

Creating Value- Reshaping the Present Financial System

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ABSTRACT

The present financial system is indulged in creation of money instead of value. This is being done through creation of debt and bidding up of assets values in the financial markets. In the backdrop there are some important questions which are to be answered. Firstly, are the money and capital markets working correspondently to their ability of generating real goods and services? Is the growth rate (real) of a country is reciprocal to the finances being applied? Is the requirement of goods and services of whole world population being met? The answer to all these and similar questions is in negative. The situation is forcing us to look into a new financial system. Further there is a dire need that we should develop new financial institutions which may create value instead of creation of credit and money. One of the important characteristics of Islamic financial system is that it creates values through creation of more and more good and services. If we want financial institutions to create value we should shift to Islamic financial system. One of the examples is venture capital which is based on Islamic concept of “*Mudarabah*”. We are well aware that one of the main reasons of USA present industrial and technological development is venture capital. However, it is very painful that so far the Muslim world has almost ignored it. Unfortunately so far our efforts are to make some how the unlawful/undesirable western commodities acceptable through Islamic coating. In this paper an effort is being made to look into a financial system, which can produce value instead of money, based on Islamic Principles of finance.

KEY WORDS: Creation of Value, Maximization of wealth of Society and Islamic financial system

1- INTRODUCTION

“Recognition of finance as a central determinant of accumulation in the development process of a capitalist economy dates back to the works of Hilferding, Keynes, Schumpeter, and Kalecki “[11]. “Common to their different theories was the vision of the economy as a sequential process where credit needs to be extended to enterprises and money advanced to workers, for production, investment and exchange to be possible” [9]. However, unfortunately the expectations attached with this vision are not being met.

“The present financial system in the world is involved in creating money instead of value. There are two common ways to create money without creating value. One is by creating debt. Another is by bidding up assets values. The global financial system is adept at using both of these devices to create money delinked from the creation of value” [22]. “Over the last twenty-five years, the link has been studied more systematically by *monetary circuit theory*, which analyzes the properties of the circuit process of a monetary production economy where money is created through credit by banks and provides unique (transaction) services “[11]. However, the global financial system in hand, which is based on interest plus corporate form of organization, has brought no positive change in the life of humanity instead it has made it miserable for the masses.

There are some important questions in front of financial world. Firstly are the money and capital markets working correspond to their ability of generating real goods and services? Is the growth rate (real) of a country is reciprocal to the finances being applied? Is the requirement of goods and services of whole world population being met? The answer to all these and similar questions is in negative. Unfortunately the finances are not being used with the objective of creation of value to its full capability. There is no doubt that in such a way the objective of maximization of wealth is being met (This is also debatable in view of present corporate governance issues). But a million dollar question here is that in what

shape? In my opinion the objective of maximization of wealth can not be met until correspondently equivalent goods and services are not created by the money. the ideal situation is that 100 US \$ should create a real value of US\$ 100 at least if not more. The market price of a share at a stock exchange should be correlated to the net worth of a company and its value of goods and services produced. Korten [22] in his book “When the Corporation Rule the World” rightly observed as follows:

“The link between money making and value creation has become even more tenuous. From \$ 1.5 to \$2 trillion dollars now change hands daily in the world’s foreign exchange markets. Only some 2 percent is related to trade in real goods and services. In January 2000, before a market correction brought many high tech stocks back down near earth, 170 Internet firms that had gone public since 1995 had a combined stock market valuation of \$600 billion on total revenues of only \$ 8 billion.”

He further observed:

“From 1990 to 1999, the market value of world output (GDP) increased by 129 percent from \$ 31.4 to 40.5 trillion (in constant 1998 dollars). During the same period the total capitalization (market value) of global stock markets rose by 293 percent from \$ 9.4 trillion to \$ 27.5 trillion.”

In the present financial system there is no equilibrium (symmetry) between the process of creation of money and creation of welfare for the whole humanity in the world. “The modern banking system manufactures money out of nothing. The process is perhaps the most astounding piece of sleight of hand that was ever invented. If you want to be slaves of the bankers, and pay the costs of your own slavery, then let the banks create money” [28]. The world is heading toward a situation where a few hands will hold the whole world economy through effective, efficient and advanced scientific mechanisms of control [5]. There is no doubt that the present corporate sector is mainly responsible for this situation however, unfortunately the present financial system having the attributes as discussed, is also principally responsible for this situation. The present trend of the economy in the world has made the future of mankind very dark. Now what is emerging in the world would be equally harmful for other communities and not for the Muslims only [5].

The financial system based on Islamic teaching can play a vital role in the back drop of evolving a new financial system to produce real economies through creation of value. In terms of conventional economics it is said that wants are unlimited whereas the resources which will satisfy these are limited. While the Islamic teachings on the one hand keep wants within limits, discourage wastage of resources and motivate care for the others but on the other hand it strongly promote to produce more and goods and services as Allah has created unlimited resources. These are the underlined principles for a financial system based on Islamic teachings. All the specific modes of financing the business activities prescribed under Islamic teachings like “*mudarabah*”, “*musharakah*”, “*salam*” and “*Istisna*” and non specific indirect financing arrangements like Ijarah and credit sale all directly or indirectly involved in producing goods and services. One of the most important characteristics of Islamic financing is that it is an asset-based financing [31]. The owners equity created on these ingredients will give stable net worth to the business units which will not only lead to proper valuation of firms but also brings stability in the financial markets. The prices of investments in these markets would be correlated to the performance of firms in terms of real creation of value instead of bubbles.

