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## Shariah Investment in India: An Unexplored Opportunity

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### **Abstract:**

*The Religious set of banking, especially Islamic Banking and Investment was nonexistent around 30 years back. But in 2006, Islamic financial institutions' (IFIs) assets worldwide were estimated at more than \$300 billion, with another \$400 billion in financial investments, according to a study by accounting firm KPMG. Which is considerable and the growth momentum noticed by KPMG is also substantial.*

*According to the study conducted by Consulting firm McKinsey & Co the current growth rate of Islamic Banking & Investment is 15% annually and in coming 5 years this rate is going to be 20%.*

*Islamic finance is built on the premise that while “commerce had always been central to Islamic tradition, profits from pure finance [are] viewed with suspicion. Profits from commerce are fundamentally different from those generated by money-lending.”*

*Islam prohibits riba (“extra” or interest) and usury (excessive interest), because fixed, pre-determined interest-based lending casts an inherent risk of the lender exploiting the borrower. Islamic banking differs in the relationships between borrower and lender, favouring profit-and-loss sharing or partnership finance.*

*Most large western financial institutions have Islamic subsidiaries or at least Islamic products. In the US, a Dow Jones Islamic market index (DJIM) was launched in 1999 to benchmark Shariah-compliant portfolios, even employing a board of Shariah scholars.*

*Lately though the formal introduction in Banking is delayed jointly by RBI and SEBI, because of complex methods of operation.*

**Key words:** Islamic Banking, Ethical Fund, Shariah Law, BSE TASI Shariah, CNX NIFTY Shariah

### **1. Review of Literature**

Some work is being done in this regard however the available credible data set is much more prominent now. [http://crisil.com/crisil-young-thought-leader-2008/dissertations/Dissertation\\_SoumikMajumdar.pdf](http://crisil.com/crisil-young-thought-leader-2008/dissertations/Dissertation_SoumikMajumdar.pdf)

Though in the above mentioned paper, it is documented that Taurus Parsoli Ethical Fund (launched on March 20<sup>th</sup> 2009)<sup>1</sup> was the Maiden Shariah fund in India, but it is observed from the available data that Benchmark Shariah Bees<sup>2</sup> were already existent (launched on 5<sup>th</sup> Mar 2009) when Taurus launched their fund. TATA Ethical Fund was launched on Sept 5, 2011 as they repositioned their TATA Select Equity Fund.<sup>3</sup>

### **2. Research Methodology**

With the help of existing research papers and industrial data from credible sources, an attempt has been emphasized on the growth of the Shariah Investment products in India. Apart from being a strict religious method, it has been also observed that the risk appetites of such investment vehicles are different than the common western investment vehicles.

<sup>1</sup> <http://www.global-islamic-finance.com/2008/08/as-islamic-finance-booms-globally-egypt.html>

<sup>2</sup> [http://www.moneycontrol.com/india/mutualfunds/mfinfo/investment\\_info/MCM049](http://www.moneycontrol.com/india/mutualfunds/mfinfo/investment_info/MCM049)

<sup>3</sup> [http://www.moneycontrol.com/india/mutualfunds/mfinfo/investment\\_info/MBM025](http://www.moneycontrol.com/india/mutualfunds/mfinfo/investment_info/MBM025)

<sup>4</sup> [http://www.moneycontrol.com/india/mutualfunds/mfinfo/investment\\_info/MTA010](http://www.moneycontrol.com/india/mutualfunds/mfinfo/investment_info/MTA010)

Study period is from 1996 to 2012. Country and Capital Market under consideration is of India. Lot of data is available though the sources and the data interpretation hold the key over here.

### 3. Study

Shariah Law recommends two types of screening.

#### 3.1. Sector Based Screening

Business activities related to the following are excluded:-

- Pork
- Alcohol
- Gambling
- Financials
- Advertising and Media (newspapers are allowed, sub-industries are analyzed individually)
- Pornography
- Tobacco
- Trading of gold and silver as cash on deferred basis
- During the selection process, each company's audited annual report is reviewed to
- Ensure that the company is not involved in any non-Shariah compliant activities
- Companies that are found to be non-compliant are screened out

#### 3.2. Accounting Based Screening

Companies left after passing through sector based screen are then examined for compliance in financial ratios as certain ratios may violate compliance measurements.

The three areas of focus are: leverage, cash and the share of revenues derived from non-compliant activities. All of these are subject to evaluation on an ongoing basis

#### 3.3. Leverage Compliance

For inclusion in the S&P CNX Nifty Shariah Index compliance is measured as:

Debt / Market value of equity (12 month average) < 33 %<sup>i</sup>

Now let's see the evolution of Shariah Investment in India

Action	Year
Action Year Establishment of Anand Sinha Committee under the Reserve Bank of India for studying Islamic Financial Products.	2005
Raghuram Rajan Committee recommends Islamic banking for financial inclusion of Muslim community in India.	2008
Government of India calls for bid in connection with reconstruction of National Minority Development Finance Corporation (NMDFC) on Shariah lines.	2008
SEBI permits India's first Shariah tolerant Mutual Fund, advised by TESIS. 2009 SEBI permits India's first Shariah tolerant Venture Capital Fund. 2009	2009
SEBI permits India's first Shariah tolerant Venture Capital Fund.	2009
GIC (Re), a government of India owned company, appoints TESIS for Shariah advisory	2009
Government of the state of Kerala appoints a consulting firm to seek advice on starting an Islamic NBFC	2009

