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**CONTENTS OF PART - IX**

Sr. No.	Name & Author Name	Page No.
1	Human Rights in the Perspective of Intellectual Property Rights in India Dr. Mahendra Pachadkar	1-5
2	Photooxidative Degradation of Methyl Orange in Visible Light by MnO ₂ Nanoparticles and its Application of Treatment of Waste Waters Mrs. Deepa M. Audi	6-13
3	Merits and Demerits of Demonetisation in India Dr. Rohidas B. Pawar	14-18
4	Critical View on Consumer Responses towards Two Wheeler Insurance Behaviour Dr. Dinesh D. Bhakkad	19-25
5	Islamic Banking Dr. Rodney D'Silva Dr. Edwin Barreto	26-35
6	A Study on the Impact of Social Networking Sites on Behavior of Consumers Specially Young Generation with Reference to Ulhasnagar Region Dr. Vinod S. Chandwani	36-42
7	Area and Production of Sunflower in Selected districts of Karnataka Chandrashekhar K. M. Dr. S. B. Nari	43-49
8	Marketing Communications in a Virtual Community: An Insight Dr. Swapna Datta Khan	50-60
9	Assertiveness and Resilience among Women Practitioners and Non-Practitioners in Martial Arts Anupama K. Arun Shambhavi Shastry	61-69
10	Child Labour and Human Rights [A Study on the Right to Primary Education Protection among the Child Labourers as a Fundamental Right Bellary District Y. Janardhana Reddy B. Ananda Naidu	70-75
11	Rural Green Marketing: Challenges and Opportunities in India Roopa D.	76-83

**CONTENTS OF PART - IX**

Sr. No.	Name & Author Name	Page No.
12	“A Study of Awareness of Agriculture Insurance”- with Reference to South Goa Shilpa D. Korde Dr. (CA) Subrahmanya Bhat	84-91
13	Emerging Trends in Indian Contemporary Drama with Reference to Problems of Indian Society Dr. Arti Maheshwari	92-96
14	Naturalistic Intelligence (Nature Smart), Environmental Education and Sustainable Development Hemalatha S. Naik Dr. H. R. Jayamma	97-103
15	Challenges and Opportunities for Electronic Payment System in India: A Study Shriraj G. Parsekar Sunny S. Pandhre	104-109
16	A Framework on Behavioural Dynamics of Leaders in Social Entrepreneurial Ventures Dr. Rajdeep K. Manwani Ms. Neelima Chaudhary	110-121
17	The Opinion Leadership Approaches in Understanding Consumer Buying Behaviour Dr. Sunitha Chakravarthy	122-127
18	Corporate Finance Divya P. Palabhavi	128-134
19	Determinants of Dividend Policy - A Review of Empirical Studies Manjunatha K.	135-140
20	An Analysis of Health Scheme to Alleviate Malnutrition: Rashtriya Bal Swasthya Karyakram (RBSK) Miss. Annapurna H. Kumbar	141-152
21	To Study Crypto Investment Strategies Asim Yakub Momin Megha Balasaheb Bagade	153-156

5. Islamic Banking

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Introduction

Islamic banking is the alternative banking methodology administered under Sharia'a principles. Unlike conventional banking, Islamic banking system is run under the principles of partnership, mutual solidarity and reciprocal social development. Islamic banking, by principle, is different from the conventional banking system as payment of interest, which is known as 'Riba' is strictly prohibited in Islamic banking.

The Quran clearly defines that profit must be earned from exchange of goods and services, but not from exchange of money itself. Islamic banks fundamentally emerged to full fill this basic need of Muslims to enjoy banking services in compliance with Islamic principles.

In India where only conventional banking system is in operation, the Muslim community is deprived of the Islamic Banking System (IBS). Therefore, a sizeable number of Muslims either do not maintain any relationship with the conventional banking system or do not accept any interest on their deposits. Hence, it is believed that there is tremendous scope for IBS in India.

The interest free banking or Islamic banking is based on the premise that every depositor participates in the activities of the bank and is entitled for the share in its profits. Similarly, the advances made by the bank are not really advances in the conventional sense of the term, but a share in the capital of the entrepreneur which the bank invests. The return on this investment is a share of profit earned by the entrepreneur. It may vary in accordance with the market conditions and the ability of the fund managers. Islamic finance also adopts fee-based financing approach in compliance with Sharia'a law.

Objectives of the study

1. To understand the concept of Islamic banking.
2. To study the perception of Islamic banking among individuals in Goa.

Scope

The study focuses on the prospects of Islamic banking in India. The scope of the study is very wide as it can give a major boost to availability of finance to entrepreneurs.

Research methodology

Primary data has been collected by using a structured questionnaire which was administered to 150 respondents through personal interviews. Secondary data was gathered from government publications, journals and research studies.

History

The first Islamic bank launched was Mit Ghamar in Egypt, which commenced in 1963 but closed down in 1967. The bank had nine branches in operation, 250,000 depositors and close to two million Egyptian pounds in deposits. It earned profits by engaging in trade and industry directly or in partnership with others, and to a lesser extent by financing business on a profit-sharing basis.

In 1971, as part of its policy of co-opting Islamic groups in its fight against leftist elements, the Egyptian government created the Nasser Social Bank. The official goals were to 'broaden the base of social solidarity among citizens' and 'provide aid to needy citizens'.

Need for Islamic banking in India

The Sachar Committee Report (SCR, 2006) has clearly brought out the poor state of affairs of the Muslim community in India with specific details to their banking activities. With less than 8 percent of the Muslim population holding bank deposits, it becomes clear that there is a huge gap between the Muslims and the rest of the country. The non-availability of the interest-free banking mechanisms is the cause for such a situation. Further, according to Raghuram Rajan Committee Report, these economically disadvantaged strata of the society do not even access banking products and services due to reasons of faith. It is the responsibility of the secular government of India to ensure that the lagging groups have the necessary tools to overcome such inequalities.

This economic inequality could be greatly reduced with the establishment of Islamic banks, as it would provide interest-free credits to the deserving class and this would also result in more participation in the banking activities by the under-banked communities. One important point to be noted here is that Islamic banks would not be a privilege exclusively for the Muslims