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IFFI's of India in Crisis

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IFFI'S OF INDIA IN CRISIS

Since 1970's IFFI's of India started operation similar to that of modern banking and non-banking financial companies. But ten of them operating on large scale collapsed within a span of 20 years. A scrutiny of two collapsed NBFC's namely Barkat Leasing and Financial Service Ltd., Mumbai and Al Ameen Islamic Financial Investment Corporation, Bangalore reveals various economic and non-economic reasons of failure. Low capital yield, higher cost of operations, unprofessional management, lower capital base, higher NPA's, market fluctuations and absence of shock observers etc are found major causes. It is however observed that bankers have not succeeded but the Islamic banking principles have not failed. Many people's desire to invest their funds on PLS basis is silver lining. Hence few remedial steps can strengthen interest free financial movement in India, which is in crisis at present.

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IFFI'S OF INDIA IN CRISIS

INTRODUCTION

Interest free financial institutions (IFFI) of India are the forerunners in the history of global Islamic financial movement. Adherence to Godly ordains that "Trade is permitted but interest is forbidden" (1) has been found to be the major factor contributing evolution of institutional form of this ordain. Tracing the history of growth of interest free financial institutions in India, it is reported that such organized credit society had shown its presence as early as 1890. (2) According to the directory of Islamic banks in India (3), such efforts in the organized sector in the style of the Patni Cooperative Credit Society Ltd. was established in1942, almost immediately after the adoption of Indian Cooperative Act 1940. However out of 159, most of the interest free financial institutions were established during the 80's and 90's of the 20th century (4). A recent study conducted by Bagsiraj shows that these institutions have grown to a size of 292 with a break up of 85 as financial associations of persons (FAPS) 144 as registered Islamic welfare societies / trusts (IFS), 14 as Islamic Cooperative Credit Societies (ICCS) and 49 as Islamic Investment and Financial Companies (IFIC). (5) It implies that the total institutions catering to Islamic financial need of the people of India FAPS are 29.10 percent, IFS are 49.32 percent, ICCS are 4.80 percent and IFFC's are 16.78 percent. It may be noted that these institutions primarily fulfill the casual social need of the people at a very small scale. They stand almost nowhere so far as the commercial needs of the people are concerned.

It is however observed that growth as well as performance of these institutions is found erratic and more so incompatible with growth and performance of modern banking and non-banking financial houses. Few of them operating on comparatively larger scale collapsed within a span of less than 30 years giving a big jolt to the on going interest free movement in India. New Amanat Investment Co., Shariah Investment Company, Barkat Leasing and Financial Services Ltd. and Baitun Nasr Cooperative Credit Society Ltd. of Mumbai, Al Fahad Investment, Al Falah Finance and Investment

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Company of Delhi, Minar Lease Finance Ltd., Al Falah Finance Ltd., and Farzan Capitals Ltd., Hyderanad and Al Ameen Islamic Financial and Investment Company, Bangalore have totally collapsed. Those still operational are classified as marginal unit with highly unimpressive growth performance. Few others are alleged to be sick units prone to extinction.

Paucity of seed capital partial adherence to financial discipline, lack of professionally trained staff, shortsighted entrepreneurial decisions, market recession, absence of call money market, lack of risk management plans, absence of marketable financial products, and lack of broad based support from the depositors are observed to be the important reasons for the crisis and collapse of the major non-banking financial institutions / companies, claiming to be the champions of Islamic banking system in the country.

Being spread over an area of 3214 kms from north to south and 2933 kms from east to west, it is beyond reach of an individual researcher to conduct a thorough probe into the functioning of all these institutions collapsed or in crisis. Hence an effort manageable is made in this paper to probe into the reasons of failure of two important institutions namely Al Ameen Islamic Financial and Investment Corporation – Bangalore and Barkat Leasing and Financial Services Ltd. - Mumbai as case studies, which comprises 25% of the institutions closed. These were non-banking financial companies (NBFC's) with comparatively larger capital and business base among all IFFI's of India in the organized sector. It may be noted that interest free financial institutions in the unorganized sector are numerically more but carry little importance so far as financial transactions of Indian money and capital markets are concerned. Therefore they have not been selected three existing operational institutions from three different fields, viz NBFC, and cooperative Sector, namely Al Najib Milli Mutual Benefits Ltd. Najibabad, Seyad Shariah Finance Ltd., Trinavelli, and AICMEU's Baitulmal cooperative Credit Society Ltd. Mumbai have also been taken for scrutiny to find out their status, strength and challenges. It is expected that the analysis will not only shed lights on the reasons of collapse but also strength and weaknesses of operational units – the remaining future of interest free financial movement of India.

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GROWTH PERFORMANCE

The study in this paper is organized under four sections. Section I deals with growth performance of (a) Al Ameen Islamic Financial Investment Corporation (AIFIC), (b) Barkat Leasing and Financial Services Ltd. (BLFS), which have closed down at the beginning of the current century. Section II deals with the growth performance of (a) AICMEU's Baitulmal Cooperative Credit Society Ltd. (ABCCS), (b) Al Najib Milli Mutual Benefits Ltd. (AMMB) and (c) Seyad Shariah Finance Ltd. (SSF) which are functioning and continue to cater the designed services to their stakeholders. Section III Scrutiny report which deals with probable reasons for the collapses and crises of above-mentioned institutions comparison with related conventional financial system in the country is also made wherever possible. And finally section IV deals with conclusions and suggestions that may strengthen and augments the cause of existing interest free institutions and as well as financial movements in India. RBI – The central bank of India uses various parameters (6) to assess and analyze the financial stability and growth of banking and non-banking companies. In view of the significance, two parameters namely Financial Health Status and Important Financial Indicators have been applied for scrutiny and analysis in this study.

SECTION I

AIFIC, Bangalore

AIFIC, which collapsed and practically closed by the beginning of the present century, was registered as NBFC in 1986 under the Indian Companies Act 1956. (6) It was promoted by a group of socially committed persons enriched with experience of managing a conventional cooperative bank named Amanat Cooperative Bank in Bangalore. AIFIC booklet (7) narrates the basic principles underlying AIFIC as (a) Interest is prohibited but trading is permitted, (b) There can only be participative financing with sharing of profit or loss. No lending can be effected on consideration of

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interest. (c) Money complied with human resources only can be a source of wealth and money by itself cannot increase.

AIFIC commenced its business immediately after its incorporation in 1986. It mobilized funds as Share Capital, Mudarabah Deposits and Scheme Deposits, which included Advance Link Deposits, Transfer Deposits and Housing Deposits etc. The companies deployed its funds primarily for leasing of automobiles and equipments (Ijarah), Venture financing on profit / loss basis (Mudarabah), Project financing on profit loss sharing basis (Musharakah), interest free loans, Vehicle refinance scheme, Housing Finance schemes and Resale on deferred installments (Murabahah).

It is found that initially AIFIC was well received by the people and well managed by the group of promoters. As a result, the financial base of the company grew with leaps and bounds. It declared dividend @ 10+ percent annually for several years. Encouraged with performance AIFIC opened as many as 24 branches all over the country. However this growing trend could not celebrate its silver jubilee. For practical purposes company ceased its full-fledged operations before the close of the last century. Almost all its branch offices are now closed except its HQRS at Bangalore where few directors and other executives are trying hard to pacify and recover and refund the dues of claimants. It is perhaps one of the reasons why current correct accounts of the company could not be had. However, based on the available printed annual reports / audited financial statements, effort is made for evaluation on the basis of two basic parameters namely financial health status and important financial indicators, as stated earlier.

Financial Health Status: - **Financial health status refers to financial soundness of the institution from the point of view of its liability and assets holdings. Accordingly the following table is drawn. It deals with six major items namely total owned funds, total deposits, total borrowings, total outstanding and total liquidity and credit deposit ratios. Based on this information the financial ratios as percentage of the total assets have also been calculated.**

The following table shows variations in the compositions of total owned funds, total deposits, and total borrowings as constituents of the total fund year after year. But no

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definite relationship among them either in terms of growth or decline can be established. Similar is the case of total outstanding, which comprises of loans and advances, investments and other assets. It may be observed that company has been on path of growth although the rate of growth has varied from year to year. In case of deposits, negative growth is observed in few years that had adversely affected the growth of loans and advances and also volume of investments.