Table 1

It was observed that 61% of the stocks that are listed in India are Shariah compliant, in comparison with 57% in Malaysia, 51% in Pakistan, and a mere 6% in Bahrain. 283 out of 500 stocks of BSE 500 are Shariah compliant. 39 out of 50 stocks of Nifty are Shariah compliant & 23 out of 30 stocks of Sensex are Shariah compliant.<sup>4</sup>

<sup>5</sup> [http://crisil.com/crisil-young-thought-leader-2008/dissertations/Dissertation\\_SoumikMajumdar.pdf](http://crisil.com/crisil-young-thought-leader-2008/dissertations/Dissertation_SoumikMajumdar.pdf)

So, Indian Indexes are more Shariah Compliant than its peers. Also India is the only Country with maximum Shariah compliant stocks among the BRIC countries.

These are attractions which could stimulate global Shariah giants to invest in Indian markets. One surprising fact came out during the research that Shariah Funds grow higher in a same set of macroeconomic & taxation environment than the normal Index.

BSE Shariah 50 has grown from 515.85 in 2008 to 1139.1 in 2012 (121% growth). This growth is significant compared to the growth (78%) in flagship Index Sensex. Sensex from 9647.31 in 2008 has reached 17197.93 in 2012.<sup>5</sup>

These all may be the reason that on September 5<sup>th</sup> 2011, TATA AMC has repositioned their Select Equity as TATA Ethical Fund following the Shariah lines of investment.

Tata Group's investment unit is seeking to attract about \$100 million within three years to India's first Shariah-compliant fund aimed at global investors, targeting equities in a country that lacks regulations for establishing an Islamic debt market.<sup>6</sup>

On 11<sup>th</sup> November 2010, Reliance AMC also came up with their Reliance India Shariah Growth Fund.<sup>7</sup>

Two Life Insurance Companies who use Shariah Compliant stocks, Bajaj Alliance & TATA AIG has generated higher returns than a host of traditional funds.<sup>8</sup>

But despite such silver linings the AUM (Asset under Management) data speaks of a completely different story. Out of the three funds in the said space in India Goldman Sachs Benchmark Shariah suffered a downfall of AUM from .25 Cr to 87 Lacs in 3 years (2009-2012). Taurus has grown from 2.48 Cr to 26.7 Cr 2009 to 2012) & TATA has grown from 103 Cr to 111 Cr (2011-2012).<sup>9</sup> The total Asset under management by Indian Mutual Funds hover around 6 Lack Crores of INR. So, It is been observed here that the allocation to Shariah compliant funds are so negligible.<sup>10</sup>

That clearly indicates that despite showing substantial outperformance these set of funds are out of favour. In fact Taurus Ethical Fund has generated 28% Vs 15% of its benchmark S&P CNX Shariah 500.

There are three Indices present in INDIA as of now. First one is S&P CNX Shariah 500 and the second is BSE TASI Shariah 500, the third one is Nifty Shariah.

Returns	BSE Tasis Shariah	BSE 500	Sensex	Nifty Shariah	S&P CNX Shariah
YTD	-6.48%	-7.05%	-5.43%	-6.43%	-6.98%
1 Year	9.61%	7.48%	10.94%	5.43%	5.12%
2Year	117.79%	111.07%	100.29%	79.33%	93.43%
3 Year	48.58%	20.79%	24.29%	10.43%	13.92%
Since Inception	17.07%	-14.13%	-4.21%	-13.37%	-15.50%

Table 2

(Data Source Is BSEINDIA & NSEINDIA)

#### 4. Analysis & Findings

The researcher observed that although the Shariah funds have been launched with the aim of targeting a particular community, yet the fund houses have not been very successful in their endeavor.

The researcher observed that investors who want to take an exposure to a socially responsible fund can consider investing into this category. These funds take a lot of defensive calls that can be seen from their exposure into the Pharma space.

Also, it has been noticed that these funds are Bullish in Infrastructure space. Pharma being a stable sector and Infrastructure being a high growth area, they complement each other very well. Also, they tend to focus on OIL & Gas in a big way apart from Technology. Since, India has always a gap between demands & supply in OIL & Gas it enables space for growth. The Shariah compliant funds have outperformed, BSE-30, NSE-50, S&P CNX Shariah 500 on a consistent basis in last 3 years. The difference is being created

<sup>6</sup> <http://beta.bseindia.com/indices/IndexArchiveData.aspx?expandable=3>

<sup>7</sup> <http://www.financialexpress.com/news/tatas-shariah-fund-targets-100-m-from-gulf-in-3-yrs/706873/>

<sup>8</sup> <http://www.bloomberg.com/quote/RISGFIN:MP>

<sup>9</sup> [http://articles.economicstimes.indiatimes.com/2010-03-11/news/28416924\\_1\\_shariah-taqwaa-advisory-nifty-index-fund](http://articles.economicstimes.indiatimes.com/2010-03-11/news/28416924_1_shariah-taqwaa-advisory-nifty-index-fund)

<sup>10</sup> [http://www.moneycontrol.com/news/mf-experts/shariah-funds-will-they-riseshine\\_698506.html](http://www.moneycontrol.com/news/mf-experts/shariah-funds-will-they-riseshine_698506.html)

<sup>11</sup> <http://businesstoday.intoday.in/story/mutual-fund-industry-losing-investors/1/24486.html>

despite the economic, political, and Taxation environment being the same for Shariah compliant set of stocks and the entire universe of stocks.

