INTERNATIONAL FINANCIAL CENTRE (IFC)

LEARNING OUTCOMES

After going through the chapter student shall be able to understand

- Constituents of IFC
- Islamic Finance
  - Major difference between Islamic Finance and other forms of Finance
  - Concept of Riba
  - Major Islamic Financial Instruments

International Financial Centre (IFC) is the financial center that caters to the needs of the customers outside their own jurisdiction. Although appears to be similar terms. Broadly, speaking IFC is a hub that deals with flow of funds, financial products and financial services though in own land but with different set of regulation and laws.

Thus, these centers provide flexibility in currency trading, insurance, banking and other financial services. This flexible regime attracts foreign investors which is of potential benefit not only to the stakeholders but as well as for the country hosting IFC itself.

Accordingly, through IFCs, businesses that currently cannot be done in India can be done at IFC. Although there are numberless direct and indirect benefits of setting up IFC but some major benefits emanating from establishing IFC are as follows:
(i) Opportunity for qualified professionals working outside India come here and practice their profession.

(ii) A platform for qualified and talented professionals to pursue global opportunities without leaving their homeland.

(iii) Stops Brain Drain from India.

(iv) Bringing back those financial services transactions presently carried out abroad by overseas financial institutions/entities or branches or subsidiaries of Indian Financial Market.

(v) Trading of complicated financial derivative can be started from India.

1. CONSTITUENTS OF IFC

Although there are many constituents for IFC but some of the important constituent are as follows:

(i) **Highly developed Infrastructure**: A leading edge infrastructure is prerequisite for creating a platform to offer internationally competitive financial services.

(ii) **Stable Political Environment**: Destabilized political environment brings country risk investment by foreign nationals. Hence, to accelerate foreign participation in growth of financial center, stable political environment is prerequisite.

(iii) **Strategic Location**: The geographical location of the finance center should be strategic such as near to airport, seaport and should have friendly weather.

(iv) **Quality Life**: The quality of life at the center showed be good as center retains highly paid professional from own country as well from outside.

(v) **Rationale Regulatory Framework**: Rationale legal regulatory framework is another prerequisite of international finance center as it should be fair and transparent.

(vi) **Sustainable Economy**: The economy should be sustainable and should possess capacity to absorb all the shocks as it will boost investors’ confidence.

GIFT – India’s First International Finance Center

To compete with its rivals Dubai, Hong Kong the idea of setting up an International Financial Center in India was coined in 2007 at Gandhinagar, Gujarat. The main motive of setting up IFC in India was to retain the financial services businesses in India which moves out of India.

Since foreign investors normally remains hesitant to get registered in India GIFT city provides them a separate jurisdiction where it is easy to do business because of relaxed tax and other laws.

With the objective of achieving sustainable growth and achieving above cited objective India’s honorable Prime Minister in inaugurated India’s first International Exchange – India INX, a wholly owned subsidiary of Bombay Stock Exchange on 9/1/2017. The India INX has stated trading in Index, currency, commodity and equity derivatives.
On 5th June, 2017, National Stock Exchange (NSE) the competitor of Bombay Stock Exchange (BSE) also launched its trading at GIFT. Initially, it started trading in derivative products in equity, currency, interest rate futures and commodities. However, it is planning to trade in more equity instruments of Indian and foreign companies, base metals, energy and interest rates.

Hence, with all these development more and more financial institutions are setting business units in GIFT as they will pay reduced taxes as valid for special economic zones and also can easily offer foreign currency loans to Indian Companies abroad and foreign firm.

2. ISLAMIC FINANCE

Since India is becoming a globalized economy and world where about 1/4th population is of Muslims, the concept of Islamic finance based on Islamic principles and values cannot be ignored.

While Islamic finance has roots in the past but there is resurgence in past 30 years. Though Islamic finance is different from the conventional finance but it has same objective of providing economic benefits to the society.

According to Wikipedia, Islamic Finance Banking or Sharia Complaint finance is banking or financing activity that complies with Sharia (Islamic law) and its practical application through the development of Islamic economies.

Since under Islamic finance money is considered as only a mean of carrying out transactions any earning on the same in form of interest (Riba) is strictly prohibited.

2.1 Sharia Board

To ensure that all Islamic finance products and service offered follow principles of Sharia Rules, there is a board called Sharia Board which oversees and reviews all new product offered by financial institutions.

