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Theoretical Basis of Financing Investment Activities Using Islamic Financial Instruments

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Abstract

The article examines the theoretical and legal foundations of financing investment activities using Islamic financial instruments, the organizational system, as well as individual approaches to improving the theoretical foundations of the implementation of Islamic financial instruments in our country.

Keywords: Islamic finance, investment, investment activity, foreign investment, financing, financing mechanism, Islamic banks

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1. Introduction

In the process of economic transformation in any country there will be a shortage of financial resources. In such conditions, not only domestic, but also foreign investments are required to finance investment activities. By attracting foreign investment, the state must, first of all, ensure the attractiveness of the investment climate, that is, improve the financial and credit mechanism. Today, financing investment activities with Islamic financial instruments is one of the fastest growing areas in the world and includes innovative financing mechanisms.

In his address to parliament, the President of the Republic of Uzbekistan Shavkat Mirziyoyev noted that "the time has come to introduce Islamic financial services in Uzbekistan. “Therefore, to support the socio-economic development of Uzbekistan and the private sector, it is advisable to attract funds from existing banks, investment funds and companies whose activities in Muslim countries are based on Islamic finance”[1]. For this, of course, it is necessary to take a fresh look at the national banking system, that is, to develop scientific proposals and practical recommendations for the introduction of financing mechanisms through Islamic financial instruments, along with traditional financing mechanisms.

2. Analysis of the relevant literature

Today, the geographic presence of Islamic finance extends beyond the traditional markets of the Middle East and Southeast Asia and now includes new players from different regions of the world such as Africa, East Asia and America. Given the positive prospects for the industry in these markets, it will be possible to develop financing for investment activities through Islamic finance.

At the same time, there are different views on the introduction of financing mechanisms through Islamic financial instruments. Specifically, Ibrahim Wardé classifies Islamic financial products based on the set of legal, financial, economic and political relationships that arise from the use of these instruments.

It should be noted that in the process of studying the analysis of the relevant literature by economists, the issues of "investment activity" and "Islamic financial instruments" were considered in different interpretations.

In particular, the Russian expert in the field of Islamic finance R. Ya. Bekin gives the following classification of Islamic financial products: - instruments based on the mechanism of distribution of profits and losses or investment funds of financing: muzaraba, musharak; - Debt financing instruments: murabbah, salam, and also exceptions and rent.

R.R. Vakhidov distinguishes two most common groups of financial instruments: equity financing instruments and debt financing instruments. To the instruments based on capital R. R. Vakhidov includes muzaraba and musharaka, which are based on means of debt financing - murabaha, ijara, salam and sukuk.

“Muzoraba is a special form of partnership in which one partner gives money to another to invest in a commercial enterprise,” Usmani said.

I. Wardi, on the other hand, described Muzaraba as “one of the parties, Rabb al-Mal (beneficial owner or“ quiet partner ”), entrusts money to the other party, who uses the money in accordance with the trust".

[1] Address of the President of the Republic of Uzbekistan Shavkat Mirziyoyev to the Oliy Majlis. 29.12.2020 y. https://president.uz/uz/lists/view/4057

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M. Kalimullina Mushoraka, "there is a partnership agreement between two or more parties in which each partner contributes a certain amount of money or tangible assets to a common business, according to which each of them can use the company's assets on a profit-making basis. exchange gives. "He described.

The authors did not pay sufficient attention to the process of financing investment activities at the expense of Islamic financial instruments in the implementation of the factors considered.

3. Research methodology

The article examines the scientific works of economists from Uzbekistan and abroad on the analysis of sources that provide the process of financing investment activities through Islamic financial instruments in the new Uzbekistan. Also, the work of economists was used to improve the system of financing investment activities through Islamic financial instruments.

4. Analysis and discussion of the results.

Today, in conditions when the level of transformation of the economies of developing countries is increasing, it is difficult for each country to individually increase its economic power.

High growth rates of assets of Islamic banks operating in Muslim countries, their growing participation in international financial markets lead to an increase in interest in the activities of Islamic banks around the world.

Even in the United States and the United Kingdom, the growing number of people who have converted to Islam and refused to use traditional banking services are allowing commercial banks in the country to offer the services of Islamic financial instruments used in Islamic banking.