Table – 1

Al-Ameen Islamic Financial & Investment Corporation (India) Ltd.

Financial Health Status

Financial Years **(Rs. in Lacs)**

Items	**1990-91**	**1994-95**	**1995-96**	**1996-97**	**1997-98**	**1998-99**
1. Total Owned Fund	**58.06**	**120.21**	**136.73**	**146.06**	**540.88**	**1080.51**
a) Reserve Fund	5.43	11.99	14.18	14.26	14.26	14.26
b) Share Capital	52.63	108.23	122.55	131.80	526.62	1066.25
2. Total Deposit	**267.34**	**941.43**	**1045.74**	**1008.29**	**1310.48**	**613.63**
a) Fixed Deposit + bonus accrued & due	267.34	941.43	1045.74	1008.29	1310.48	613.63
3. Total Borrowings	**264.60**	**637.19**	**915.77**	**1080.38**	**1085.29**	**1369.88**
a) Others (Other Liabilities)	264.60	637.19	915.77	1080.38	1085.29	1369.88
4. Total Outstanding	**538.98**	**1433.49**	**1903.92**	**2051.93**	**2742.98**	**2948.65**
a) Loan	332.25	421.85	451.18	529.57	636.92	886.24
b) Investment	0.00	69.38	133.92	167.43	161.48	159.21
c) Other Assets	206.73	942.25	1318.82	1354.93	1944.58	1903.19
5. Liquidity Ratio	**8.65%**	**15.62%**	**9.26%**	**8.18%**	**6.59%**	**3.77%**
6. Credit - Deposit Ratio	124.28%	44.81%	43.14%	52.52%	48.60%	144.43%
Total Assets (1+2+3)	**590.00**	**1698.83**	**2098.23**	**2234.73**	**2936.65**	**3064.02**
Financial Ratio as Percentage of Total Assets						
Total Own Fund	**9.84%**	**7.08%**	**6.52%**	**6.54%**	**18.42%**	**35.26%**
Reserve Fund	0.92%	0.71%	0.68%	0.64%	0.49%	0.47%
Share Capital	8.92%	6.37%	5.84%	5.90%	17.93%	34.80%
Total Deposit	**45.31%**	**55.42%**	**49.84%**	**45.12%**	**44.62%**	**20.03%**
Fixed deposit + Bonus Accrued	45.31%	55.42%	49.84%	45.12%	44.62%	20.03%
Total Borrowings	**44.85%**	**37.51%**	**43.64%**	**48.34%**	**36.96%**	**44.71%**
Others	44.85%	37.51%	43.64%	48.34%	36.96%	44.71%
Total Outstanding	**91.35%**	**84.38%**	**90.74%**	**91.82%**	**93.41%**	**96.23%**
Loan	56.31%	24.83%	21.50%	23.70%	21.69%	28.92%
Investment	0.00%	4.08%	6.38%	7.49%	5.50%	5.20%

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Other Assets	35.04%	55.46%	62.85%	60.63%	66.22%	62.11%

Source: Audited Financial Statements of the Company for Several Years.

The year after 1995-96, is observed unhealthy rather heavily crisis ridden. In spite of heavy injection of funds in terms of share capital, the company could not overcome the crises of dues to be paid and therefore closed.

ii) Important Financial Indicators: - **It contains information mainly about income, expenditure and profits. These indicators not only reveal the profit or loss status but also provisions and contingencies that strengthen company's financial base.**

Table – 2

Al-Ameen Islamic Financial & Investment Corporation (India) Ltd.

Important Financial Indicators

Financial Years **(Rs. in Lacs)**

Items	**1990-91**	**1994-95**	**1995-96**	**1996-97**	**1997-98**	**1998-99**
1. Total Income	**90.08**	**205.36**	**294.88**	**291.96**	**232.80**	**173.32**
a) Profit (Lease + H.P)	51.62	164.62	204.84	215.26	173.22	107.47
c) Others	29.63	33.53	82.04	62.92	47.43	57.84
d) Miscellaneous	8.82	7.21	8.00	13.78	12.15	8.01
2. Total Expenditure	**58.57**	**154.96**	**231.07**	**275.12**	**485.41**	**318.47**
a) Service Expended	1.06	1.74	2.13	2.33	0.54	1.19
b) Operating / Intermediate Exp.	57.51	153.22	228.94	272.79	484.87	317.28
of which Wage Bill	12.02	32.82	46.86	51.68	68.20	72.14
c) Provision and Contingencies	21.23	38.81	50.21	46.89	111.17	150.41
3. Operating Profit / Loss	**31.51**	**50.40**	**63.81**	**16.84**	**-252.61**	**-145.16**
4. Net Profit / Loss	10.28	11.59	13.60	-30.05	-363.77	-295.57
5. Spread (Net Service Income)	**50.56**	**162.87**	**202.71**	**212.93**	**172.68**	**106.27**
6. Total Assets	**590.00**	**1698.83**	**2098.23**	**2234.73**	**2936.65**	**3064.02**
Financial Ratio as Percentage of Total Assets						
Total Income	15.27%	12.09%	14.05%	13.06%	7.93%	5.66%
Profit (Lease + HP)	8.75%	9.69%	9.76%	9.63%	5.90%	3.51%
Others	5.02%	1.97%	3.91%	2.82%	1.62%	1.89%
Miscellaneous	1.50%	0.42%	0.38%	0.62%	0.41%	0.26%
Total Expenditure	9.93%	9.12%	11.01%	12.31%	16.53%	10.39%
Service Expended	0.18%	0.10%	0.10%	0.10%	0.02%	0.04%
Operating / Intermediate Exp.	**9.75%**	**9.02%**	**10.91%**	**12.21%**	**16.51%**	**10.36%**
Wage Bill	2.04%	1.93%	2.23%	2.31%	2.32%	2.35%
Provision and Contingencies	3.60%	2.28%	2.39%	2.10%	3.79%	4.91%
Operating Profit	5.34%	2.97%	3.04%	0.75%	-8.60%	-4.74%

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Source: Audited Financial Statements of the Company for Several Years.

Accordingly the above table 2 contains detail information about income earned with sources of earning, expenditure made with details of operating cost of which percentage of wage bill and finally contingencies and provisions. Based on these figures financial ratios are calculated which provide compositions and variations in respective items over the years.

The above table suggests that the total income, total expenditure and operating cost have not only grown year after year but also record increasing trend as percentage of total assets. Operating profit as well as provisions and contingencies record declining trend year after year. Further their percentage share in total assets also record decline. Further after 1995-96, company records not only declining trends but also shows negative growth in terms of operating profits due to increase in operating cost and declining profits. This has led to the consumption of not only contingent funds but also part of capital in the last few years. This derailing, which started in 1996-97, could not be corrected. Hence company totally stopped operation in 2000 -01.

(B) BLFSL, Mumbai

Promoters loaded with social commitment and enriched with 15 years experience of running a cooperative credit society registered a sister concern namely Barkat Leasing and Financial Services Ltd. (BLSFL) Mumbai **in 1991 as an NBFC – a leasing company permitted by RBI to accept variable rate fully convertible debentures and equity. The credit society did not have any provision of accepting funds for investment on the profit / loss sharing basis. As a result, a large group of persons interested in making investments and earning halal profits remain devoid of earning halal income. Keeping in view, the laws of the land, this company was floated to fill up the gap pertaining to permissible productive use of money in the Islamic Banking and Financial Sector in India. The company kept close links with existing credit society and created new links and ties with similar other financial institutions that were operating without the facility of investments on PLS system. These efforts bore fruits. The company opened its branches all over the country and mobilized huge deposits to the tune of over Rs. 160 millions. Initially its performance was satisfactory. It invested its major funds in stock market equity shares, estate properties and joint ventures. Apparently, on account of**

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heavy erosion in values of shares and estate properties, it collapsed with a life span of merely one-decade. The current status is that all offices are sealed, operation totally suspended and court matters are pending. The growth performance of the company, during these years may be evaluated with the help of financial health status and important financial indicators in lines ahead.

