Asia's funding gap in the infrastructure space. In short, Islamic lending transactions are governed by *Shariah*, which bans speculation and specifies that income must come from shared business risk.

Voluntary and Charitable Sectors *(Zakat and Waqf)*

Obligatory alms referred to as *zakat* which is one of the fundamental pillars of Islam that has direct economic bearing on the distribution of income and emancipation of the poor. It is obligatory for every Muslim whose wealth exceeds a certain threshold level (*nisab*) to distribute a percentage of their wealth and income among specified heads annually. The percentage of *zakat* varies from 2.5% paid on assets such as cash, gold, silver, goods for trade, etc. to 5% on agricultural products if the crops are irrigated or 10% if they use water from natural sources such as rain, rivers or springs. Early Islamic history demonstrates that *zakat* was used as an effective distributive scheme in taking care of the poorer sections of the population in Muslim societies.

Kahf (1997) reports that *zakat* collected in Saudi Arabia, Yemen and Pakistan varies between 0.3-0.4 percent of GDP. Shirazi and Amin (2009), who studied the potential for institutionalized *zakat* to reduce the rate of poverty in Organization of the Islamic Co operation (OIC) countries, estimate that the maximum that can be collected through *zakat* ranges between averages of 1.8 percent to 4.3 percent of GDP annually.

Waqf is a charitable endowment that has wide economic implications and can play an important role in increasing social welfare. Whereas the corpus of this endowment is usually immovable assets such as land and real estate, moveable assets such as cash, books, grain to use as seeds, etc. are also included. In addition to providing support for religious matters, which was its original purpose, *waqf* can be established for provision of economic relief to the poor and the needy, and to provide social services such as education, health care, public utilities, research, service animals and environmental protection. Examples of the latter types of *waqf* include those created to preserve forests, feed birds and maintain animals such as horses and cats (Kahf, 2000). *Quad al Hasan* is one form of *waqf* is cash to be used either for providing interest-free loans or investing, with its return assigned to designated beneficiaries.

2.3. Regulation and Supervision

Islamic banks may be exposed to displaced commercial risk, which is especially relevant where they are competing with conventional banks. This competition may force Islamic banks and their shareholders to forego part of their profits to pay comparable rates of return to their clients, or to avoid subjecting their investment account holders to having to bear losses in cases when the return on underlying assets falls short. This has led to complexities in the manner in which Islamic banks build reserves against losses and how these are treated in the calculation of regulatory capital.

Islamic banks are also subject to equity investment risk because their assets are made up of physical investments whose returns are uncertain. In this context, they are also subject to the risk of depositor flight if market interest rates rise beyond the rate of return that can be funded by the Islamic banks' own assets (the so-called "rate of return risk"). The requirement of *Shariah* governance and compliance on uses and sources of funds also poses risks: a determination of noncompliance could also trigger client flight. In addition, market and operational risks could be heightened by the complexity of products, a reliance on commodities to structure some operations, and the lack of hedging instruments. The difficulty of selling debt, charging accrued interest in case of default, and recognizing non performing loans (NPLs) in some profit-and-loss-sharing (PLS) contracts may heighten credit risk In addition; the scarcity of Shariah-compliant liquidity instruments and infrastructure may increase liquidity risk. Similarly, the practice of asset-based financing sometimes leads to a high concentration in real estate and commodities investments, and to the creation of complex corporate structures. Moreover, Islamic banks' greater focus on consumer financing rather than industrial or business financing reflects greater certainty over guarantees, collateral value, and investor rights.

The unique characteristics of Islamic Banks have been addressed by specialized Islamic standard-setting bodies. Conventional standards apply in all banking systems. However, taking into account the unique nature of Islamic Banks, special standards have been developed through dedicated standard-setting bodies. The industry has two key standard setters: the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), established in 1990, for *Shariah* accounting and auditing standards, and the IFSB, set up in 2002, for regulatory and supervisory standards. These institutions have developed a wide range of technical standards and guidance notes, working closely with the Basel Committee and similar conventional standard-setting bodies to ensure coherence and consistency with their standards (IMF, April, 2015).

The *Shariah* Board

In most jurisdictions, the function and role of ensuring *Shariah* compliance within an Islamic bank is the responsibility of a *Shariah* board, which oversees and is assisted by internal auditors, *Shariah* auditors, or external auditors (although the latter appear to be in the minority), and by *Shariah* review, control and research functions. *Shariah* boards are comprised of a specified number of *Shariah* scholars and sometimes specialists such as economists, accountants, financial sector experts, and lawyers. Their main function is to review and ensure that all transactions, contracts, products and activities relating to the Islamic bank, comply with *Shariah* law and principles. *Shariah* boards can issue fatwa and rulings that are binding on Islamic financial institutions. Generally, *Shariah* boards review transactions ex-ante, and approve them from a *Shariah* perspective, although in some cases, this may be done on an ex-post basis. It is important to mention that *Shariah* boards are also responsible for the entire Shariah governance regime within the financial institution; even though there is usually a mechanism that allows direct access to the board of directors if there is some type of failure (or alleged failure) within this *Shariah* governance regime.

Different types of *Shariah* board models exist in various jurisdictions. There are essentially two main models of *Shariah* boards. Some jurisdictions have centralized. *Shariah* boards, in some cases within the Central Bank, which issue binding rulings for all Islamic banks. Many other countries adopt a decentralized approach where individual *Shariah* boards exist within each Islamic bank, with power to issue decisions that are only binding on the institution in which they are housed. The two models are not always incompatible, as there are countries with a centralized *Shariah* board that also require individual Islamic banks to have their own *Shariah* boards. In such jurisdictions, the *Sharia*h board within the bank issues rulings that are binding on the bank, subject to the rulings issued by the centralized *Shariah* board. (IMF, November 2015)

The *Shariah* board is a key part of an Islamic financial institution. It has the responsibility for ensuring that all products and services offered by that institution are compliant with the principles of *Shariah* law. Boards are made up of a committee of Islamic scholars and different institutions can have different boards. An institution's *Shariah* board will review and oversee all new product offerings before they are launched. It can also be asked to deliver judgments on individual cases referred to it, such as whether a specific customer's business proposals are *Shariah*-compliant. The demand for *Shariah*-compliant financial services is growing rapidly and the *Shariah* board can also play an important role in helping to develop new financial instruments and products to help the institution to adapt to new developments, industry trends, and customers' requirements. The ability of scholars to make pronouncements using their own expertise and based on *Shariah*, highlights the fact that Islamic finance remains innovative and able to evolve, while crucially remaining within the bounds of core principles.

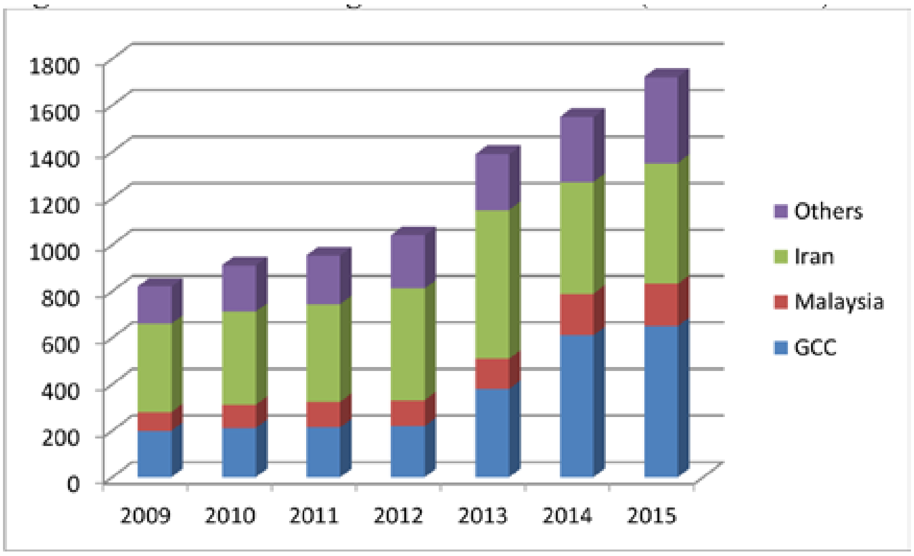
2.4. Current Status of Islamic Financial Markets

Islamic finance is one of the fastest growing segments of emerging global financial markets, it is often stated that the market is far below its true potential. The pulse of the international Participation banking industry are the nine core markets — Bahrain, Qatar, Indonesia, Saudi Arabia, Malaysia, United Arab Emirates, Turkey, Kuwait and Pakistan. It is gaining popularity in western countries including UK, France, and Canada with the involvement of both government and the private sector. According to Ernst and Young despite its growth it makes up only a fraction of the banking assets of Muslims. It has been growing faster than banking assets as a whole growing of an annual rate of 17.6% between 2009 and 2013, and is projected to grow by an average of 19.7% a year to 2018 (The Economist, September, 2014). The current size of the Islamic finance market ranges from $1.66 trillion to $2.1 trillion with expectations of market size to $3.4 trillion by the end of 2018 (Naveed 2014).

Islamic financial services continue to show strong participation in various regions. The percentage participation of Islamic financial assets in 2014; GCC countries is 34%, ASEAN, 13%, South Asia 12%, Turkey and ROW (Rest of the World) 6% (World Competitiveness Report, 2016). As per S&P Global

Rankings Report of 2017, Islamic financial assets have shown tremendous growth in GCC countries, Malaysia, Iran and others (Fig.2.1).