Islamic finance is a term that reflects financial business that does not contradict the principles of Sharia. Traditional finance, in particular the traditional banking business, relies on raising funds and financing the population and entrepreneurs. Therefore, the relationship between commercial banks and customers is always a debtor-creditor relationship. The main aspect of traditional banking is interest, which is prohibited by Sharia.

The most important aspect of traditional banking is that money creates money or money has interest premium money. This practice of usury (Arabic "usury") is contrary to the principles of Islamic finance. Money is never accepted as a commodity. Instead, Islamic law consistently sees money as a medium of exchange, a measure of value, and a unit of account. Since money cannot create money on its own, an alternative to interest must be established between money and profit.

That is why Islamic banks are primarily engaged in trade, leasing and paid operations, as well as investment activities. Islamic banks cannot take deposits and lend for the purpose of earning interest. The essence of the relationship between Islamic banks and their customers varies according to different financial instruments or contracts. The main financial instruments in Islamic finance are:

Murobaha - a contract of sale between the parties means that the contract is for a surcharge. Murobaha is the most common method of asset financing used by Islamic banks. This agreement is signed tripartitely between the customer, the supplier of the goods and the Islamic Bank. The bank buys a short-term or long-term asset from a supplier and sells it to the customer at a higher premium, subject to payment on time. The bank may pledge the funded asset or require another type of guarantee.

Unlike traditional banks, the additional profit agreed on price does not change over time. In practice, Islamic banks can provide a discount for a Murobaha contract if they make an early payment in full so as not to lose competitiveness with traditional banks, where the discount cannot be agreed in advance in the Murobaha contract.

Penalties for late payments may be included in the contract as compensation, but must be distributed as charitable funds. Because this fine is only aimed at disciplining the customers and preventing the customers from abusing the Murobaha terms. The bank may receive a portion of this penalty to cover costs incurred by the bank due to the customer's late payment (e.g., costs incurred to recover payments). There is no penalty for missed opportunity or capital expenditure.

Muzoraba is a profit sharing agreement between an investor ("Robbul mol") and an entrepreneur ("Muzorib"). In the contract, the investor agrees to distribute the profits to the entrepreneur in the agreed ratio or percentage.

First, as a source of capital for entrepreneurial activity, an entrepreneur can receive an investment from an Islamic bank under the Muzaraba agreement. If the bank agrees, both parties provide funds to the entrepreneur, realizing that they will share the profits of the enterprise.

Second, in the activity of attracting deposits from banks, it is considered as an investment in money raised from individuals or legal entities under the Muzaraba agreement. The Bank uses these investments to finance commercial activities, ie individuals and entrepreneurs. Under the contract, the bank agrees to pay the depositor a share of its profits in return for the investment at a pre-agreed rate.

Investment financing through negotiations - also involves participation in business-related risks in order to distribute the profits received by entrepreneurs who are clients of the bank. The parties to the contract will benefit only if these enterprises are successful. If the project fails, the financier loses capital and the entrepreneur loses the time and effort spent on the project.

Muzoraba, unlike Mushoraka, does not give the investor ('robbul mol') the right to participate in the management of the business.

Mushoraka is a form of partnership. This can be likened to the purchase of shares in a normal capital market, but the investment made should be limited to shares and financial securities or other assets that comply with Sharia principles.

As a form of capital-based financing such as Muzaraba, Mushoraka is an obligation on the part of the financier to participate in the risks associated with entrepreneurial activity. In a partnership, all partners are joint ventures that share the profits or losses of the business. The profit-sharing ratio is an agreed-upon ratio, but the loss-sharing ratio should always be proportional to the partners contribution to the capital. It also allows the investor to participate in making important decisions on enterprise management, day-to-day operations and business development.

The distribution of profits may vary depending on the share of the parties in the investment and the efforts to manage the enterprise. Musharaka is the most flexible and convenient tool for financing various economic sectors.

A lease is a lease or lease agreement, in its own name. If the lease provides for the possibility of transferring the right of ownership to the customer, the lease agreement is called "Lease muntahia bi tamlik" (lease ending with ownership). The purpose of this financing instrument is to transfer the leased object to the lessee in his name upon the expiration of the lease term.

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This lease concept is an alternative product to financial leasing used by Islamic financial institutions. There are several forms of lease, which reflect different ways of transferring ownership of an asset, such as gift, sale, and transfer of shares from the lessor to the lessee.