2.2 How Islamic Finance is different from Conventional Finance

Major differences between Islamic finance and other form of finance (Conventional Finance) are as follows:

<table>
<thead>
<tr>
<th>Basis</th>
<th>Islamic Finance</th>
<th>Conventional Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Promotion</td>
<td>Islamic Finance promotes just, fair and balanced society. Hence, interest is prohibited.</td>
<td>Based on commercial objectives and interest must be paid irrespective of outcome of business.</td>
</tr>
<tr>
<td>Ethical framework</td>
<td>Structured on ethical and moral framework of Sharia. Verses from the holy Quran and</td>
<td>No such framework.</td>
</tr>
<tr>
<td>Speculation</td>
<td>The financial transactions should be free from the element of uncertainty (Gharar) and gambling (Maisir)</td>
<td>No such restrictions.</td>
</tr>
<tr>
<td>-------------</td>
<td>-------------------------------------------------------------------------------------------------</td>
<td>----------------------</td>
</tr>
<tr>
<td>Unlawful Goods and Services</td>
<td>Islamic Finance must not be involved in any transactions not involve trade not allowed as per Islamic principles such as alcohol, armaments, pork and other socially detrimental products.</td>
<td>There are no such restrictions</td>
</tr>
</tbody>
</table>

### 2.3 Concept of Riba

In Islamic Finance, the meaning of Riba is interest or usury. As mentioned earlier in Islamic Finance money is considered as medium of exchange, store of value or unit of measurement only, hence Riba is considered haram i.e. unfair reward to the provider of capital for little or no effort or risk undertaken. Due to this reason, Islamic finance models are based on risks and profit/loss sharing contract (as clear from the financial products discussed above).

Riba is equated with wrongful appropriation of property belonging to others and hence Muslims are asked to accept principal only and forego principal even, if borrower is unable to repay the same.

In this backdrop in Islamic banking a link must be established between money and profit as an alternative to interest. This is in sharp contrast of conventional banking which is simply based on lender borrower’s relationship.

Since, interest is not allowed in Islamic Finance, depositors are rewarded by a share in the profit from the underlying business (after deduction of management fees) in which the funds of depositors have been channeled.

Thus, it can be said that money has no intrinsic value i.e. time value of money.

The relationship between depositor and banker can be viewed as:

(a) Agent and Principal or
(b) Depositor and Custodian
(c) Investor and Entrepreneur
(d) Fellow joint partners
As mentioned above Islamic finance products are based on profit sharing coming section shall discuss the various Islamic finance products.

2.4 Islamic Finance Instruments

Although there are number of Islamic Finance products, but some of common products/instruments are as follows:

2.4.1 Mudaraba

The Mudaraba is a kind of profit sharing arrangement wherein one party provides 100% of the capital involved and other party provides specialized knowledge and entrusted with exclusive responsibility of working. In case there is profit it shared among them in the pre-decided ratio and if there is loss only financier will borne the same.

2.4.2 Musharaka

It is a kind of joint business venture wherein all parties provide the capital in the business in agreed ratio and also have right to participate in the business. While the loss is strictly shared in the ratio of their capital contribution, the profit is shared as perpre-agreed ratio.

2.4.3 Sukuk

It is one of the most popular Islamic financial products. It is a kind of 'Debt Certificate' representing ownership in business or assets and through this instrument company borrows the money. Although it appears to be conventional debt instruments but is differs in following aspects:

• To have share in profit of assets.
• To have share in the underlying assets on realization of assets.

2.4.4 Ijara

It is a kind of lease financing arrangement wherein one party transfer the asset to other partly for some specific time for specific fee which includes capital cost of assets and profit margin of the lessor. In this arrangement, the responsibility for maintenance of the leased items remains with the lessor.

2.4.5 Murabaha

Also, known as cost plus contract it is a kind of trade credit or loans and mainly helps exporters and importer in meeting their funding requirements. The main feature of this arrangement is that profit margin of the financier is known to the buyer. In this arrangement financier buys thee assets and sells to the client (buyer) and buyer pays to the financier in installments consisting of following two elements:

• Cost of asset financed.
• Financier’s profit on acquisition of asset.

2.4.6 Istisna
It is a kind of funding arrangements for long term construction contracts wherein client pays some initial amount and balance amount is payable is repaid in installments. The whole project is funded by the financer and completion of project it is delivered to the client.

### 2.4.7 Salam

It is analogous to forward contract in the conventional finance. Though cash is received by the seller immediately on sale but goods as per pre-decided quality, quantity and time shall only be delivered in future. This sale shall be at the discounted price so that financer could make some profit out of the deal. However, it is important to note that Salam is prohibited in commodities such a gold, silver and other type of monetary assets.

---

**TEST YOUR KNOWLEDGE**

**Theoretical Questions**

1. Which Islamic Financial Instrument is closer to the concept of Venture Financing as per conventional finance and why.

2. Differentiate between ordinary lease as per conventional finance and ‘Ijara’ as per Islamic Finance.

**Answers to Theoretical Questions**

1. Please refer paragraph 2.4.1

2. Please refer paragraph 2.4.4