Fig.2.1
Islamic Banking Assets 2008-2015 (in Million $)

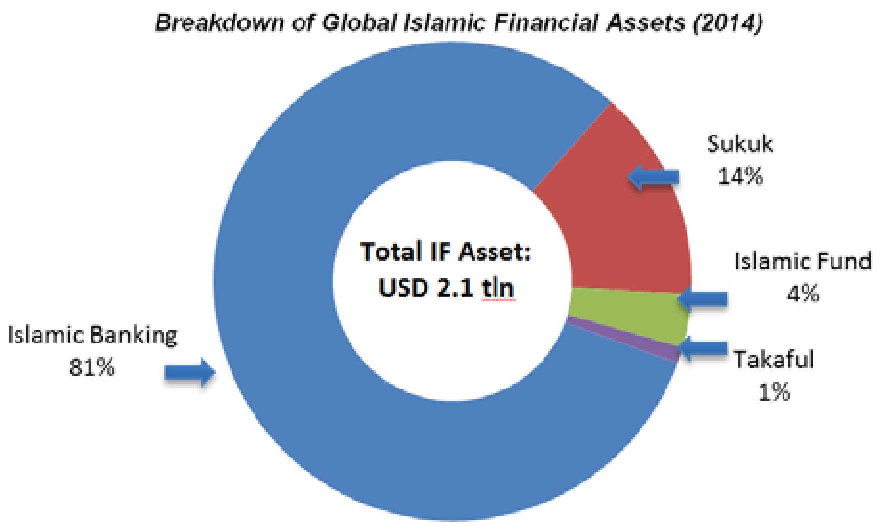


Source: S&P Global Ratings Report, 2017

The global Islamic finance industry reached approximately USD 2.1trillion in 2014, witnessing double digit growth rates across all sectors of the Islamic financial services industry. Country wise contribution of Islamic banking assets shows that Kingdom of Saudi-Arabia at 36% is the highest contributor in total Participation banking assets followed by Malaysia at 17% and UAE 16%.

The breakdown of global Islamic financial assets shows that banking constitutes 81%, *sukuk* or Islamic bond 14%, Islamic fund 4% and *takaful* or Islamic insurance 1% (Figure 2.2).

Fig. 2.2
Breakdown of Global Islamic Financial Assets, 2014



Source: World Islamic Banking Competitiveness Report, 2016

Combined profitability of the top 20 Islamic banks has increased by US$1b to cross US$7b in 2014, growing with a CAGR of 14% during 2010-2014 (See Table 2.1). This resulted in healthy growth of ROE, which has positively contributed towards increasing shareholder's equity (22 banks have crossed the equity landmark of US$1b).

Table 2.1
Return on Equity of Leading Islamic versus Conventional Banks

Particulars	Average ROE	Average Assets	Average Growth 2010-14
Leading Islamic banks by assets	12.60%	23billion$	14%
Comparable conventional average	14.50%	87 billion$	11%

Source: World Islamic Banking Competitiveness Report, 2016

2.5. Developments in India

India, a secular and pluralistic society is the second largest Muslim population of the world. There is lack of awareness about the principles and practices of Islamic finance among Muslims and non-Muslims in India. Research indicates that nearly one-fifth of Muslims in the country are economically well off and are desperately looking for real Islamic investments. In addition, non-Muslims in India are also interested to know more about the benefits of Islamic finance. Considering the significance, the government of India has begun its discussions on the viability of introducing Islamic finance in India.

There are however various types of Islamic Financial Organisations that carry out financial transactions on an interest free basis. There are several *Baitul Mals* (House of Treasury where by charity funds are collected and spent on the poor and needy) working in cities as well as in villages. Only 10 to 15 Islamic financial institutions with deposits of about Rs 75 crore are operating all over the country in various states. They are actually Non-Banking Finance Companies (NBFCs) which work on profits/loss basis. They are by and large catering to the needs of local area except a few of them operating across districts or states. Their sources of funds are limited and as a result these banks have to operate on small scale (Jeet Singh & Preeti Yadav, 2013).

Islamic investment business is gaining considerable grounds and companies like McKinsey & company Inc. and Bearys Group have started big business through *Shariah* Investment funds. East Wind launched Islamic Index and Reliance money and Religare have launched *shariah* compliant portfolio management services. As a result Indian stock market is also observing better trends in *shariah* compliant stocks. The strengths that Indian economy have in this field are the demand for Islamic financial products in comparison to recent economic turmoil, Islamic financial products are safe Indian economy would benefit from inflow of funds from GCC countries it addresses the issue of financial inclusion by reducing sideling income disparities as well as giving access to banking services to those people due to religious grounds. The problems facing are lack of experts, existence of prejudices, increasing competition from micro finance and lack of political consensus are the major hurdles in the arena of Islamic banking (Pawandeep, 2008).

A study on *shariah* compliant stocks in Indian stock market reveals that the current share of *shariah* compliant market capitalization (61percent) is highest even when compared with the number of Islamic countries such as Malaysia, Pakistan, Bahrain etc. where share of *shariah* compliant market capitalization was 57 percent, 51 percent, and 6 percent respectively of the total market capitalization

Sector wise computer software, drugs and pharmaceuticals and automobile ancillaries were the largest sectors among the *shariah* compliant stocks. They constituted about 36 percent of the total *shariah* compliant stocks on NSE (Shariq Nisar, 2008).

Table 2.2
Shariah Compliant Stocks in India during December, 2007

Parameter	NSE	BSE 500
Number of Companies in the sample	1331	500
Number of *Shariah* Compliant companies	405	257
% of *Shariah* compliant market cap of total	61.4	60.44

(Source: Shariq Nisar, 2008)

Table 2.3
Top Shariah Compliant Sectors at NSE

Sectors	Number of Companies	Market cap (Rs. Crore)
Computer software	59	450096
Telephone services	4	316974
Infrastructure and real estate	27	242311
Drugs and pharmaceuticals	35	140476
Finished steel	4	118067
Cement	15	99509
Cosmetis, toiletries and soaps	6	59820
Total	405	2818934

(Source: Shariq Nisar, 2008)

It was not long ago that infrastructure finance in India was entirely borne through budgetary provisions and resources of public sector infrastructure companies. Recently significant numbers of private players have in-vested in building and operating infrastructure assets ranging from road to ports, airports, and power and tele-communication sector. According to estimates 50% of the infrastructural investment would be met by budgetary resources, still remaining INR 32, 50,000 crores need to be met through debt and equity instruments. A funding gap of INR 14,60,784 crores which is 22.47 % of total required investment is projected (Working Sub-Group on Infrastructure, 2013). In the dried up investment atmosphere of India, *sukuk* can be one way out. By the nature of *sukuk*, the returns are directly based on the revenue generation by the projects; therefore there is no liability for the interest to be paid to the investors. This non interest burden on the economy lessens the chances of fiscal deficit due to non compulsion of interest payment against various debts undertaken to finance infrastructure in the nation; which in turn helps the economy to be stress free (Yash Majeethia, 2014). The table below shows the list of major Islamic financial institutions in India published by Islamic Finance WIKI, 2016.

Table 2.4
List of Major Islamic Financial Institutions & Advisory in India, 2016

Islamic Financial Institutions
AICMEU's Baitulmal Cooperative Credit Society Ltd.
Alternative Investments and Credits Limited
Janseva Cooperative Credit Society Ltd.
Sahulat Microfinance Society
Secura Investment Management
Zamzam Capital LLP
Zayd Chit Funds Pvt. Ltd.
Advisory
Taqwaa Advisory and Shariah Investment Solutions
Infinity Consultants

(Source: http://wiki.islamicfinance.de/index.php/Islamic_financial_institutions#India

Reports also reveal that in relation to those who have dealings with banks, thousands of crores of their interest money is lying idle in the banks and these saving are not ploughed back by them into economic activity of the country. According to Report by Grail Research, part of US-based management consultancy Monitor Group, ―India could be a significant market for Islamic banking institutions, provided there is a favourable change in regulatory environment and increased awareness among Muslims and India as a whole. Planning Commission of India constituted a high level Committee on Financial Sector Reforms under Dr Raghuram Rajan, former IMF Chief Economist and RBI governor recommended interest free finance to be introduced in the main Banking sector with the objective of inclusion and growth through innovation. While interest-free banking is provided in a limited manner through NBFCs and cooperatives, the Committee recommends that measures be taken to permit the delivery of interest-free finance on a larger scale, including through the banking system. This is in consonance with the objectives of inclusion and growth through innovation.

2.6. Kerala and Islamic Finance

Kerala has a good potential in exploring the avenues of Islamic finance since 26.56% of the population constitute Muslim community. Interest free institutions in Kerala originated during 1970s. Between 1970 and 1995 the number of institutions increased from 6 to 59. By 2010, it reached to 390 (Table 2.5).

In Kerala more than 500 interest free institutions are working in organized and unorganized sector. Few are registered as finance company and co operative society. In a study on *Thanal*, an Islamic microfinance institution functioning in *Maranchery panchayat* of *Malappuram* district, it was found that it improved saving habit of people in coastal area. Loans are mainly used for meeting the living expenses and emergency needs and hence reduced the vulnerability. Most of the members are from low income family irrespective of religion. However, it was found that only very small portion of loans create self employment. Lack of government support and professional approach will affect the expansion (Muhmmed K Palath, 2011).