(i) Financial Health Status:- **As stated earlier RBI, the central bank of the country, while determining the financial health status of an operating financial institution takes into account items like total owned funds, unsecured loans, total borrowings, total outstanding liquidity and unsecured loan ratio. On the similar pattern financial health status of the company has been determined with information taken from audited financial statements of the company from several years. The following table 3 gives the summary of this status. Based on this summary, the financial ratios as percentage of total assets of the company have been obtained.**

Table 3

Barkat Leasing and Financial Services Limited

Financial Health Status

Financial Years **(Rs. in Lacs)**

Item	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98
1. Total Owned Fund	**25.16**	**26.28**	**30.53**	**69.16**	**100.14**	**144.84**
a) Reserve Fund	0.16	1.28	2.46	6.53	8.88	1.24
b) Share Capital	25.00	25.00	28.07	62.64	91.26	143.60
2. Unsecured Loans	**0.00**	**32.75**	**147.65**	**616.60**	**902.85**	**1340.18**
a) Others	0.00	32.75	147.65	616.60	902.85	1340.18
3. Total Borrowings	**2.43**	**23.30**	**40.17**	**111.08**	**190.43**	**155.62**
a) Others	2.43	23.30	40.17	111.08	190.43	155.62
4. Total Outstanding	**21.49**	**74.91**	**201.39**	**777.06**	**1183.19**	**1640.88**
a) Loan	4.79	23.35	45.49	21.18	19.25	23.08
b) Investment	1.97	10.72	54.70	504.29	815.04	1200.46
c) Other Assets	14.73	40.85	101.21	251.59	348.90	417.34
5. Liquidity Ratio	22.08%	9.01%	7.77%	2.48%	0.86%	-0.01%
6. Unsecured Loan Ratio	0.00%	71.29%	30.81%	3.44%	2.13%	1.72%
Total Assets (1+2+3)	**27.59**	**82.33**	**218.35**	**796.84**	**1193.43**	**1640.64**

Financial Ratio as Percentage of Total Assets

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A. Total Own Fund	**91.19%**	**31.92%**	**13.98%**	**8.68%**	**8.39%**	**8.83%**
Reserve Fund	0.57%	1.55%	1.13%	0.82%	0.74%	0.08%
Share Capital	90.63%	30.36%	12.86%	7.86%	7.65%	8.75%
B. Unsecured Loan	**0.00%**	**39.78%**	**67.62%**	**77.38%**	**75.65%**	**81.69%**
Others	0.00%	39.78%	67.62%	77.38%	75.65%	81.69%
C. Total Borrowings	**8.81%**	**28.30%**	**18.40%**	**13.94%**	**15.96%**	**9.49%**
Others	8.81%	28.30%	18.40%	13.94%	15.96%	9.49%
D. Total Outstanding	77.92%	90.99%	92.23%	97.52%	99.14%	100.01%
Loan	17.37%	28.36%	20.83%	2.66%	1.61%	1.41%
Investment	7.13%	13.02%	25.05%	63.29%	68.29%	73.17%
Other Assets	53.42%	49.61%	46.35%	31.57%	29.24%	25.44%

Source: Audited Financial Statements of the Company for Several Years

Financial ratios show not only share of each item among total items considered but also indicates the growth performance of a company in respective fields over the years. Percentage composition of total assets is observed in descending order with respect to unsecured loans, total borrowings and total owned fund. Further share capital is found to be the major component of total owned fund whereas others of unsecured loans and others of total borrowings are observed to be the major components. Further share capital is found to be the major component of loans and total outstanding (investment). On the contrary declining trend is found in total owned fund, loans and other assets over the years. During 1997-98 total outstanding, as percentage of total assets became 100% leading to liquidity crisis for the company.

Important Financial Indicators: **- The following table 4 contains items related to company's income, expenditure, operating cost, operating profit and total assets etc. on similar pattern of RBI's parameters on trend and growth of the financial sectors in India. These figures have been picked up from the audited reports of the company for various years. Based on these basic figures, financial ratios indicating compositions and progress over the years have been calculated.**

Of the total income, lease rent is the major constituent whereas operating / intermediation cost is the major part of the total expenditure as percentage of total assets. Further over the years erratic growth is observed in income, with a variation of 10 %, and provisions and contingencies, with a variation of 5%. Increasing trend in expenditure but a decreasing trend in provisions and contingencies, and operating profits are observed. In the closing years total expenditures almost doubled the total

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income. The company must have been compelled to adjust and accommodate the losses with capital account. Ultimately it resulted closure, as most of the capital was not in liquid forms.

Table – 4

Barkat Leasing and Financial Services Limited

Important Financial Indicators

Financial Years **(Rs. in Lacs)**

Item	**1992-93**	**1993-94**	**1994-95**	**1995-96**	**1996-97**	**1997-98**
1. Total Income	**2.93**	**6.36**	**32.03**	**98.69**	**158.56**	**78.74**
a) Lease Income	2.48	5.38	18.58	36.82	67.89	77.04
b) Profit	0.00	0.35	9.13	16.63	1.66	0.78
c) Others	0.45	0.62	4.31	45.24	89.01	0.92
2. Total Expenditure	**0.91**	**2.96**	**22.01**	**76.61**	**124.13**	**153.43**
a) Service Expended	0.00	0.10	0.31	0.32	0.38	0.93
b) Operating / Intermediate Exp.	0.91	2.86	21.70	76.29	123.75	152.50
of which Wage Bill	0.18	0.44	2.93	13.06	26.12	80.18
c) Provision and Contingencies	1.86	2.12	7.55	15.55	26.78	24.97
3. Operating Profit / Loss	**2.02**	**3.40**	**10.01**	**22.08**	**34.42**	**-74.69**
4. Net Profit / Loss	**0.16**	**1.28**	**2.46**	**6.53**	**7.64**	**-99.66**
5. Spread (Net Service Income)	**2.48**	**5.28**	**18.27**	**36.50**	**67.50**	**76.11**
6. Total Assets	**27.59**	**82.33**	**218.35**	**796.84**	**1193.43**	**1640.64**
Financial Ratio as Percentage of Total Assets						
Total Income	10.61%	7.72%	14.67%	12.38%	13.29%	4.80%
Lease Income	8.98%	6.54%	8.51%	4.62%	5.69%	4.70%
Profit	0.00%	0.43%	4.18%	2.09%	0.14%	0.05%
Others	1.63%	0.76%	1.97%	5.68%	7.46%	0.06%
Total Expenditure	3.30%	3.60%	10.08%	9.61%	10.40%	9.35%
Service Expended	0.00%	0.12%	0.14%	0.04%	0.03%	0.06%
Operating / Intermediate Exp.	**3.30%**	**3.48%**	**9.94%**	**9.57%**	**10.37%**	**9.30%**
Wage Bill	0.65%	0.54%	1.34%	1.64%	2.19%	4.89%
Provision and Contingencies	6.74%	2.57%	3.46%	1.95%	2.24%	1.52%
Operating Profit	7.31%	4.13%	4.59%	2.77%	2.88%	-4.55%
Net Profit	0.57%	1.55%	1.13%	0.82%	0.64%	-6.07%

Source: Audited Financial Statements of the Company for Several Years

SECTION II

Operating Institutions

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The above two financial institutions have closed their operations and are under litigation. Heavy jerks and jolts felt on account of these collapses have turned the environment totally hostile and un conducive for growth and development of Islamic financial intermediaries in India. This was reinforced by closure of many other financial institutions operating like cooperative banks, cooperative credit societies and welfare societies under the conventional banking and financial system with Muslim and Non Muslim managements within a span of last five years. This has created a total distrust among depositors about smaller financial institutions in the organized and unorganized sector, of which interest free financial institutions are a major part. However existing institutions are trying hard to maintain slow but steady growth. Of th e25% institutions selected for study only two NBFC's and one Cooperative Credit Society in operation have responded. Hence they have been selected for scrutiny and analysis, which constitute approximately 7% of the existing IFFI's of India in the organized sector. Moreover parameters of study, continue to remain the same as above.