Takoful is derived from the Arabic word ‘kafala’, which means to guarantee. More precisely, it comes from the verb ‘takafala’, which means mutual guarantee and protection of each other. Therefore, when translated literally, it means mutual help.

It should be noted that the Takoful agreement is based on the idea of helping each other, with each participant contributing to the common fund to provide financial assistance to a member in need of any assistance under a mutual protection agreement. Basically, Takoful is very similar to traditional mutual insurance in terms of its philosophy and structure. All of Takoful’s activities should be based on Islamic principles, in which a Sharia council should be established, and the claims should be truly legitimate.

Salam means to pay the price of the raw material immediately, and to purchase the raw material for delivery at the agreed delay. In the Salam contract, the price is paid in full and in advance. These types of contracts can be applied where raw material prices are subject to change. The buyer is guaranteed a purchase price on the day the contract is signed, thereby preventing price increases (i.e., it is used as a risk management tool).

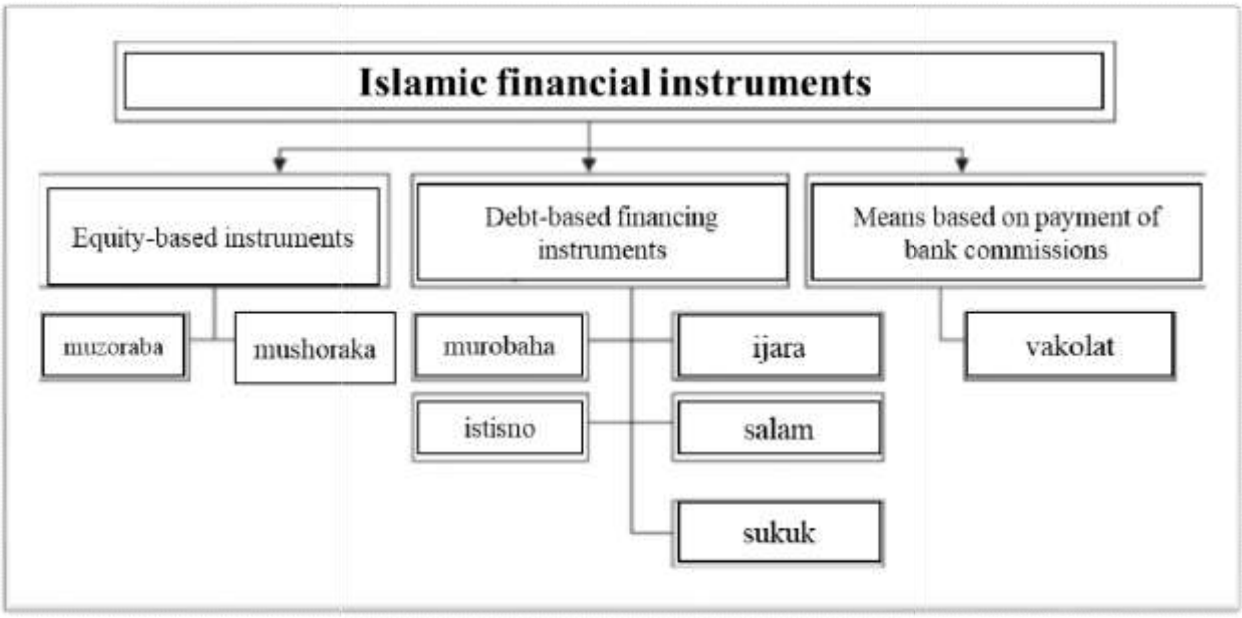

Figure 1. Islamic financial instruments in financing investment activities[2]

An exception is a contract for the financing of an object with the specified characteristics between the parties at a fixed price for the construction, production or restoration of the object for sale, for a specified period. Exception financing is provided in the form of advance payments to the customer who builds, manufactures or restores the commercial facility.
Sukuk is an investment certificate of equal denomination representing property interests. Sukuk can be thought of as an Islamic financing instrument similar to a security that benefits investors and is backed by traditional assets. Sukuk is formed in accordance with the principles of

[2] Created independently by the author

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Shari'ah, which prohibits usury or interest. Sukuk is issued by states or organizations and can be based on various agreements, in particular Murobaha, Ijara, Istisna, Mushoraka and others.