Table 2.5
Growth of Interest-free Institutions in Kerala

Year	No. of Institutions	Working Capital
1970-75	6	4.05
1975-80	4	11.05
1980-85	12	12.49
1985-90	15	9.73
1990-95	22	19.93
1995-00	130	199.27
2000-05	120	761.79
2005-10	82	98
Total	391	1116.31

(Source: Yaqoob, 2009)

A case study of *Athani*, an interest free microfinance initiative operating at *Kuthiyathode panchayath of Alappuzha* district, Kerala ,which aims to alleviate rural poverty by providing financial as well as non-financial services to the rural poor for generating employment and to setting up microenterprises. Results show that household income, expenditure on children's education, housing conditions, drinking water source, consumption of nutritious food, expenditure on clothes, spending on food items and ownership of household asset had increased significantly due to the influence of invested money. The findings also indicate that there is great potentiality of interest free micro financing to cater to the needs of the poor as well as poorest of the poor (Ameer P.A, 2013).

Kerala has financial companies and NBFC functioning on Islamic financial principles. *Secura* is an investment management company in association with reputed professionals in business to provide investments management services to venture capital funds, real estate investment trusts, mutual funds, offshore funds, private equity funds or any other funds. The Management team of the Company consists of a high calibre team with relevant experience in real estate, legal, corporate, finance, construction, development, retail and other sectors. In addition to the Investment and Professional Fund Management *Secura* do entire Project Management, Leasing of spaces (be it retail, residential or commercial) and Corporate Legal and Management Consultancy. The Fund launched by *Secura* is the First SEBI Registered Real Estate Venture Capital in Kerala and First *Shariah* Compliant Venture Capital Fund in India. Over the period *Secura* has created its own unique benchmark in the Venture Capital Industry as well as in the *Shariah* compliant financial models in India.

Zirva Shariah Securities is the exclusive *Shariah* compliant stock broker in India. Over the last three years *Zirva Shariah Securities* has built an astounding record of helping its clients earn market beating return on their investments by giving high performing *Shariah* compliant stock picks. It gives their clients such powerful daily stock recommendations which can do wonders to investor's portfolio. This ability has been created as a result of their tedious research to find high performance *Shariah* compliant stocks that can rewrite the investment story of the *Shariah* compliant investor. They are committed to the niche space of *Shariah* compliant stocks and investors can now be rest assured that by working with us their portfolios are not only becoming *Shariah* compliant but capable of earning world class returns.

Alternative Investments and Credits Limited (AICL) is a finance company operating on Islamic Finance principles of equity and justice. Established in the year 2000, *AICL* through its successful operation by declaring dividends over the years has set the path for Islamic Finance institutions in the Country. *AICL* was the end result of a state wide campaign against the nuances of interest. It provides consultancy and educational services and boosts its business diversification through a subsidiary company *AICL Builders and Developers Limited*.

Cheraman Financial Services Limited, a non-banking finance company registered with RBI promoted by the Kerala State Industrial Development Corporation focusing on *Shariah* compliant financing projects was launched in 2013. The group carries out financial leasing and equity funding activities through this vertical on a pan India basis. The company initially focuses on healthcare and construction equipments, IT equipments, commercial vehicles and industrial machineries for leasing. Fund focuses on manufacturing and service sectors with special focus on Kerala. This initiative is expected to provide the much needed impetus to manufacturing and service sectors of the state. *Cheraman Funds Management Ltd* undertakes the investment management activities of the Fund.

The present study focuses on '*Secura*', a venture capital investment company working on *shariah* principles. Along with the geographical spread of investments, the fund capitalizes on both the early mover advantage as well as reaps the benefits of economies of scale in the implementation/construction stage of its various investments/projects. A venture capital real estate fund reduces the risk profile of real estate as an asset class by offering diversified investment portfolio managed by experienced investment managers. Thus, it provides the benefit of a defensive investment alternative. *Mudarabah* is the core of Islamic banking and the Two-tier *Mudarabah* model is the basic theoretical model used by Islamic banks to structure venture capital (Iqbal and Molyneux, 2005). The two-tier *Mudarabah* is an equity-based structure used to create asset and liabilities where the Islamic bank is placed between investors and depositors who provide money and borrowers and beneficiaries who require money. Under this model, a bank or company is organised as a joint stock company with the shareholders supplying the initial capital. It is managed by the shareholders through their representatives on the board of directors. Its main business is to obtain funds from the public on the basis of *mudarabah* or profit sharing and to supply funds to businessmen on the same basis. Its gross income comprises the share in the actual profits of the fund users, in accordance with an agreed ratio of profit sharing.

The present study by making a case study of working and performance of Islamic financial company (*SECURA*) in Kerala attempts to explore the type of financial contracts undertaken by the company. The working of the company is presented in the next chapter and financial performance of the company through measuring profitability, liquidity and credit performance in the chapter 4.

Chapter 3

ISLAMIC FINANCIAL PRACTICES AND UNDERLYING INSTRUMENTS OF 'SECURA', AN ISLAMIC INVESTMENT MANAGEMENT COMPANY

Asset management companies offer their intermediary function not only to households, business firms and governments, but also to the other categories of financial intermediaries. By pooling savings from a large group of investors, asset managers can reduce risk by helping individuals diversify their financial wealth amongst many more assets than they could afford to do in general, given transaction costs. They also provide a high level of liquidity to their fund clients by investing in assets that are relatively illiquid. And their ability to trade in large blocks of securities allows them to reduce the value of the dealing commission to be paid as a proportion of the value of the transaction. Unlike other investments real estate investments are more comfortable because they are real. Real estate investments fall into two broad categories: residential and commercial. Residential real estate includes all single family units, buildings meant for one to four families. Commercial real estate investments focus on land or buildings that have profit generating activity (Mishkin 2008).

The opportunities for Islamic asset management are open and closed-end mutual funds; equity benchmarks; leasing companies involved in asset-backed financing. Islamic investment financial institutions provide venture capital financing to small, medium and big companies in a number of sectors. They avoid involvement in prohibited and unlawful activities and offer services to all projects except those manufacturing or dealing with forbidden products and services, such as alcohol, pork, interest-based financial services and the like. Their services relate to venture capital and corporate finance, including syndication finance, project finance and transactions in the capital markets. Asset management or management of funds includes equity funds and real estate funds. Islamic corporate finance activities of investment institutions are similar to conventional corporate finance except that the products and services offered are *Shariah*-compliant. These services include: equity issues such as IPOs, offers for sale, rights issues; private placements; strategic reviews; financial restructurings; acquisitions, mergers; joint ventures, alliance searches and studies (Muhammad Ayub, 2007).

The present chapter elucidate the working of the Islamic Investment Management Company '*Secura*', located at Calicut, Kerala.

SECURA - An Investment Management Company

SECURA is an investment management company by *Hi Lite* group to provide investment management services to venture capital funds, mutual funds and other private equity funds. *HiLITE* group, founded by a team of professionals that joined in the late nineties has its business operations based at Calicut. Teamed with professionals equipped with dedication, competence and extensive experience in all the fields that the group has its business activities, *HiLITE* evolved as a group in the early 2007. The management team of *Secura* includes professionals having experience in real estate, legal, corporate, finance and other sectors. *Secura* has created a unique model in the Venture Capital Industry as well as in the *Shariah* compliant financial models in India.

SECURA through its Real estate Fund helps enterprises, which may not fall within the norms of conventional financing. In the case of high growth and high risky ventures, like real estate projects and those promoted by new entrepreneurs, the intellectual capital by way of the project idea/concept and the relevant track record are often the major contributions from the promoters. At this stage, the venture capitalist steps in with his contribution by way of equity / equity related instruments besides other value added and need-based services such as strategic management support etc. After the enterprise settles down with profitable operations and normally with capability to raise funds from conventional sources, the venture capitalist exits by selling out his shareholding. Besides investment and project managing services, it offers advice and guidance regarding legal matters to clients. The Project Management Consultancy of the Company undertakes the leasing of residential, commercial and retail spaces for the projects run by the company as per necessities.

3.1. SECURA - An Alternative Islamic Financing Model

The Fund launched by *SECURA* is the First SEBI Registered Real Estate Venture Capital Fund in Kerala and First *Shariah* Compliant Venture Capital Fund in India. Over the period *Secura* has created its own unique benchmark in the Venture Capital Industry as well as in the *Shariah* compliant financial models in India. It is a close-ended venture capital fund with a focus on the Indian real estate and allied sectors. This fund was formed as a contributory trust under the provisions of Indian Trust Act, 1882. The trustee of the Fund is *IL&FS Trust Company Ltd*. The *Shariah* certification of the fund is done by *Taqwaa Advisory and Shariah Investment Solutions (TASIS)*. Members of *TASIS Shariah* Board are highly qualified and have vast exposure in the field of commercial transactions. Apart from India, Board members provide *Shariah* consultancy services in the countries of Europe, North America and Africa.