A) ABCCS Ltd. Mumbai

AICMEU'S Baitulmal Cooperative Credit Society Ltd. **Mumbai abbreviated as ABCCS Ltd. Mumbai was incorporated as interest free cooperative credit society in 1984 with a meager capital of Rs. 25,000/-. It was promoted by an NGO (All India Council of Muslim Economic Upliftment Ltd.) with the purposes of furthering the cause of interest free financial movement in India on the one hand and provides an opportunity to the people to practice interest free financial transactions on the other. During the period of twenty years the society has experienced horizontal growth to size of over 15,000 members / depositors with total fund of over 11 million rupees.**

i. Financial Health Status – **The following table 5 contains information about total owned fund, total deposits, total borrowings, total outstanding liquidity ratio and credit deposit ratio taken from the society's audited financial statements of several years. It shows increasing trends in liquidity over the years from 9.17% to 16.16% and 71.27 % to 83.68% in credit deposit ratio over reference period. Based on the information financial ratio are also calculated.**

Table – 5

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AICMEU'S Baitulmal Co-Op. Credit Society Ltd.
Financial Health Status

	Financial Years					**(Rs. in Lacs)**
Item	**1994-95**	**1999-00**	**2000-01**	**2001-02**	**2002-03**	**2003-04**
1. Total Owned Fund	**10.97**	**17.57**	**19.07**	**20.04**	**22.40**	**23.09**
a) Reserve Fund	0.58	1.86	2.36	2.81	4.30	4.35
b) Share Capital	10.40	15.71	16.71	17.23	18.09	18.73
2. Total Deposits	**88.97**	**95.17**	**89.12**	**90.79**	**86.87**	**95.79**
a) Demand Deposits	69.76	55.75	49.60	54.96	46.35	51.43
b) Term Deposits	19.21	39.42	39.52	35.83	40.52	44.36
3. Total Borrowings	**3.28**	**4.91**	**5.15**	**3.83**	**3.64**	**1.85**
a) Others (Other Liabilities)	3.28	4.91	5.15	3.83	3.64	1.85
4. Total Outstanding	**93.75**	**100.21**	**100.05**	**100.50**	**94.65**	**101.64**
a) Loan	68.03	69.71	74.12	79.38	75.96	80.15
b) Investment	14.93	21.32	16.80	13.43	14.39	13.74
c) Other Assets	10.79	9.18	9.13	7.70	4.31	7.74
5. Liquidity Ratio	9.17%	14.82%	11.72%	12.34%	16.16%	15.81%
6. Credit - Deposit Ratio	76.47%	73.25%	83.17%	87.43%	87.44%	83.68%
Total Assets (1+2+3)	**103.22**	**117.64**	**113.34**	**114.65**	**112.91**	**120.72**
Financial Ratio as Percentage of Total Assets						
Total Own Fund	**10.63%**	**14.94%**	**16.82%**	**17.48%**	**19.84%**	**19.12%**
Reserve Fund	0.56%	1.58%	2.08%	2.45%	3.81%	3.61%
Share Capital	10.07%	13.36%	14.74%	15.03%	16.03%	15.52%
Total Deposit	**86.19%**	**80.89%**	**78.63%**	**79.19%**	**76.94%**	**79.35%**
Demand Deposit	67.58%	47.39%	43.76%	47.94%	41.05%	42.60%
Term Deposit	18.61%	33.51%	34.87%	31.25%	35.89%	36.74%
Total Borrowings	**3.17%**	**4.17%**	**4.55%**	**3.34%**	**3.22%**	**1.53%**
Others	3.17%	4.17%	4.55%	3.34%	3.22%	1.53%
Total Outstanding	90.83%	85.18%	88.28%	87.66%	83.84%	84.19%
Loan	65.91%	59.25%	65.40%	69.23%	67.28%	66.39%
Investment	14.46%	18.12%	14.82%	11.71%	12.74%	11.38%
Other Assets	10.45%	7.80%	8.06%	6.71%	3.82%	6.42%

Source: Audited Financial Statements of the Society for Several Years

It reveals that deposits, owned funds and borrowings are the major items in order of their contribution to the total liabilities. Similarly loans, investments and other assets hold the same position in total outstanding as percentage of total assets. Over the years an increasing trend is observed in reserve as well as in share capitals. Declining trend is found in total deposits with decrease in demand deposits and increase in term deposits,

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which carry same profit over the years. Further a declining trend is observed in total borrowings as well as other assets over the reference period. A variation of 10% in loans and investments is found over the reference period. At most, this may be treated as non-negative development in the financial health of the society.

Table – 6

AICMEU'S Baitulmal Co-Op. Credit Society Ltd.
Important Financial Indicators

Financial Years **(Rs. in Lacs)**

Item	1994-95	1999-00	2000-01	2001-02	2002-03	2003-04
1. Total Income	**6.96**	**11.11**	**10.69**	**11.07**	**12.77**	**11.94**
a) Service Charges	4.29	7.91	7.82	8.04	9.45	9.47
b) Non-Service Charges	0.45	2.09	1.79	2.03	1.83	2.03
c) Profit	0.00	1.09	0.83	0.99	1.40	0.20
d) Miscellaneous	2.22	0.02	0.25	0.02	0.08	0.24
2. Total Expenditure	**7.25**	**10.47**	**10.68**	**11.01**	**11.29**	**11.90**
a) Service Expended	0.00	0.50	0.31	0.25	0.40	0.23
b) Operating / Intermediate Exp.	6.98	9.38	9.81	9.93	9.82	10.56
of which Wage Bill	4.42	6.91	7.39	7.12	6.55	7.13
c) Provision and Contingencies	0.28	0.59	0.56	0.83	1.07	1.12
3. Operating Profit / Loss	**-0.30**	**0.64**	**0.01**	**0.06**	**1.48**	**0.04**
4. Net Profit / Loss	-0.30	0.64	0.01	0.06	1.48	0.04
5. Spread (Net Service Income)	**4.29**	**7.41**	**7.51**	**7.79**	**9.06**	**9.24**
6. Total Assets	**103.22**	**117.64**	**113.34**	**114.65**	**112.91**	**120.72**
Financial Ratio as Percentage of Total Assets						
Total Income	6.74%	9.45%	9.43%	9.66%	11.31%	9.89%
Service Charges	4.15%	6.72%	6.90%	7.01%	8.37%	7.85%
Non-Service Charges	0.44%	1.78%	1.58%	1.77%	1.62%	1.68%
Profit	0.00%	0.92%	0.73%	0.86%	1.24%	0.16%
Miscellaneous	2.15%	0.02%	0.22%	0.01%	0.07%	0.20%
Total Expenditure	7.03%	8.90%	9.42%	9.60%	10.00%	9.86%
Service Expended	0.00%	0.43%	0.27%	0.21%	0.35%	0.19%
Operating / Intermediate Exp.	**6.76%**	**7.97%**	**8.65%**	**8.66%**	**8.70%**	**8.74%**
Wage Bill	4.29%	5.87%	6.52%	6.21%	5.80%	5.91%
Provision and Contingencies	0.27%	0.50%	0.50%	0.72%	0.95%	0.93%
Operating Profit	-0.29%	0.54%	0.01%	0.06%	1.31%	0.03%

Source: Audited Financial Statements of the Society for Several Years

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ii. Important financial indicators**: - The above table 6 contains information with respect to income, expenditure, profit and total assets taken from the audited financial statement of society for several years. Based on this, financial ratios as usual percentage to total assets have been calculated.**

The above table reveals that service charges are the major source of income and operating cost of which wage will is the major source of total expenditure. Over the period an increasing trend is observed in income as well as operating cost and wage bill hence total expenditure, and provisions and contingencies. Although operating profit is observed as negligible, absence of loss and increase in provisions and contingencies show a movement towards healthy financial status of the society.

B) ANMMB Ltd. –

Al Najib Milli Mutual Benefits Ltd. **(ANMMB LTD.) is another financial NBFC, which was registered in 1990 by the management of Muslim Fund (MF) Najibabad – a major player of the unorganized sector categorized as an Islamic Welfare society. With an initial mobilized fund base of Rupees fifteen millions in 1990-91 it has progressed well and operates with a fund of over Rs. 261 millions. It has 43 branches sharing offices and operations with Muslim Fund. In fact similar to that of Barkat and Baitun Nasr, ANMMB Ltd. and MF operate like a sister concern under a common management. Although registered with a purpose of providing an Islamic alternative of the conventional banking and financial system, its modes of major investment to a larger extent is similar to that of conventional commercial banks where no discrimination in investment is made on the basis of interest free or interest ridden avenues. However in loans and advances, it follows rules conforming to Shariah code.**

Table – 7
AL-NAJIB Milli Mutual Benefits Ltd.