The rapid development of Islamic finance has proven the practicality of Islamic financial solutions. Given the advantages offered by Islamic finance, they represent a unique alternative in these non-traditional markets.

In particular, the Islamic financial sector has become an independent and complete financial system covering the banking, capital markets and insurance sectors. Today, the global assets of the Islamic financial sector are estimated at $ 2 trillion and have the potential to grow to $ 3 trillion by 2020.

Analyzing the data presented, it should be noted that unconventional markets for Islamic finance are emerging and evolving: African countries are organizing the first issue of sovereign sukuk, while East Asian countries are working to allow Islamic finance to their domestic markets.

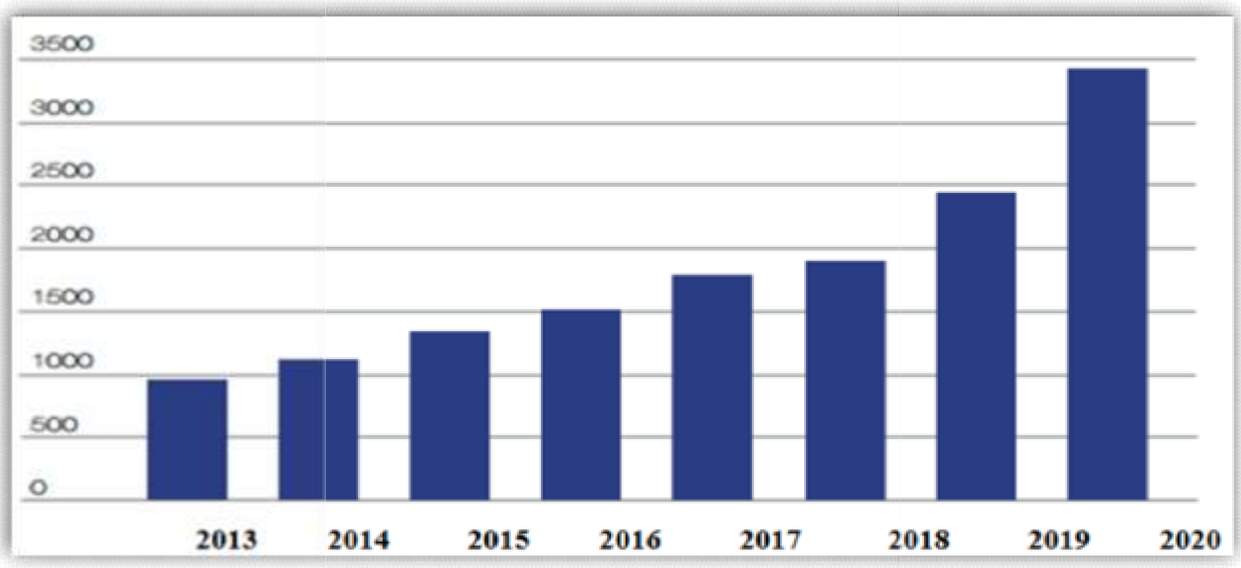

Figure 2. Total assets of the Islamic financial sector in 2013-2020[3]

In addition, investing in Islamic finance through the first sovereign sukuk and Islamic “windows” European banks in Russia and Germany are working to develop a system of financing through alternative or Islamic financial instruments, in addition to the traditional banking system.

5. Conclusions and suggestions

In conclusion, it should be noted that in order to keep pace with globalization and innovative changes in the world, it is necessary to develop a roadmap for the development of investment activities in our country through Islamic financial instruments or on the basis of partnership. This roadmap should improve the existing legislation (amendments and additions to the legislation on banking, taxation, securities), advocacy, development of Islamic financial infrastructure, development of international cooperation and the public sector, development of the market of Islamic financial services.

[3] https://www.conferences.uz/plugins/themes/bootstrap3/pdf/conf_25_2020/9

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It is also necessary to develop a legal framework for the establishment of new Islamic banks in the country. It is necessary to consider the issue of opening Islamic "windows" after the fulfillment of all necessary conditions for the full functioning of the financing of investment activities through Islamic financial instruments.

In our opinion, the implementation of the above proposals is in the Republic of Uzbekistan. Islamic finance will increase the financing of investment activities through Islamic financial instruments, which in turn will pave the way for the rapid development of the real manufacturing sector of Uzbekistan.

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