Venture Capital financing is a mechanism to institutionalize innovative entrepreneurship. In other words, Venture Capital Financing denotes the investment in high-risk ventures willing to share in the risk of the project, with the expectation of commensurate levels of returns. The Venture Capital investment in any real estate projects are typically at "Land Cost" stage, means a fund invests and collaborates with developers/land owners from inception to completion. Along with the geographical spread of investments, the fund capitalizes on both the early mover advantage as well as reaps the benefits of economies of scale in the implementation/ construction stage of its various investments/ projects. A Venture Capital real estate fund reduces the risk profile of real estate as an asset class by offering diversified investment portfolio managed by experienced investment managers. The concept of Islamic venture capital comes under ***Mudarabah* or Profit – Sharing** of Islamic financial contracts.

The two primary alternative modes to conventional financing are Profit-and-Loss Sharing (PLS) contracts, namely *Mudarabah* (Islamic venture capital) and *Musharakah* (Islamic joint venture), which dominate the theoretical literature on Islamic finance**.** Islamic partnership contracts can be clearly applied into the conventional venture capital concept in order to make it *Shariah*-compliant. Although the details of practices of the conventional venture capital companies may not be totally consistent with Islamic principles, these details can be easily customized without compromising the positive aspects of the concept (Al-Suwailem, 1998).

3.1.1. Mudarabah or Profit – Sharing

Mudarabah is defined as a form of partnership between one who contributes capital (*rabb al-mal* or capital provider) and the other who contributes efforts in the form of managerial skills (*mudarib* or manager) Al-Zuhaily (2007); Abdullah M., Shahimi. S & Arshad N.C (2008). It is basically a contract made between two parties to finance a business venture. The parties are a *rabb al-mal* (investor) who solely provides the capital and *mudarib* (entrepreneur) who solely manages the project. This is akin to a conventional Venture Capital, where there exists a relationship between the capital provider and the manager. If the venture is profitable, the profit will be distributed based on a pre-agreed ratio. In the event of a business loss, it should be borne solely by the capital provider to the extent of the capital contribution. The key to a *Mudarabah* structure is the fact that the manager cannot be placed at risk to bear losses, unless proven negligent.

It is necessary for the validity of *Mudarabah* that the parties agree, right at the beginning, on a definite proportion of the actual profit to which each one of them is entitled. The *Shariah* has prescribed no particular proportion; rather it has been left to their mutual consent. They can share the profit in equal proportions and they can also allocate different proportions for *Rab-ul-Maal* and *Mudarib*. The *Mudarabah* will stand terminated when the period specified in the contract expires. It can also be terminated any time by either of the two parties by giving notice. In case *Rab-ul-Maal* has terminated services of *Mudarib*, he will continue to act as *Mudarib* until he is informed of the same and all his acts will form part of *Mudarabah* (Muhammad Imran Ashraf Usmani, 2002).

Mudaraba is essentially an agreement between a financier and an entrepreneur — the principals. However, taking account of the modern social structure and context, the pioneers of Islamic banking brought in an intermediary between the principals and created a two-tier *mudaraba*. This modified form of *mudaraba* was introduced into conventional commercial banking in the form of profit and loss-sharing (PLS) investment accounts and financing arrangements. The earned profit (which is an uncertain and unpredictable return on capital) was to replace the interest (a predetermined fixed return) in the conventional setting. This, however, was not acceptable to the conventional banking (Abdul Gafoor, 2001).

Modus operandi of Two-tier Mudarabah

The first tier of *Mudarabah* agreement is between the bank and the depositors, who agreed to put their money in the bank's investment account and to share profit with it. In this case depositors are the capital providers (*rabb-al-mal*) and the bank function as a manager of the funds. The second tier of the *mudarabah* agreement is between the bank and the entrepreneur who seek financing from the bank; who agree that the profits accruing from the business will be shared between them and the bank in an agreed proportion but the loss shall be borne by the financier only. In this instant bank functions as a provider of capital and the entrepreneur works as a manager (Maas Riyas Malik, 2010).

SECURA Investment Management Company does the professional fund management services from the structuring of the Fund to the end of the fund through its life cycle. *SECURA* starts the professional fund management from the fund structuring stage itself. It defines and aligns the fund structuring, legal format, tax method, regulatory matters, financial patterns etc. *SECURA* manages two Domestic schemes of the *Secura* India Real Estate Fund viz; Domestic Scheme 1 and 2, which has been organised as a scheme of the *Secura India Real Estate Fund*. *SECURA* seek to make investments in privately negotiated equity and equity linked investments in unlisted or listed companies in India or in other countries subject to the prevailing regulations and laws in India. It is anticipated that the Fund will invest in sectors related to Real Estate related activities. Scheme 1of the Fund is invested by investors with a minimum amount of 5 Lakhs without maximum caps as per the SEBI (The Securities and Exchange Board of India) Regulations. Domestic Scheme 1 has wound up with successful payback record and the second scheme, *Secura* India Real Estate Domestic Scheme 2 is in investment stage.

It launched a new Alternative Investment Fund, *Secura India Realty AIF*. This is the third investment fund managing by *Secura* Investment Management (India) Pvt Ltd. The AIF with minimum 1 crore investment size, as per SEBI Regulations, targets to invest in privately identified realty and development projects to raise Rs. 200 crore with the green shoe option of Rs.100 crore more. *IL&FS Trust Company Limited (ITCL)*, Mumbai is the trustee to the Fund and *Taqwaa Advisory and Shariah Investment Solutions Pvt Ltd (TASIS)*, Mumbai is the *Shariah* Auditor. The amount can be paid in instalments in three years; with a down payment of 10 per cent of the capital commitment. The tenure of the fund is seven years from the final closing. "We had raised small-sized funds in our earlier outings. Now that the norms to tap into offshore investors have been relaxed, we are looking at a bigger capital pool," M.A Mehaboob, Managing Director, *Secura* Investment Management said.

The primary objective of the fund is to carry out investments as permissible under the regulations of SEBI and raise resources to provide venture capital assistance to portfolio companies operating in the Indian real estate and allied sectors to generate superior risk-adjusted returns. With the investment potential in real estate sector is growing at a steady pace, he said the company is looking at an annualised RoI (Return on Investment) of 15-20 per cent, with a profit share post hurdle of 80:20 with catch-up. While the company's first scheme, *Secura India Real Estate Fund Domestic Scheme 1,* has completed with a payback record of 18 per cent per annum, the second scheme, *Secura India Real Estate Domestic Scheme 2,* is in the investment stage and its tenure will be over in 2017. The company has investments in four ongoing real estate projects in *Kozhikode* and had earlier invested in four other real estate projects, which are already completed. It has *IL&FS Trust Company Ltd* as trustee and *Taqwaa Advisory and Shariah Investment Solutions Pvt. Ltd as Shariah* advisor (October 17, 2016, The Hindu, Business Line).

Thus, it provides the benefit of a defensive investment alternative. *Secura* delivers a unique business model to achieve the reasonable return at every stage of business cycle. This is achieved through various thoughtful processes. Generally *Secura* partnering with reputed entrepreneurs to develop and enhance their property development real estate project portfolio through funding the special purpose vehicles from the stage of purchase of land itself. Every investment by *Secura* will be after a careful study of and analysis with the restrictions and guidelines of Shariah. Through these multilevel processes *Secura* creates unique model of investment and business in Indian economy as well as *Shariah* economy.

Secura does joint ventures with reputed entrepreneurs to develop commercial, residential, or retail properties in Kerala, especially in northern Kerala. It divides its funds among 4 or 5 projects to hedge the risk. Each and every step of the investment and disbursement is being monitored by *TASIS (Shariah* certification firm). They do *Shariah* auditing every three months, it covers both, the investment and disbursement of the fund.

SECURA perform *shariah*-complaint investment through mobilizing funds from retail investors and pooled them in to a pool of investment. This pool of investment is kept in a conventional bank under a current account, which pays zero interest. Secura issued units to investors at the face value till the Initial Closing. After the Initial Closing it charged 2% and 4% premium respectively to investors who chose to invest after the Initial Closing. Premium is allowed in *Shariah*, because it is an additional capital brought by investors who have invested at a later stage to share profits proportionately with their counterparts, who had invested earlier. It is called *Wakala* in Islamic finance.

3.3. Wakala

The literal meaning of a '*wakala*' is an agency or a delegated authority where the muwakkil (principal) appoints the *wakil* (agent) to carry out a specific job on behalf of the muwakkil. Under the general principles of Islamic *Shariah*, a *wakala* agreement is an agency agreement whereby the *wakil* acts as agent for the *muwakkil* in accordance with the provisions of the *wakala*. An action performed by the *wakil* as an agent on behalf of the *muwakkil* is deemed an action by the *muwakkil* himself. However, the *wakil* is under a duty of care and skill to act diligently when performing his obligations. The subject matter of the agency and the obligations of the *wakil* should be known and defined and should not contravene Islamic *Shariah* principles. Agency is not permissible in acts prohibited under Islamic *Shariah* such as selling alcohol or gambling and acts of disobedience such as theft, unlawful seizure of property or conducting *interest*-based business.