Financial Health Status

Financial Years **(Rs. in Lacs)**

Item	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04
1. Total Owned Fund	23.68	28.44	32.21	37.16	45.76	62.53

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a) Reserve Fund	3.23	3.75	4.25	5.51	6.68	8.85
b) Share Capital	20.45	24.70	27.95	31.66	39.08	53.68
2. Total Deposits	**1617.19**	**1932.85**	**1719.16**	**1707.67**	**1897.14**	**2230.34**
a) Demand Deposits	1325.07	1618.77	1394.49	1337.54	1472.92	1712.66
b) Term Deposits	283.38	303.10	314.77	355.99	409.78	494.83
b) Miscellaneous Deposit	8.74	10.98	9.90	14.14	14.43	22.85
3. Total Borrowings	**160.93**	**85.28**	**248.03**	**269.13**	**211.55**	**319.21**
a) Loans & Adv. from Banks	80.69	84.06	118.84	72.50	160.70	157.80
b) Others (Share Money+Adv)	80.24	1.22	129.19	196.62	50.85	161.41
4. Total Outstanding	**1071.83**	**1115.18**	**1187.23**	**1215.34**	**1266.86**	**1516.00**
a) Loan	819.50	869.50	893.67	930.89	1002.47	1232.00
b) Investment	164.96	158.76	156.01	152.24	147.87	150.07
c) Other Assets	87.38	86.93	137.55	132.20	116.51	133.93
5. Liquidity Ratio	40.51%	45.51%	40.62%	39.65%	41.20%	41.96%
6. Credit - Deposit Ratio	50.67%	44.99%	51.98%	54.51%	52.84%	55.24%
Total Assets (1+2+3)	**1801.80**	**2046.57**	**1999.40**	**2013.96**	**2154.45**	**2612.07**
Financial Ratio as Percentage of Total Assets						
A. Total Own Fund	**1.31%**	**1.39%**	**1.61%**	**1.85%**	**2.12%**	**2.39%**
i) Reserve Fund	0.18%	0.18%	0.21%	0.27%	0.31%	0.34%
ii) Share Capital	1.14%	1.21%	1.40%	1.57%	1.81%	2.06%
B. Total Deposit	**89.75%**	**94.44%**	**85.98%**	**84.79%**	**88.06%**	**85.39%**
i) Demand Deposit	73.54%	14.81%	15.74%	17.68%	19.02%	18.94%
ii) Term Deposit	15.73%	0.54%	0.50%	0.70%	0.67%	0.87%
iii) Miscellaneous Deposit	0.48%	0.54%	0.50%	0.70%	0.67%	0.87%
C. **Total Borrowings**	**8.93%**	**4.17%**	**12.41%**	**13.36%**	**9.82%**	**12.22%**
i) Loans & Adv. from Bank	4.48%	4.11%	5.94%	3.60%	7.46%	6.04%
ii) Others (Share Money + Adv.)	4.45%	0.06%	6.46%	9.76%	2.36%	6.18%
D. Total Outstanding	59.49%	54.49%	59.38%	60.35%	58.80%	58.04%
i) Loan	45.48%	42.49%	44.70%	46.22%	46.53%	47.17%
ii) Investment	9.16%	7.76%	7.80%	7.56%	6.86%	5.75%
iii) Other Assets	4.85%	4.25%	6.88%	6.56%	5.41%	5.13%

Source: Audited Financial Statements of the Company for Several Years

i) Financial Health status: - **The above table 7 has been prepared on RBI prescribed parameters of financial health status of NBFC's. As usual it contains total owned fund, total deposits, total borrowings, total outstanding, investments and credit deposit ratios.**

Based on the figures, financial ratios too have been calculated as pointers of financial health status of the company. It may be seen that total deposits, total borrowings and total owned funds constitute total liabilities of the company in descending order of

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importance. Similarly loans and advances, investments and other assets as part of the total outstanding are observed to be placed in descending order of importance as percentage of total assets. Over the years a positive growth is observed in total owned funds (reserves as well as capital), total borrowings, and total loans and advances. On the contrary a declining trend is observed in total deposits and total investments. Variable growth rate is observed in other assets and term deposits.

ii) Important Financial Indicators**: - The following table 8 contains information which indicates financial health, soundness of the company from income, expenditure and surplus / profit point of view. Financial; ratios from this table drawn on the basis of figures obtained from audited financial statements have been calculated.**

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Table – 8
AL-NAJIB Milli Mutual Benefits Ltd.

Important Financial Indicators

	Financial Years					(Rs. in Lacs)
Item	**1998-99**	**1999-00**	**2000-01**	**2001-02**	**2002-03**	**2003-04**
1. Total Income	**147.35**	**167.25**	**184.25**	**183.23**	**175.37**	**194.87**
a) Interest Charges	146.56	165.66	178.46	180.01	170.73	187.74
b) Non-Interest Charges	0.67	0.74	0.76	0.53	0.37	0.35
c) Profit	0.00	0.71	0.00	0.25	0.00	0.56
d) Miscellaneous	0.11	0.14	5.03	2.44	4.26	6.23
2. Total Expenditure	**140.99**	**159.48**	**173.98**	**173.63**	**165.43**	**183.74**
a) Service Expended	33.44	32.53	35.29	32.64	31.22	39.41
b) Operating / Intermediate Exp.	107.55	126.95	138.69	140.99	134.21	144.34
of which Wage Bill	67.85	73.99	75.23	80.43	85.71	87.58
c) Provision and Contingencies	5.32	7.25	9.53	8.35	8.77	8.96
3. Operating Profit / Loss	**6.36**	**7.77**	**10.27**	**9.60**	**9.94**	**11.13**
4. Net Profit / Loss	**1.04**	**0.52**	**0.75**	**1.25**	**1.17**	**2.17**
5. Spread (Net Service Income)	**113.12**	**133.13**	**143.17**	**147.37**	**139.51**	**148.33**
6. Total Assets	**1801.80**	**2046.57**	**1999.40**	**2013.96**	**2154.45**	**2612.07**
Financial Ratio as Percentage of Total Assets						
Total Income	8.18%	8.17%	9.22%	9.10%	8.14%	7.46%
Interest Charges	8.13%	8.09%	8.93%	8.94%	7.92%	7.19%
Non-Interest Charges	0.04%	0.04%	0.04%	0.03%	0.02%	0.01%
Profit	0.00%	0.03%	0.00%	0.01%	0.00%	0.02%
Miscellaneous	0.01%	0.01%	0.25%	0.12%	0.20%	0.24%
Total Expenditure	7.82%	7.79%	8.70%	8.62%	7.68%	7.03%
Service Expended	1.86%	1.59%	1.77%	1.62%	1.45%	1.51%
Operating / Intermediate Exp.	**5.97%**	**6.20%**	**6.94%**	**7.00%**	**6.23%**	**5.53%**
Wage Bill	3.77%	3.62%	3.76%	3.99%	3.98%	3.35%
Provision and Contingencies	0.30%	0.35%	0.48%	0.41%	0.41%	0.34%
Operating Profit	0.35%	0.38%	0.51%	0.48%	0.46%	0.43%
Net Profit	0.06%	0.03%	0.04%	0.06%	0.05%	0.08%

Source: Audited Financial Statements of the Company for Several Years

The above table reveals that company runs in profit even after making necessary provisions and contingencies, as income is more than expenditure. It may however be noted that of the total income earned i.e. 8.18% of the total assets comes from interest whereas meager 0.04 % comes from non-interest income. Of the total expenditure accounting 7.82 % of total assets, operating expenditure is the major source in which

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wage bill makes the lion's share. Over the years variations in total income with continuously declining share of non-interest income and increasing share of miscellaneous income is observed. Erratic growth in almost all the financial indicators is observed, indicating instability in growth performance.