So, indirectly it can be stated by the study that Shariah compliant set of stocks are having a better risk return relationship than the rest of the universe. In fact the shallow volume of the Indian Shariah funds should have put additional pressure on the fund managers to go for bulk deals and maintain redemption pressure. But in the study the significant outperformance has made a statement in itself that with a steady fund flow in these sets of funds even more prominent outperformance could be seen.

One interesting finding came out of this study by the researcher is despite following the same methods of selecting stocks for an Index generation & maintenance, the returns across the Shariah Indexes (S&P CNX Shariah, Nifty Shariah & BSE TASI Shariah) in India are substantially different. The study suggests that there is a further scope of research.

## 5. Conclusion & Recommendation

The current allocation to Shariah compliant fund may be miniscule, but the outperformance is visible in the study. The highest number of Shariah compliant stocks is in Indian Indexes, compared to any other Islamic nations.

Again India being a part of BRIC is considered as one of the favoured destinations among the Foreign Institutional Investors (FII). So, technically speaking it can be concluded that Shariah in India is in its infancy, but with a promise of a glorious future ahead. It is recommended by a researcher that as an investor one could passively invest in the BSE TASI Shariah 500 index, so, an ETF tracking the index is recommended. Here the researcher wants to inform that Benchmark Goldman Sachs Shariah ETF is tracking the other Index, which is S&P CNX Shariah 500.

Investor awareness is recommended by the researcher. Though it may be a certain religious fund, but can be a part of any portfolio, as a risk adjusted investment vehicle. When Systematic Investment Plan started it was unknown to a common retail Indian investor, but, now after 15 years later the story is completely different.

Similarly with Shariah compliant stocks and funds a dedicated set of customer awareness initiative is recommended.

This study does aim to highlight Shariah compliant investments as an asset class, solely from a returns and coverage point of view without any geo-political or religious comment.

## 6. Limitations of the Study

This study is carried out within the economic domain of the Union of India. Only two indices are compared with the existing Shariah Indices in a time frame of 3 Years. Since, it is a new walk of study, so, data availability is limited. The study also does not intend to focus on the detailed sector specific study across varied sectors. This study is limited to existing Shariah Models of Index. Focussed group study of Islamic investors could bring a lot of primary data (which was not within the boundary of this study).

## 7. Scope for Further Research

Scope of further study is huge as the three dimensional analysis can be carried out. First being the time span, second being the sector analysis and third being comparing with more non Shariah Indices. A new model or Index with a new focus can be constructed.

The % holding of stocks within these Shariah Indices are different, and that leads to the outperformance. Identification of that could open floodgates of Research ideas. TASI, Mumbai are currently undergoing a lot of similar kind of studies.

## 8. References

1. Crisil Young Thought dissertation by Soumik Majumdar
2. Islamic Asset Management- Forming the future for Shariah compliant Investment by Sohail Jaffer
3. Stability of Islamic Finance: Creating a resilient financial environment for a secure future by Hossein Askari, Zamir Iqbal, Nouredine Krichene & Abbas Mirakhor
4. Bloomberg
5. Moneycontrol- CNBC TV-18
6. India Times
7. Business Today
8. BSEINDIA

## 9. Teaching Notes

- Understanding the basis of Islamic Investment
- Impact of "Interest Factor" in Islamic Investment
- To know the forbidden sectors for investment in the view of Islamic Law
- To understand the choice difference within Shariah Indices
- To notice the GAP in outperformance among Shariah Indices, despite the same LAW governing them all

## 10. Key Take Away

Being in such a diverse Country like India, different methods of Investments are available. But even within the similar set, governed by the similar pattern of rule the outcome could be completely different. Purely from a Investment perspective also, people can take

part in Shariah Funds, even being non-Muslims. Here this method is working as a Hedge against the possible Capital Market volatility.

**11. Identification Of Intended Course**

Finance, Behavioural Finance, Wealth Management, Portfolio Planning

**12. Suggested Student Assignment**

- To study the Correlation between different Shariah based Indices.
- To identify the % holding difference in Stocks within those Shariah based Indices, that eventually leads the Indices to Outperformance.

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<sup>ii</sup> (Source is All Bees presentation from Goldman Sachs<sup>ii</sup>).

<sup>ii</sup> <http://www.tasis.co.in/>

<sup>ii</sup> Links are provided as footnotes