The inherent nature of *wakalah* is based on delegation or authorization of the *wakil* by the *muwakkil* resulting in the *wakil* having fiduciary duties (*amanah*) towards the *muwakkil* within what has been authorized to him. A *wakalah* contract shall be binding in any of the following situations: (a) the *wakalah* contract involves the rights of another party; (b) the *wakalah* contract involves a fee (*wakalah bil ujrah*) ; (c) the *wakil* has commenced the work authorized to him and discontinuity of the work would cause damage to the contracting parties; or (d) the contracting parties have agreed not to terminate the *wakalah* contract within a specified time (BNM, 2015). *'Wakalah bil-ujrah'* (agency contract with fee) takes place in the venture capital concept when other external companies/managers, usually experts in the business area undertaken by the investee, are hired to consult and help the investee company. If the Venture Capital Company operates on fee-based contracts, *wakalah bil-ujrah* will come into the picture (A Jaleel, 2002).

SECURA manages the whole affairs of the construction projects from the conceptual stage to commissioning. It includes administration and operation of the projects, project procedure systems, project coordination systems, overall project control management, documentation, design management, design concept creation, design analysis, optimum method engineering, prequalification and appoint of contractors and consultants, purchase and procurement management, purchase and procurement method, management of building construction, quality inspection, status, progress and information management, schedule management, integrated schedule structuring, execution system, payment systems structure, cost planning, project budget control, project cash flow etc.

SECURA Investment Management Company provides Corporate Legal consulting services in the areas of Legal viability of the projects, Legal and financial analysis, Legal due diligence, Effective and viable legal structuring and related corporate legal advice deploying the experience and expertise of team *SECURA*. Its services include tax advisory, financial structuring, merger and amalgamation and other corporate matters. It structures all the business affairs considering the Indian and International laws.

3.4. LEASING OR IJARAH

By separating an asset's ownership rights from use rights leasing principle or *ijarah* makes the use of an asset independent from its financing. The owner of the assets bears all the risks associated with ownership and the user of the asset pays a fixed price or rent for the benefits of the asset. One can use an asset without owning it. Therefore, *ijarah* plays an important financial role (Kahf, 1992). In Islamic law, *ijarah* is a contract of a known and proposed usufruct of specified assets for a specified time period against a specified and lawful return or consideration for the service or return for the benefit proposed to be taken, or for the effort or work proposed to be expended. As a contract, it refers to hiring or renting any asset/commodity to benefit from its usufruct. It also encompasses the hiring of labour and any contract of work for anyone against a return (wage).

SECURA develops Joint Venture properties which will be leased first and sold out later and it will share the profit or loss. It does not lease its joint venture projects – to firms involved in

a) Manufacture, sale or distribution of alcohol, narcotic substances or tobacco products;

b) Gaming or gambling;

c) Manufacture or distribution of weapons and defense related products;

d) Production, processing, packaging, or any other business activity relating to pork or pork products and other non- *halal* meat products;

e) Conventional banking and investment, insurance or any other interest related financial services activity.

f) The production or distribution of pornographic materials or conduct of business involving vulgar entertainment.

3.5. Projects of SECURA

Diverse projects managed by *SECURA* comprise of commercial, retail and residential purposes. In the commercial and retail category three projects were completed and three are ongoing.

Commercial and Retail Projects

EMPORA ASTER is located at *Malaparamba* junction, Calicut. The land area of this project is 28.98 cents. The building structure of the project is of B+G+3 storied Commercial and office space comprising 18,262 sq ft with a saleable area of 12,820 sq ft.

EMPORA ASTER

EMPORA VIEWS is located at *Malaparamba* junction, *Calicut*. The land area of this project is 27.78 cents. The building structure of the project is of 2B+G+6 storied Commercial and office space comprising around 31,826 sq feet with a saleable area of 25,000 sq ft.

EMPORA VIEWS

EMPORA GEMZ is located at NH By-pass *Thondayad, Calicut*. The Land area of the project is 25.93 cents and structure of building is B+G+6 storied Commercial and Office space comprising around 13,959 sq feet with a saleable area of 12,100 sq ft.

EMPORA GEMZ

Residential Projects

The *Autumn Leaves* is Housing Layout Development with common amenities, recreational spaces etc. This would be suitable for construction of budget houses with all modern amenities at affordable cost. The project is located at *Velliparamba*, near Medical college *Calicut* having access from *Thondayad* Bypass too via *Palazhi*. The total land area of the project is of 2 acres and 26 plots ranging from 4 cents to 8 cents. '*Autumn Leaves'* formed as a gated community which provides facilities like independent villa plots, 5 meter wide road, recreation area, children play area, round the clock security, landscape, connection points of KWA and KSEB etc.

'*Autumn Leaves'* is surrounded with facilities like Medical College, *Sadbhavana International School, Hilite Mall, Apollo cradle, Metro Cardiac* etc within the radius of 4km. Better opportunity, one to have dream house according to the individual taste and desire.

AUTUMN LEAVES

AUTUMN LEAVES is a Housing Layout Development that stands for harmony between human beings and nature. It pledges a soothing life experience of peaceful mind and living. It is located at *Velliparamba*, near *Calicut* Medical College. *Autumn leaves* spans in an area of 2 acres with 26 plot ranging from 4 cents to 8 cents. It is indeed a dream made of.

Autumn-Leaves- Secura Investment Management

(Source: http://www.securaindia.com/autumn-leaves.php)

The financial performance of the company during 2009-10 to 2013-14 is presented in the following chapter. It depicts the financial soundness and credit worthiness of the company.

Chapter 4

FINANCIAL PERFORMANCE OF ISLAMIC INVESTMENT COMPANY – "*SECURA*"

Financial performance analysis is the process of determining the operating and financial characteristics of a firm from accounting and financial statements. The goal of such analysis is to determine the efficiency and performance of firm's management, as reflected in the financial records and reports. The remarkable development of the Islamic banking sector throughout the world calls for an analysis of the degree of performance of Islamic banks. While performance evolution is the key to sustained growth and development of any organization, it ensures that performance improvement initiative ties in with the organization's vision, mission, and value. According to Samad and Hassan (1998), evolution of a bank's performance is important for all of its stakeholders, i.e. depositors, bank managers and regulators. In a competitive financial market, bank performance provides signals to depositors-investors on whether to invest or withdraw funds from the bank. Similarly, it flashes directions to bank managers on whether to improve its deposit service or loan service or both to improve its finance. Regulators around the world will also use analysis of bank performance for its regulation purposes and to monitor developments or any pertinent issues to preserve banking system stability and the financial system as a whole.

In the words of Frich Kohlar "the performance is a general term applied to a part or to all the conducts of activities of an organization over a period of time often with reference to past or projected cost efficiency, management responsibility or accountability or the like. Thus, not just the presentation, but the quality of results achieved refers to the performance. Performance is used to indicate firm's success, conditions, and compliance. Financial performance analysis includes analysis and interpretation of financial statements in such a way that it undertakes full diagnosis of the profitability and financial soundness of the business. Financial performance can be analysed through various tools or techniques of financial analysis. Various accounting techniques such as comparative financial analysis, common-size financial analysis, Trend analysis, Fund Flow Analysis, Cash Flow Analysis, Ratio Analysis, value Added Analysis etc. may be used for the purpose of financial Analysis. The present study uses ratio analysis for analyzing financial performance of *SECURA*, an Islamic investment management company in Kerala.

4.1. Ratio Analysis

The financial ratios used for analyzing performance of a financial institution are grouped under three broad categories: Profitability; liquidity and risk and solvency (Samad and Hassan, 2000). The objective in using a ratio when analyzing financial information is to standardize financial data of a firm or firms at different periods of time. It helps us identify financial strengths and weaknesses of a company (Arther J Kewon, 1999).

4.1.1. Profitability ratios:

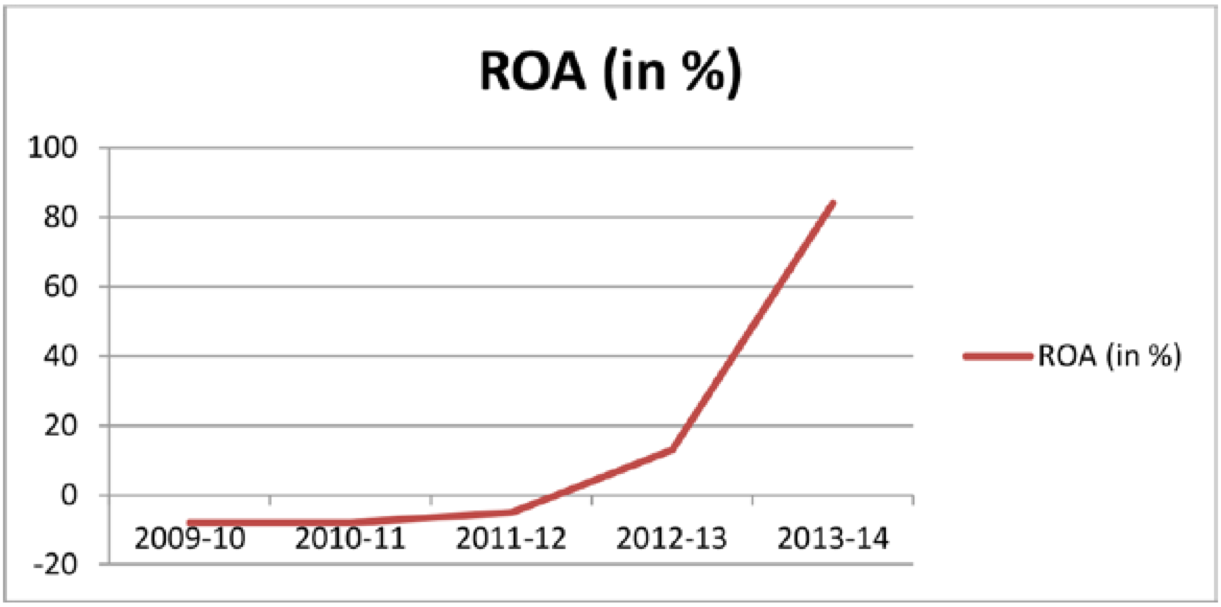
The major profitability ratios used in this study are Return on Asset (RAO), Return on Equity (ROE) and Profit Expense Ratio (PER).