C) Seyad Shariah Finance Ltd**. (SSF Ltd.) registered company in 1987-88 commenced its full-fledged operation after 1990-91 with permission from RBI as NBFC in Trinulevelli, Tamail Nadu. It was promoted as an alternative for Shariah based financial transactions after the collapse of Madras based Al Mizan Ltd. around 1990. In absence of response of the survey questionnaires the study and analysis ahead is based on information provided by Bagsiraj in his report on Islamic Financial Institutions in India (8).**

(1) Financial health Status: -

On the basis of the contents of the parameters prescribed by RBI and used in this study, the following table 9 has been drawn. It contains all basic information with respect to owned fund, deposit, borrowings, loans, investments, fixed assets, investments and credit deposit ratios.

Table - 9

Seyad Shariah Finance Ltd.

Financial Health Status

Financial Years **(Rs. in Lacs)**

Item	**1994-95**	**1995-96**	**1996-97**	**1997-98**	**1998-99**
1. Total Owned Fund	**152.23**	**179.33**	**223.80**	**349.88**	**449.29**
a) Reserve Fund	67.83	86.48	109.35	112.78	142.84
b) Share Capital	84.40	92.85	114.45	237.10	306.45
2. Total Deposits	**708.68**	**992.88**	**1276.62**	**1392.70**	**1132.08**
3. Total Outstanding	**839.48**	**1144.43**	**1454.11**	**1664.96**	**1521.77**
a) Loan	90.45	230.96	571.25	1058.53	738.73
b) Investment	161.35	122.14	95.67	61.30	43.91
c) Fixed Assets	587.69	791.34	787.19	545.13	739.13
4. Investment Ratio	18.74%	10.42%	6.38%	3.52%	2.78%
5. Credit - Deposit Ratio	12.76%	23.26%	44.75%	76.01%	65.25%
Total Assets (1+2+3)	**860.90**	**1172.20**	**1500.43**	**1742.59**	**1581.37**
Financial Ratio as Percentage of Total Assets					
Total Own Fund	**17.68%**	**15.30%**	**14.92%**	**20.08%**	**28.41%**

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Reserve Fund	7.88%	7.38%	7.29%	6.47%	9.03%
Share Capital	9.80%	7.92%	7.63%	13.61%	19.38%
Total Deposit	**82.32%**	**84.70%**	**85.08%**	**79.92%**	**71.59%**
Total Outstanding	97.51%	97.63%	96.91%	95.55%	96.23%
Loan	10.51%	19.70%	38.07%	60.74%	46.71%
Investment	18.74%	10.42%	6.38%	3.52%	2.78%
Fixed Assets	68.26%	67.51%	52.46%	31.28%	46.74%

Source: Islamic Financial Institution Of India, by Bagsiraj

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Financial ratios as percentage of total assets have also been calculated. These ratios reveal that deposits (no bifurcation available) and owned funds are the only constituents of the total liability. The company has borrowed no funds. The total assets are comprised of fixed assets, investments and loans in descending order of importance. Over the years non – linear variations are observed in owned fund, loan, investments and other assets. It suggests instability in the financial status of the company during reference period.

ii) Important Financial Indicator: -

The following table 10 contains important financial indicators figure and financial ratios which indicate income expenditure and profit / loss status of the company.

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Table – 10
Seyad Shariah Finance Ltd.

Important Financial Indicators

	Financial Years				(Rs. in Lacs)
Item	**1994-95**	**1995-96**	**1996-97**	**1997-98**	**1998-99**
1. Total Income	**250.04**	**412.37**	**507.79**	**533.53**	**495.36**
a) Investment Earnings	235.25	388.02	468.98	469.65	433.66
b) Other Income	14.79	24.35	38.81	63.89	61.70
2. Total Expenditure	**115.18**	**167.14**	**277.09**	**285.14**	**290.72**
a) Service Expended	59.06	93.22	146.21	166.40	127.09
b) Operating / Intermediate Exp.	56.11	73.91	130.89	118.74	163.62
of which Wage Bill	8.15	13.59	18.11	24.11	18.84
d) Provision and Contingencies	124.01	232.79	300.96	290.41	214.82
3. Operating Profit / Loss	**134.86**	**245.23**	**230.69**	**248.39**	**204.64**
4. Net Profit / Loss	**10.86**	**12.44**	**-70.27**	**-42.02**	**-10.18**
6. Total Assets	**860.90**	**1172.20**	**1500.43**	**1742.59**	**1581.37**
Financial Ratio as Percentage of Total Assets					
Total Income	29.04%	35.18%	33.84%	30.62%	31.32%
Investment Earnings	27.33%	33.10%	31.26%	26.95%	27.42%
Other Income	1.72%	2.08%	2.59%	3.67%	3.90%
Total Expenditure	13.38%	14.26%	18.47%	16.36%	18.38%
Service Expended	6.86%	7.95%	9.74%	9.55%	8.04%
Operating / Intermediate Exp.	**6.52%**	**6.31%**	**8.72%**	**6.81%**	**10.35%**
Wage Bill	0.95%	1.16%	1.21%	1.38%	1.19%
Provision and Contingencies	14.40%	19.86%	20.06%	16.67%	13.58%
Operating Profit	15.67%	20.92%	15.38%	14.25%	12.94%
Net Profit	1.26%	1.06%	-4.68%	-2.41%	-0.64%

Source: Islamic Financial Institution of India, by Bagsiraj

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Financial ratios indicate that income earned as percentage of total assets is twice more than total expenditure. Further investment earnings constitute major part of the total income whereas in expenditure, provisions and contingencies, operating cost and service expended (bonus) are major constituents in descending order of share as percentage to total assets. With exception of year 1997-98, a growing trend is observed in an almost all financial indicators. Because of higher allocations of provisions and contingencies allocation's net profit shows negative trends in the last three years period under reference.

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SECTION III

COLLAPSE AND CRISIS

A critical look at the financial health status and important financial indicators of the institutions collapsed and those functioning marginally confirm the general observations made in the beginning of this paper. Intensive look at the annual audited financial statements and reports, directors annual reports, information gathered from stakeholders and personal interviews with the help of the Interview Schedule annexed and discussions made with stakeholders of collapsed as well as operational units, various social and economic reasons for failure as well as unimpressive growth have been observed. For instance IFFI's of India has been facing the basic challenge of non-availability of a visionary group leadership. It may be observed from the analysis of response of the interview schedule that 90% promoters / directors of these institutions come from non-finance sector loaded with emotions but defunct from the essential education and training for management of financial institutions. Further successful business and financial wizard of the community have not come forward for cooperation and the promotion and development of these institutions. In practice these institutions convey a sectarian view of serving Muslim community from the bane of interest. With the result practically it attained the status of a charitable work and confined to Muslim Community alone. Truly speaking these institutions have not been established to promote and provide a just and fair alternative financial system as opposed to existing exploitative interest ridden system. Hence the system could not become the talk of the town. Further as per the reports collected, 90% of the board members attended the meetings with a view to provide moral support and not with a view for participation and sense of ownership. Lackadaisical attitude of board members have trusted the responsibilities to manage and grow with a small group of 10% i.e. the Chairman or the Managing Director, one probable reason for non-availability / non-coining of a financial product conforming to Shariah limits. The difference in approach and strategy vis a vis suspicion among different promoters / managers of these IFFI's have further weakened the movement. So much so that even majority of Muslims of India, who may be called de Jure **owner of the system, remained unaware about the existence of these institutions. According to Bagsiraj over 77% Muslim are unaware about the existence and operations of IFFI's of India and the money mobilized by them accounts a meager**

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0.37% of the total estimated savings of Muslims of India. (9) Needless to say that under given situation the IFFI's of India have to die, the infant death or creep and crawl with lopsided growth features like a developing country without protective trade policy**. However some important economic reasons observed during the course of study are summarized as below –**