Return on Asset (ROA) shows the ability of management to acquire deposits at a reasonable cost and invest them in profitable investments (Ahmed, 2009). Return on assets indicates the profitability on the assets of the Bank after all expenses and taxes (Van Horne 2005). ROA can be increased either by increasing profit margins or asset turnover but they can't do it simultaneously because of competition and trade-off between turnover and margin. ROA is net earnings per unit of a given asset. It shows how a bank can convert its asset into net earnings. So those financial institutions that maintain higher ROA will make more profit. The formula for calculating Return on Asset (ROA) = Profit after tax/ total asset. It measures efficiency of the business in using its assets to generate net income. The higher values of return on assets shows business are more profitable and vice versa.

Secura is a shariah complaint investment management company manages real estate venture capital funds. The type of Islamic mode of financing that *Secura* undertakes is *Mudarabah*. *Mudarabah* is a profit-and-loss sharing contract in which financier or *rabb-ul-mal* provides all capital needed for financing a project and other party known as *mudarib* or agent, provides labour and effort. In this contract the proportionate share in profit is predetermined by mutual consent between the two parties but in case of loss only financier bears the capital loss and *mudarib* loss by get nothing in return for his expended time, effort and labour. In the case of Secura, two-tier *mudarabah* is undertaken ; on the one side it acts as a *Mudarib* and manages funds of investors called *rabb-ul-mal* and on the other side, it provides venture capital by taking the role of *rabb-ul-mal* and entrepreneurs works as managers. Once the period of contract ends, capital with agreed rate of profit is returned back to the investors through Initial Public Offering. Subsequently company calls for new scheme and undertakes new contract between investors and company.

The present study covers the period from 2009-10 to 2013-14 during which the Company manages its first domestic scheme. The Fund is invested by investors with a minimum amount of five lakhs without maximum caps as per the SEBI (The Securities and Exchange Board of India) Regulations. Return on Asset, one of the important profitability indicators of the company during the initial stage of the launching of the fund is negative (2009-2011). In 2012-13 it becomes 13% and comes to 84% during 2013-14 (See graph 4.1). Domestic scheme 1 has winded up during 2013-14 and Company pay back pre-agreed rate of profits to its investors.

Graph 4.1
Return on Asset (ROA) during 2009-2013



(Source: Financial Statements of the Company, various years)

Return on Equity (ROE)

ROE is a key profitability ratio that investors use to measure of the amount of a company's income that is returned as shareholder equity. This metric reveals how effectively a corporation is at generating profit from the money that equity investors have put into the business. Higher ROE means better managerial performance; however, a higher return on equity may be due to debt (financial leverage) or higher return on assets. Financial leverage creates an important difference between ROA and ROE in that financial leverage always magnifies ROE. It is calculated as Return on Equity (ROE) = Profit after tax/ equity capital. Return on equity or return on capital is the ratio of net income of a business during a year to its stockholders' equity during that year. It is a measure of profitability of stockholders' investments. It shows net income as percentage of shareholder equity. ROE is net earnings per rupee equity capital. The higher ratio is an indicator of higher managerial performance.

Return on equity is an important measure of the profitability of a company. Higher values are generally favourable meaning that the company is efficient in generating income on new investment. Investors should compare the ROE of different companies and also check the trend in ROE over time. However, relying solely on ROE for investment decisions is not safe. It can be artificially influenced by the management, for example, when debt financing is used to reduce share capital there will be an increase in ROE even if income remains constant. ROA and ROE are the indicators of measuring managerial efficiency.

Even though company faces negative returns for 3 years, it was compensated in the subsequently coming years. Return on equity is highest in the year 2013-14 (See Table 4.1). Since the business of the company is a long term nature, it successfully managed domestic scheme 1 and pay back its investors.

Table 4.1
Return on Equity

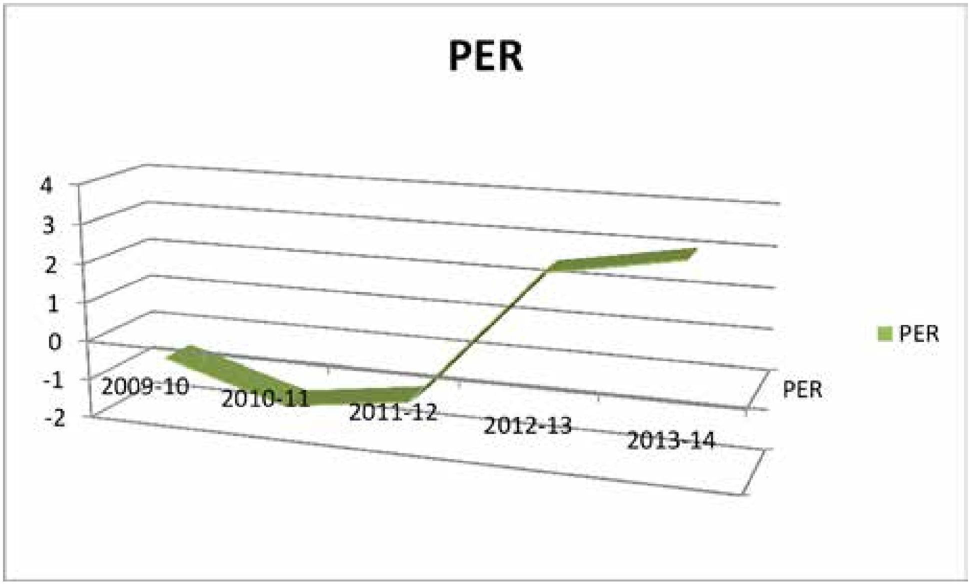
Year	ROE (in %)
2009-10	-8
2010-11	-8
2011-12	-5
2012-13	14
2013-14	112
Mean	21
S.D	51.69
C.V	2.46

(Source: Financial Statements of the Company, various years)

Profit Expense Ratio (PER)

Profit-Expenditure Ratio helps managers and owners assess the business's financial health. Expenditure of the company increases due to various expenditure items. However company's profit can be increased in tune with the rise in expenditure. It is calculated by dividing profit by total expense. The higher ratio indicates higher ability and therefore is an indicator of better performance. It can understand that with the rise in expenditure of the Company, profit also rises (See Graph 4.2).

Graph 4.2
Profit Expenditure Ratio



(Source: Financial Statements of the Company, various years)

All the indicators of profitability of the Islamic financial company are positive during the five year period of study. The company can make profits only through *shariah* approved projects. In spite of this, the indicators of profitability of the Company show that it upholds a favourable level of profitability. The average Return on Assets stood at 15% and Return on Equity is 21% during 2009-2013.

4.1.2. Liquidity Indicators

The major indicators of liquidity are Current Ratio (ratio of liquid assets to current liabilities) and Current Asset Ratio (Ratio of current asset to total asset). The liquidity of a business is defined as its ability to meet maturing debt obligations.

Current ratio = Current asset (CA) / current liability (CL). It indicates how the bank management has been able to meet current liability. A high ratio is an index that shows bank has more liquid asset to pay back the trust (deposit) of the depositors. When withdrawals significantly exceed the new deposits banks usually recourse to replace this shortage of funds by selling securities. Government securities are easily sold and are considered liquid.

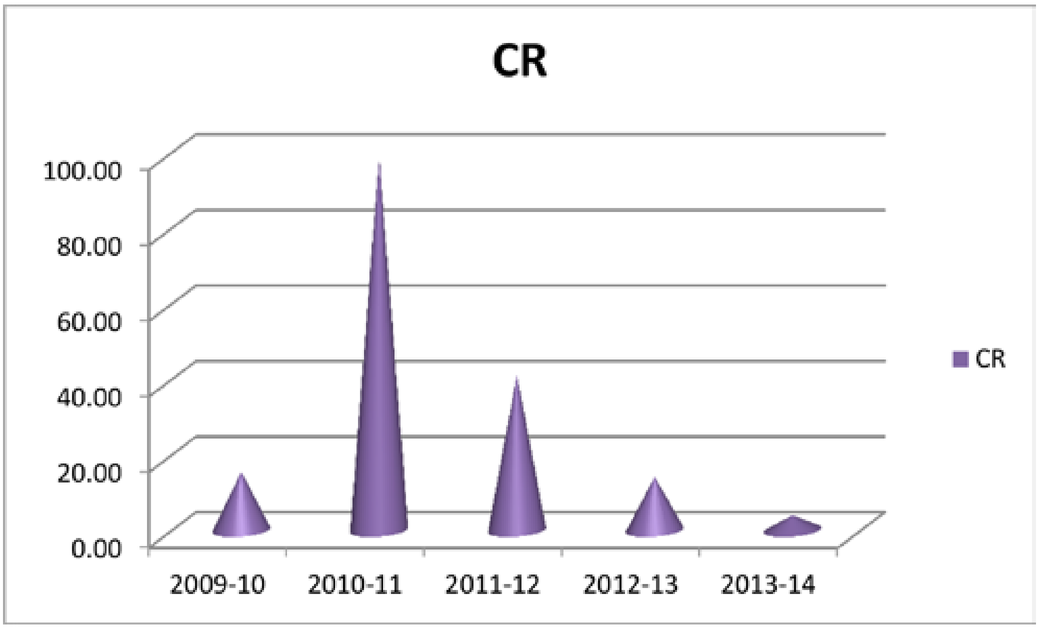
Current Ratio indicates whether the company can pay debts due within one year out of current assets. It was 15.49 in the starting year of the Company rose to 98.81 in 2010 and then falls to 14.12 in 2012-13. In the year 2013-14, it falls to 3.92 due to disclosure of first domestic scheme. Conversely, it shows consistency during the period (See Table 4.2).