1. Low Capital Yield: - **Comparatively low capital yield of IFFI's is found as one of the important reason for poor growth. For instance in case of Al-Ameen business per employee in 1998-99 is calculated as Rs. 10.81 lakhs and income earned is Rs.1.18 lakhs. Moreover total income earned is 5.66% of the total assets. (T2) Similarly in case of Barkat Leasing business per employee is found as Rs. 8.38 lakhs and income as Rs. 1.18 lakhs. This yield amounts to Rs. 4.80% of the total assets. (T4) In case of operating units Al Najib records business per employee as Rs. 2.63 lakhs and income earned is Rs.0.42 lakhs. This yield amounts to 7.46% of the total assets in 2003-04. (T8) For AICMEU's Baitulmal business per employee is accounted as Rs. 4.15 lakhs and income earned is Rs. 0.49 lakhs. This yield amounts 9.89% of the total assets in 2003-04. (T6) No such figures could be had for comparison from NBFC's. However according to financial parameters of public sector banks, business per employee in 19 nationalized banks in India is minimum Rs. 73.00 lakhs and maximum Rs. 185 lakhs leading to a mean value of Rs. 129 lakhs. Whereas income earned per employee is minimum Rs. 0.20 lakhs and maximum Rs. 1.89 lakhs making mean value of yield as Rs. 1.05 lakhs. Further return on assets is recorded as minimum Rs. 0.09 lakhs and maximum Rs. 1.43 lakhs giving the mean value of 0.76% of yield on assets. (10) These figures do not fit for comparison but can certainly be taken as an indicator as they belong to financial sector of India.**

2. Non – Professional Management: - **Managerial efficiency is treated as key to success. This becomes more pronounced when applied to commercial activities. Globalization has further added prominence to this activity with the title of corporate governance. The corporate governance can be defined as a set of systems and processes, which ensures that a company is managed in the best interest of all the stakeholders. (11) Although there is considerable degree of debate about what actually constitutes corporate governance, there is unanimity that its key element includes improving**

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performance through monitoring and ensuring accountability of management to share holders and stakeholders. This discussion discloses the care and concern with which modern financial institutions are ought to be managed. Contrary to these essentials, IFFI's of India collapsed suffer grossly on these counts.

In response to question number 6 A of the interview schedule, respondent from Al Ameen reported a total managerial staff of 151 persons. Out of this Directors constituted 3.97% and non-directors 92.03%. Among the directors 20% has Post Graduate (PG) degree in Medical Sciences, 20% simple Graduates (Gr.) degree with active socio political commitments and 60% were non-graduates. Among non-directors 2.65% were professionally qualified graduates, 17.88% were simple graduates and 17.88% were non-graduates. Further only professionally qualified personals had past managerial and financial training, others were devoid of even bookish knowledge as well as practical training and experience in the field of finance and financial management.

In Barkat, the respondent report that strength of employees (183 staff) including directors constitutes 3.82% of total employees, of which 14.29% were professionally qualified, 71.42% simple graduates and 14.29% were non-graduates. Managers accounted 8.74% of the total staff of which 6.25% were professionally qualified, 56.25% were commerce graduates and 37.5% were non-graduates. Clerical staff constituted 87.44% of the total staff of which 0.67% were graduates and 99.37% were non-graduates. Further only few of them had past experience and training. However it was reported that there had been an in house training and orientation arrangements at every quarter and one month on hand training at the time of induction.

Among the operational units Al-Najib (465 staff) has 12 directors of which 8.33% were graduates and 91.67% Non-Graduates (Literates). Among managerial staff 0.86% are found Post Graduates, 10.10% simple graduates and 89.04% non-graduates. None of the employees are reported to have any relevant past background in finance education, training and experience. Further no arrangement of training and orientation has been made by the organization so far.

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AICMEU's Baitulmal is another financial unit operating at small scale (23 staff). In this unit directors constitutes 39% of total staff of which 66.67% are post graduates, 22.22% are graduates and 11.11% are non-graduates. Among managerial paid staff 7.14% are reported to be post graduates, 28.57% are commerce graduates and 64.29% are non-graduates. Although educational background in finance is found but considerable degree of non-frequent practice of in house or outside training and orientation of the staff is reported. Keeping in view of the specialized nature of work and above facts it may not be inapt to conclude that by and large these units too have been and continue to be managed by relatively unskilled people in a totally unprofessional manner.

3. Higher Operational Cost**: Another challenge of IFFI's of India is said to be higher cost of operation pushing them towards near non-viability status as a financial unit. It may be noted that operating cost of the institutions collapsed namely Al-Ameen and Barkat is found to vary between as high as 9.02% to 16.51%, and 3.30% to 10.37% as percent of total assets, between 1994-95 to 1998-99 respectively (T2,4,). Compare to this operating expenses in the conventional sector, of all India Financial Institution is reported as** 1.16%, of NBFC's 4% of public sector banks 2.26% **and of private sector banks** 2.09% of their total assets in 1998-99**. (12)**

Further the operating expenses **as percentage of total assets of the functional IFFI's under our study during 1994-95 to 2003-04 are** found to vary **between 6.76% to 8.74% for ABCCS, 5.53% to 7% for ANBB and 6.31% to 10.35% for SSF Ltd. of their total assets. Contrary to this the operational expenses of NBFC's,** Public Sector and Private Sectors Banks**, during this period are found to vary between 2.4% to 4%, 2.66% to 2.72% and 1.58% to 2.09% of the total assets respectively. What the figures quoted above suggest that one of the basic reasons for slow growth as well as crises and closure of IFFI's is their comparatively almost twice of operational cost. Under utilization of existing resources and smaller level of operation by these institutions keep them devoid of advantage of economies of scale.**

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4. Capital Fund Growth: **Another serious challenge, which IFFI's of India face, is the low capital base and lack of avenues for use of funds in an islamically permitted manner. It may be noted that capital is lifeblood of the financial system. Basic factors, which help any financial institution to mobilize adequate fund, are safety, liquidity and return of capital in addition to emotional attachments.**

Taking into consideration the total fund which is not even small fraction of NBFC's it may safely be observed that IFFI's of India have not been able to win the trust of the public on these counts. Prevailing system of the money and capital market frustrate them to devise any financial instrument comparable with bonds, securities and debentures, which not only guarantee capital but ensure return too. The experience of avenues of investment on PLS system has been extremely discouraging for almost all existing and closed institutions. It may not be inapt to quote here that 90% of the institutions that have collapsed had largely investment-based operation on PLS and not lending based operation.

Low percentage of reserves, absence of deposit insurance guarantee (enjoyed by conventional sector financial houses), lack of Government support and patronage are some of the basic factors causing very slow growth rate in capital and deposits. Lack of transparency and recurring failures of particularly these Islam tagged institutions **has further eroded the confidence and trust of the depositors. There are many other obstacles of legal and technical nature that have arrested the growth of funds. (13).**

5. Non - Performing Assets (NPA's)**: - Non-performing assets have been found as a major source of crises and sickness of financial institutions. It include outstanding loans without return of installments and service charges beyond 180 days which have now become 90 days in case of lending based institutions. In case of investment-based operations, it refers to depreciation in the market value of the assets below its subscribed cost. The study of audited reports of** Al Ameen **and** Barkat **during 1994-95 to 1998-99 reveals that because of sub standard accounting practices, no proper report about NPA's is generated. Loans and advances exceeding six months have been considered good contrary to established norms and practices. Therefore it is difficult to**

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arrive at a correct figure. Further instead of giving market value of investments, cost value is given which does not indicate appreciation or depreciation in value and hence the actual financial strength. In case of Al Ameen during 1994-97, loans exceeding six months i.e. NPA's are marked. It amounts to 20.05%, 21.78%, 22.87% and 14.13% of the total loans advanced and 7.6%, 8.65%, 8.72% and 6.48% of total assets during 1994-1997 respectively. Balance sheet does not contain any such mark during 1998-1999. The risky areas of loan i.e. Qard–E-Hasna, venture finance based on Mudarabah and Musharakah, account 71.73% and 59.38% of the total loans given during this period. Assuming this proportion similar, as in the past NPA's in these years too would have been around 15% of the loans.

In case of Barkat it may be noted that it had been deploying it's fund in shares of the stock market, FD's in Barkat Saving and Investment Corporations. The market value of the shares has been falling year after year. During 1995-1998 market value of investments in shares fell as low as down NAV (net asset value) to 3.7% of the subscribed cost. It seems that it reach climax of crisis by investing 51.86% of the total assets in Barkat group of companies and 27% of the total assets in Estate properties. No information about market value of this investment of 78.86% of total assets is given in the balance sheet. It is observed that there had been heavy decline in the net asset value (NAV) of estate properties all over the country. This must have very adversely affected these investments. Reports about NPA's with respect to loans and advances are available only for three years viz. 1996, 1997 and 1998. As per the auditor's report NPA's as percentage of total assets account 0.95%, 1.08% and 1.64% respectively. NPA's as percentage of total loan account 1.54%, 15.69& and 35.36% in respective years.