Table 4.2
Current Ratio and Current Asset Ratio

Year	CR	CAR
2009-10	15.49	0.99
2010-11	98.81	0.99
2011-12	41.06	0.99
2012-13	14.12	0.99
2013-14	3.92	0.98
Mean	34.69	0.99
S.D	38.36	0.004
C.V	1.1	0.004

(Source: Financial Statements of the Company, various years)

Graph 4.3
Current Ratio of SECURA for the period 2009-10 to 2013-14



(Source: Financial Statements of the Company, various years)

Current Asset Ratio (CAR) shows the ratio of current assets to total assets of the company. It is a major indicator showing liquidity of a company. It indicates the extent of total funds invested for the purpose of working capital and throws light on the importance of current assets of a firm. It should be worthwhile to observe that how much of that portion of total assets is occupied by the current assets, as current assets are essentially involved in forming working capital and also take an active part in increasing liquidity. A high CAR indicates that a bank has more liquid assets. A lower ratio is a sign for illiquidity as more of the assets are long term in nature.

Since *Secura* is a real estate venture capital company its assets are of fixed nature. However it can retain current asset ratio to a favourable level for past five years (See Table 4.4). It shows that company can easily cover its short-term obligations.

4.1.3. Risk and Solvency Ratios

A bank is solvent when the total value of its asset is greater than its liability. A bank becomes risky if it is insolvent. The following are the commonly used measures for a risk and insolvency. The ratios used are Debt Equity Ratio, Debt to Total Asset Ratio and Equity Multiplier.

Debt Equity Ratio (DER) = Debt/equity capital. The debt-to-equity ratio is a financial ratio indicating the relative proportion of shareholders' equity and debt used to finance a company's assets. A high debt/equity ratio generally means that a company has been aggressive in financing its growth with debt. A low debt/equity ratio usually means that a company has been friendly in financing its growth with debt and more aggressive in financing its growth with equity. Debt Equity Ratio measures the proportion of assets that are funded by debt to those funded by equity. The debt to equity ratio is also called the risk ratio or leverage ratio. It is a quick tool for determining the amount of financial leverage of a company.

Debt to Total Asset Ratio (DTAR) = Debt/total asset indicates the financial strength of a bank to pay its debtor. A high DTAR indicates that a bank involves in more risky business. Debt to Asset Ratio shows the proportion of a company's assets which are financed through debt. It can be inferred that the Company is maintaining a low levels of debt (See Table 4.3).

Table 4.3
Debt Equity Ratio& Debt to Total Asset Ratio

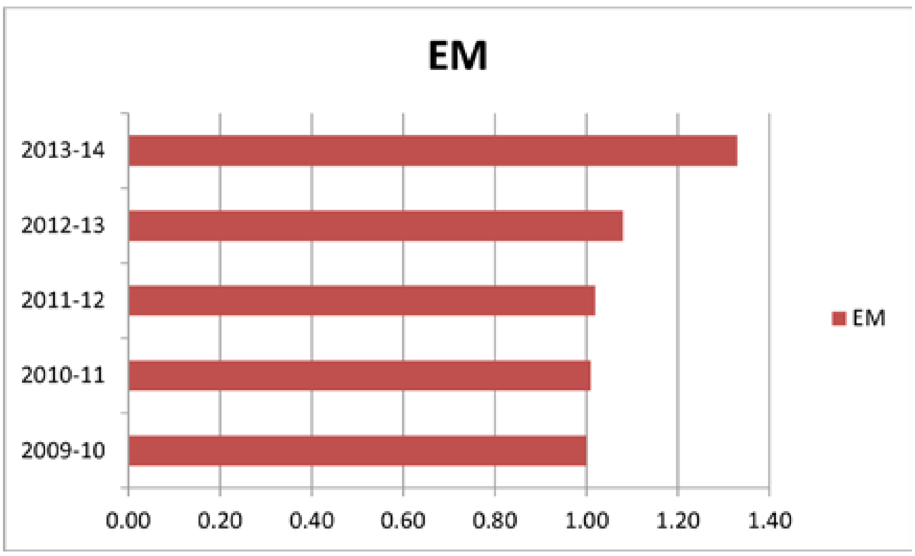
Year	DER (in %)	DTAR (in %)
2009-10	7	6
2010-11	1	1
2011-12	2	2
2012-13	8	7
2013-14	33	25
Mean	10.20	8.2
S.D	13.1	9.73
C.V	1.28	1.18

(Source: Financial Statements of the Company, various years)

Equity multiplier (EM) The ratio of total assets to shareholder's equity is referred to as equity multiplier. It captures the effects of how a company finances its assets, referred to as financial leverage (Pamela and Fabozzi, 1999).

It is the amount of assets per rupee of equity capital. It has more equity capital compared to assets shown by its Equity Multiplier. Larger equity capital indicates a higher shock absorbing capacity for the Islamic financial institution. It can withstand more assets or loan losses as opposed to bank(s) which has (have) less capital. A ratio of 1.1 means that Company's debt levels are extremely low. Only 10 percent of its assets are financed by debt. Conversely, investors finance 90 percent of its assets. This makes company very conservative as far as creditors are concerned.

Graph 4.4
Equity Multiplier



(Source: Financial Statements of the Company, various years)

The Company's performance of risk and solvency between 2009-10 and 2013-2014 revealed that Debt Equity Ratio, Debt To Asset Ratio and Equity Multiplier were decreasing over the years and retain consistency.

Table 4.4
Financial Ratios of SECURA in General during 2009-2013

Ratios		Mean	S.D	C.V
Profitability Ratios	**ROA (%)**	15.2	39.44	2.59
	ROE (%)	21	51.69	2.46
	PER	0.4	1.94	4.87
Liquidity Ratios	**CR**	34.69	38.36	1.1
	CAR	0.99	0.004	0.004
Risk & Solvency Ratios	**DER (%)**	26.29	13.10	1.28
	DTAR(%)	8.2	9.73	1.18
	EM	1.09	0.13	0.12

(Source: Financial Statements of the Company, various years)

It can be found that all the three profitability ratios of the Company are favourable. Even though company can maintain a healthy position in terms of average, S.D and C.V value shows a volatile picture especially because company's first scheme was completed at the end of four years and cross the threshold into investment stage of second scheme. It was also due to negative returns in the first two years (2009 and 2010) of the starting up of the company (See Table 4.4). Liquidity ratios presents that the liquidity position of the Company is good. It maintains a laudable level of current assets so that it can boost up the confidence of investors of the company. The risk and solvency indicators such as Debt Equity Ratio, Debt to Asset Ratio and Equity Multiplier show consistency during the five year period. Thus, when compared liquidity and risk and solvency ratios, profitability ratios are more volatile.

The overall picture of the financial performance of the Company reveals that profitability, liquidity and risk solvency of the company is favourable. Company's activities are based on asset backed financing and can maintain its profitability even if it is sector diagnostic. Its functioning is worthwhile and comparable to its conventional counterparts. The liquidity position of the company is also worthy. It completed four real estate projects successfully and managing four ongoing projects. The low debt levels of the company show that it can attract more investors and clients easily. The study summit that Islamic financial institutions have high potential in Kerala and it provides an alternative financing model.

Chapter 5
CONCLUSION

A peculiar feature of Islamic economic system is prohibition of interest or *riba* in all financial transactions. Charging of interest on loans taken for production or consumption is prohibited because it leads to accumulation of money among few, and it results inevitably in creating monopolies, opening doors for selfishness, injustice and oppression. In Islam, it is profit rather than interest that is closer to its sense of ethics and fairness. The concept of risk sharing is a major philosophy of Islam. The concept of profit involves the idea of sharing the risks of both gains and losses, and symbolizes entrepreneurship and wealth creation. This risk-sharing principle is implemented through a series of contractual arrangements. Speculative transactions are also prohibited because underlying motivation is to ensure a fair correspondence between the expected benefits and obtained benefits of both parties to a contract. Prohibitions under the *Quran* also include *haram* (forbidden) activities, which are primarily related to tobacco, pornography, arms, alcohol, and pork and gambling.