Among the operational units – Al Najib Milli Mutual Benefits Ltd., NPA's calculated from the balance sheet during 2000 to 2004, account 6.19%, 10.51%, 14.40%, 7.31% and 11.42% of the total assets. When considered as percentage of total loans and advances, revealed figures are 14.58%, 23.50%, 31.16%, 15.70% and 24.21% during the reference period, NPA's in ABCCS Ltd during the last five years i.e. between 2000 to 2004 are found as 9.78%, 12.11%, 10.42%, 9.00% and 6.63% of the total assets. When

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considered as percentage of total loans**, revealed figures are 16.77%, 18.80%, 15.17%, 13.97% and 10.51% respectively.**

Compared to this NPA's as % of total assets by NBFC's of conventional sector **in the country during last 4 years i.e. 2000 to 2003 reported as 9.9%, 11.5%, 10.6% and 8.8%. In 1999 – 2000,** NPA's public sector banks **had 5.95%,** private sector banks **had 3.61% and** foreign banks **in India had 3.16% as percentage of** total assets**. NPA's have been grossly reduced by these banks as public sector had 3.50%, private sector banks had 2.82% and foreign banks in India had 2.12% NPA's as percentage of** total assets. **(14)**

6. Poor Accounting Standard: - **In order to assess the real picture of the financial institutions and initiate corrective measures, if required, proper and standard auditing and accounting of the financial operation becomes essential. RBI has issued guidelines from time to time (15) with respect to prudential regulations for management of the funds and classification of assets into four different categories. Further it has been made obligatory on auditing firms to make proper records and report. But it is disheartening to note that IFFI's collapsed falling under the category of NBFC's have not cared to follow these norms. For instance the study of financial report for the period under reference** auditors of Al-Ameen, and Barkat **have not specifically classified their assets as standards, sub-standard, bad and doubtful and losses. Accordingly no commensurate provisioning is observed in successive years. As a result of this, the storm has been gathering for years, which caused the closures.**

It may be noted that auditors have invariably pointed out year after year about the ineffective internal audit system**. Still lack of seriousness was found about the** capital adequacy ratio **and** prescribed capital deposit ratios**. It may be noted by the functional units that what is good for conventional financial sector is also good for them and that they can therefore survive and grow only when they follow prudential norms and regulations and get their operations under strict scrutiny and observation without influencing the reports of the auditors.**

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7. Moral Hazard / Misappropriation of Fund:- **Need and greed leads to misuse and misappropriation of funds on the part of the staff as well as directors. That is why preventing misuse of the functional system and preserving its integrity is observed vital for orderly development of the financial system. It may be noted that misuse and embezzlement of the funds are found in conventional banking and financial system too. Such occurrences are treated as failure of well laid down systems and procedures. That is why RBI has created a separate fraud-monitoring cell to pay focused attention.(16) Financial frauds and embezzlement of funds are major allegations and described as major cause of failure of three IFFI's under our study. However, without rejecting allegations out rightly no approval to such allegations can be accorded without substantial evidence. Specially when there is no such mention in report in available audited financial statements. Among the operational units, mention has been made in the audited financial statement of Al Najib and ABCC Ltd. For instance embezzlement of funds in Al Najib in 1999-2000 accounts 43.18%, in 2000-01 accounts 108.76%, 2001-02 accounts 113.08%, in 2002-03 accounts 91.94% and 2003-04 accounts 66.68% of the total owned funds (share + reserves). As percentage of total assets, these are calculated as 1.14% in 1999-2000, 1.75% in 2000-01, 2.09% in 2001-02, 1.95% in 2002-03 and 1.60% in 2003-04.**

Similarly ABCCS Ltd. reported embezzlement of funds by the staff accorded in balance sheet as sundry debtors. As percentage of total owned fund **it accounts 4.70% in 1999-2000, 10.20% in 2000-01, 10.58% in 2001-02, 0.81% in 2002-03 and 0.52% in 2003-04. As percentage of** total assets, **the embezzlement is calculated as 0.70% in 1999-2000, 1.72% in 2000-01, 1.85% in 2001-02, 1.61% in 2002-03 and 0.09% in 2003-04. But this is one part of the study. Unreasonable behavoiur of beneficiaries is reported as highly discouraging. An undue holding of the borrowed fund is a great problem. While niggardliness is observed in contributing funds, mastery over the system is claimed loudly by the community members.**

8. Crisis Management**: - Financial stability and development warrants a crisis management plan by the financial institutions. These plans include confidence building measures among the stakeholders, certain proportion of assets held in liquid and semi**

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liquid form, and short term loans arrangement against assets with similar institutions and apex body. In response to question number 6 D of the interview schedule, no tangible plan is found with institutions closed. Slow recovery, high credit deposit ratio, low liquidity ratio and larger investment in fixed assets made these institutions practically liquidity defunct, inviting mistrust and stoppage on fund mobility deepening the crisis further and further. Systems of SLR and CRR as practiced in conventional banking system are found in no form in these institutions. Referring back to the tables indicating the financial health status of Al Ameen **(T1), large variations in the liquidity ratio in declining trend is observed from 15.62% to 3.77%. Similarly in case of** Barkat **again huge variation in declining trend is observed from 22.08% to 0.01% of the total assets. (T3) While comfortable liquidity ratio between 9.17% to 16.16% of the total assets is observed in case of** ABCC Ltd**., (T5) excessively high liquidity ratio is observed in case of** ANMMB Ltd **(T7) with a variation between 39.65% to 45.51% of the total assets. It is also observed that in case of the two units refereed above, no prior long term is found which is indicated with reserve funds and contingencies allocations. In case of** Al Ameen **although reserves constitutes 1.32% of the owned funds, it is merely 0.46 % of the total assets causing lower average return on total assets. (T1) Further provisions and contingencies accounts 86.78% of the total income, it merely amounts as 4.91% of the total assets. (T2) In case of** Barkat Leasing**, reserves accounts 0.86% of the total income and 0.08% of the total assets. (T3) Further allocation for provisions and contingencies accounts 31.71% of the total income which is merely 1.52% of the total assets. (T4) Comparative figures are not available for NBFC's. But for institutions without any support from an apex body or any other bank, need to maintain better** shock observer **is warranted.**

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SECTION IV

Conclusion and Suggestions

Keeping in view the closure of few major players of the interest free financial institutions (IFFI's) of India, and unimpressive growth of operational units, it may safely be observed that Islamic bankers in India have not succeed like success**. Closure of the institutions have undoubtedly created hostile environment, yet it may be treated as a temporary phenomenon and as a challenge and not as an obstacle. Entry of new intermediaries with good track record of success and desire of 80% of urban Indian Muslims (17) to invest in IFFI's on PLS system; is the silver lining for interest free sector. Therefore it would not be unreasonable to conclude that** past was perplexing **but** present is pioneering **whereas** future is promising**.**

However to make future flourishing and bright, the stakeholders have to give a serious thought about the principles and practices of Islamic finance houses in India. An analytical study of the existing institutions at a wider scale about their mode of operation in comparison to existing banking and NBFC's is long due. Moreover more realistic model(s) and careful planning is required. In this regard few following points, which are in no way exhaustive, need to be considered –

1. **Change in mindset so as to establish and run IFFI's as an alternative financial system. Challenges should be treated as an opportunity and motivator.**
2. **Establishment of an apex body, which may perform functions like a central bank with special reference to guidance, training, supervision and overdrafts at time of crisis.**
3. **Marketing of this concept among wider cross sections of the society including non-Muslims to broaden it support base.**
4. **Involvement of technocrats and business community to introduce corporate governance, norms and practices including accountability, transparency and capital adequacy etc.**

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5. **Serious involvement and exercise of Ulama and practicing economists so as to create financial instruments and products for providing scientific base for fund mobilization as well as its deployment.**
6. **Infusing competition with the entry of few of the world Islamic banks and Islamic Mutual Funds in the Indian Market, which has become possible under the new regime of globalization.**

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