Islamic financing products are broadly classified on the basis of PLS (Profit-Loss-sharing) principle and Sale based principle. The instruments under PLS mode of financing are *Mudarabah* and *Musharakah.* The important Sale based Islamic financial instruments are *Murabaha, Ijara, Isthisna, Salam, Quard al hasan and Sukuk. Mudarabah* is a profit-and-loss sharing contract in which financier who provides all capital needed for financing a project and other party known as *mudarib* or agent, provides labour and effort. In this contract the proportionate share in profit is predetermined by mutual consent between the two parties but in case of loss only financier bears the capital loss and *mudarib* loss by get nothing in return for his expended time, effort and labour. *Musharaka* is a contract in which two parties agree on the capital shares that both confer to a project. Both parties are involved in the implementation and management of the project and profits or losses are divided according to the terms agreed in the contract.

One of the major sale based contract is *murabaha*. In a *murabaha* contract of sale, the bank buys a specific item from a client for a predetermined profit over the cost of the item, and then sells the item back to the client in instalments. *Ijarah* is a contract of exchange of counter values between usufruct and rental. Islamic law permits the lease of certain assets whose benefits can be obtained by the lessee against the payment of certain agreed rental. *Salam* is a deferred delivery contract: A sale contract wherein the price is paid on the spot, but the delivery of the goods is deferred. It is essentially a forward agreement where delivery occurs at a future date in exchange for spot payment of price. *Istisna* is generally a long-term contract whereby a party undertakes to manufacture, build or construct assets, with an obligation from the manufacturer or producer to deliver them to the customer upon completion. In practice, the key advantage of an *istisna* contract is that it can provide flexibility to the customer, where payments can be made in instalments linked to project completion, at delivery or after project completion. *Sukuk* means certificates with identical nominal value that after completion of subscription operations evidence payment of a nominal amount mentioned in it by the purchaser to the issuer; and its holder will be the owner of a set of assets or profits arising from assets, or beneficiary of a project or a special investment activity. The returns on the certificates are directly linked to the returns generated by the underlying assets. *Zakat* is obligatory for every Muslim whose wealth exceeds a certain threshold level (nisab) to distribute a percentage of their wealth and income among specified heads annually. *Waqf* is a charitable endowment that has wide economic implications and can play an important role in increasing social welfare. Whereas the corpus of this endowment is usually immovable assets such as land and real estate, moveable assets such as cash, books, grain to use as seeds, etc. are also included. *Quard al hasan* is an interest-free loan. In *quard-al hasan*, the borrower only repays the principal amount.

The unique characteristics of Islamic Banks have been addressed by specialized Islamic standard-setting bodies. The industry has two key standard setters: the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), established in 1990, for *shariah* accounting and auditing standards, and the IFSB, set up in 2002, for regulatory and supervisory standards. These institutions have developed a wide range of technical standards and guidance notes, working closely with the Basel Committee and similar conventional standard-setting bodies to ensure coherence and consistency with their standards. The function and role of ensuring *Shariah* compliance within an Islamic bank is the responsibility of a *Shariah* board, which oversees and is assisted by internal auditors, *Shariah* auditors or external auditors.

Islamic finance is one of the fastest growing segments of emerging global financial markets, it is often stated that the market is far below its true potential. The pulse of Islamic banking has its roots in GCC countries, ASEAN, South Asia, and western countries like UK, France and Canada. It has been growing faster than banking assets as a whole growing of an annual rate of 17.6% between 2009 and 2013, and is projected to grow by an average of 19.7% a year to 2018.

India, a secular and pluralistic society is the second largest Muslim population of the world. There is lack of awareness about the principles and practices of Islamic finance among Muslims and non-Muslims in India. Research indicates that nearly one-fifth of Muslims in the country are economically well off and are desperately looking for real Islamic investments. In addition, non-Muslims in India are also interested to know more about the benefits of Islamic finance. Considering the significance, the government of India has begun its discussions on the viability of introducing Islamic finance in India. A study on *shariah* complaint stocks in Indian stock market reveals that the current share of *shariah* compliant market capitalization (61percent) is highest even when compared with the number of Islamic countries such as Malaysia, Pakistan, Bahrain etc. While interest-free banking is provided in a limited manner through NBFCs and cooperatives, it was recommended that measures be taken to permit the delivery of interest-free finance on a larger scale, including through the banking system. This is in consonance with the objectives of inclusion and growth through innovation.

Kerala has a good potential in exploring the avenues of Islamic finance since 26.56% of the population constitute Muslim community. Interest free institutions in Kerala originated during 1970s. In Kerala more than 500 interest - free institutions are working in organized and unorganized sector. Few are registered as finance company and co operative society. Studies on interest free micro financial societies show that they enhance financial inclusion and reduced poverty. Kerala has successful Islamic financial companies and one of them got NBFC status and government collaboration.

The present study focuses on '*Secura*', a venture capital Islamic investment management company working on *shariah* principles. It reduces the risk profile of real estate as an asset class by offering diversified investment portfolio managed by experienced investment managers. Two-tier *Mudarabah* model is the basic theoretical model used by Islamic financial institutions to structure venture capital. Under this model, a bank or company is organized as a joint stock company with the shareholders supplying the initial capital. It is managed by the shareholders through their representatives on the board of directors. Its main business is to obtain funds from the public on the basis of *mudarabah* or profit sharing and to supply funds to businessmen on the same basis. Its gross income comprises the share in the actual profits of the fund users, in accordance with an agreed ratio of profit sharing.

SECURA through its real estate fund helps enterprises, which may not fall within the norms of conventional financing. In the case of high growth and high risky ventures, like real estate projects and those promoted by new entrepreneurs, the intellectual capital by way of the project idea/concept and the relevant track record are often the major contributions from the promoters. At this stage, the venture capitalist steps in with his contribution by way of equity / equity related instruments besides other value added and need-based services such as strategic management support etc. After the enterprise settles down with profitable operations and normally with capability to raise funds from conventional sources, the venture capitalist exits by selling out his shareholding. Besides investment and project managing services, it offers advice and guidance regarding legal matters to clients.

Secura Investment Management Company provides corporate legal consulting services in the areas of legal viability of the projects, legal and financial analysis, legal due diligence, effective and viable legal structuring and related corporate legal advice deploying the experience and expertise of team *Secura*. Its services include tax advisory, financial structuring, merger and amalgamation and other corporate matters. These agency services come under *wakala* of Islamic contracts. *Secura* also practices *ijarah* or leasing. It develops joint venture properties which will be leased first and sold out later and it will share the profit or loss. It does not lease its projects to firms involved in *shariah* prohibited activities.

The study analyzed financial performance of the Company from 2009-10 to 2013-14 during which the Company manages its first domestic scheme. Return on Asset, one of the important profitability indicators of the company during the initial stage of the launching of the fund is negative (2009-2011). In 2012-13 it becomes 13% and comes to 84% during 2013-14. Domestic scheme 1 has winded up during 2013-14 and Company pay back pre-agreed rate of profits to its investors. Even though company faces negative return on equity for 3 years, it was compensated in the subsequently coming years. Profit-Expenditure Ratio shows a satisfactory level. Expenditure of the company increases due to various expenditure items. However company's profit can be increased in tune with the rise in expenditure. The company can make profits only through *shariah* approved projects. In spite of this, the indicators of profitability of the Company show that it upholds a favourable level of profitability. The average Return on Assets stood at 15% and Return on Equity is 21% during 2009-2013. Even though company can maintain a healthy position in terms of average, S.D and C.V value shows a volatile picture especially because company's first scheme was completed at the end of four years and cross the threshold into investment stage of second scheme.

The major indicators of liquidity are Current Ratio (ratio of liquid assets to current liabilities) and Current Asset Ratio (Ratio of current asset to total asset). Liquidity ratios presents that the liquidity position of the Company is good. It maintains a laudable level of current assets so that it can boost up the confidence of investors of the company. It completed four real estate projects successfully and managing four ongoing projects. Current ratio was 15.49 in the starting year of the Company rose to 98.81 in 2010 and then falls to 14.12 in 2012-13. In the year 2013-14, it falls to 3.92 due to disclosure of first domestic scheme. Conversely, it shows consistency during the period. Though, most of the assets are of fixed nature, it can retain current asset ratio to a favourable level for past five years. It shows that company can easily cover its short-term obligations.

The risk and solvency indicators such as Debt Equity Ratio, Debt to Asset Ratio and Equity Multiplier show consistency during the five year period. Larger equity capital indicates a higher shock absorbing capacity for the Islamic financial institution. A ratio of 1.1 means that Company's debt levels are extremely low. Only 10 percent of its assets are financed by debt. The low debt levels of the company show that it can attract more investors and clients easily.

Thus '*Secura*' accomplish as an intermediary not only to households, business firms and governments, but also to the other categories of financial intermediaries. By pooling savings from a large group of investors, it reduce risk by helping individuals diversify their financial wealth amongst many more assets than they could afford to do in general, given transaction costs. It promotes innovative entrepreneurship through venture capital financing. It also provides a high level of liquidity to their clients by investing in assets that are relatively illiquid. Unlike other investments real estate investments are more comfortable because they are real. It caters to residential and commercial purposes. Residential real estate includes buildings meant for one to four families and commercial real estate investments focus on land or buildings that have profit generating activity. It undertakes the leasing of residential, commercial and retail spaces for the projects run by the company as per necessities.

The services of the Company are *shariah* complaint too. They avoid involvement in prohibited and unlawful activities such as manufacturing or dealing with forbidden products and services, such as alcohol, pork, interest-based financial services and the like. It is practicing PLS principle in a commendable way. The study underline that Islamic financial institutions have high potential in Kerala and it provides an alternative financing model.

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