The Ribah free financial system of Islam specially based on the concepts of “*mudarabah*” and “*musharakah*” can bring a revolution in the world through creating real goods and services. Just imagine if there is a financial system which create goods like infrastructure, refineries, machinery, equipment etc. and services like health, education, communication compatible to finances used instead of simply creating credit; what would be the real growth rate of a country. Similarly if investment in capital market is directly related to the value of net worth and good and services produced by the companies, what would be the scenario of industrial development on the horizon of the world? Instead of meeting the objective of maximization of wealth through a number game a course to maximize it through correspondent increase in value should be the line of action. Normally in business language we talk in terms of efficiency and effectiveness. The same should be the criteria for creation of value by the creation of money.

The answer to this situation is to look for a new financial system which correspondently creates value instead of money only. One of the most important characteristics of Islamic financing is that it is an asset-based financing [31].The importance of financial system on the basis of Islamic Principles in the modern

world can be judged from the fact that concept of venture capital is based on its concept of “*mudarabah*”. We all are well aware that one of the main causes of USA industrial development is venture capital. “I suggest that a major, although not the only, difference between the U.S. economy and those of the other nation states with which we compare ourselves lies in a confluence of happy factors, some created by design and some serendipitous, which came together after World War II, under the heading of “Venture Capital” [9].

Much of the recent public attention on corporate governance has been focused on corporate accounting scandals and their prevention [16]. The new financial system having the attribute of creation of value will be an automatic check on the practice of earning management as the price of shares of a company in the market would be related correspond to its net worth and value of goods and services produced. As such it will also be helpful in addressing the issues of corporate governance.

2- LITERATURE REVIEW

Money is a great invention of humanity and had edge in a lot of aspects over barter system. However, the journey of money from gold and silver coins to present form of paper currency hidden much of its benefits. “Why is there money? Is one of the classic issue in the foundations of economy theory, with contributions extending from Smith’s *Wealth of Nations*, to present money, like written language and the wheel, is one of the fundamental discoveries of civilization. Nevertheless, the evident of superiority of money trade over the inconveniences of barter, there is counterintuitive --- superficial irrational --- quality to monetary exchange” [28]. The actual issue now is that money carries no value and its irrational manufacturing is being done with this attribute. The present monetary system, which is based on interest (*riba*), is a main player of this game.

“Commercial banks create money from nothing and lend it to society at interest. Whereas in the past the state issued gold coins and banks issued paper receipts, today it is the state that issues paper notes and electronic balances through the medium of the central bank, whilst the commercial banks use chequing facilities and accounts in order to pursue their own money creating activities. In the monetary systems of the modern economies, the majority of money supply is created by the commercial banking system” [13].

The money, financial instruments, financial markets, financial institutions and central bank are five (5) parts of financial system [12]. However, money is the focal point of present financial system. Money once consisted of gold and silver coins, which were eventually replaced by paper currency, which today is being eclipsed by electronic transfers [12]. “Today, any widely used form of money is denominated in a given currency. By sharing a currency, the individuals of a community have in common a measure of economic value, a means to store value, and a set of instruments and procedures to transfer this value. However, since the value of money lies in trust, there can be no absolute guarantee that confidence in the currency can be preserved overtime” [8]. Actually the other parts of financial system, as discussed above, are *inter-alia* working at the backdrop to keep the confidence intact. However, keeping the trust unhurt is itself a very delicate process and subject to many risks.

It is discussed earlier that the present global financial system is creating money without creating value. As such the manufacturing of money in this way has no correlation with real growth rate. Baye and Jansen [10] tested and held the following three (3) propositions:

- 1- In the long run, an increase in the growth rate of money will lead to an equal increase in the growth rate of nominal GDP.
- 2- In the long run, an increase in the growth rate of money will lead to an equal increase in the inflation rate.
- 3- In the long run, an increase in the growth rate of money will not lead to any change in the growth rate of real GDP.

Other examples of creation of money without creation of value are capital markets. “Most of the \$800 billion in currency that is traded ... goes for very short-term speculative investments---from a few hours to few days to a maximum of a few weeks That money is mostly involved in nothing more than making money.... It is money enough to purchase outright the nine biggest corporations in Japan---overvalued though they are---including Nippon Telegraph & Telephone, Japan’s seven largest banks, and Toyota Motors...It goes for option trading, stock speculation, and trade in interest rates” [20].

This brings a big question mark in valuing a firm itself. An Investor Roundtable under title “From Stock Selection to Portfolio Alpha Generation: The Role of Fundamental Analysis”, sponsored by Columbia University’s Center for Excellence in Accounting and Security Analysis, was held on December 08, 2005[7]. The following points of experts attending the roundtable are worthwhile to be noted:

“All of you use information from both financial statements and other sources to evaluate the longer-run economic performance of a company. You then assess whether the inherent economic value is reflected in the current stock price. But, in making this assessment, your focus is not on coming up with a precise valuation, but on identifying large price-to-value gaps and the risks associated with the valuation estimates. The higher a company’s sustainable returns above the cost of capital, the more it is worth “

(Lacey)

“Having said that, our discussion today has not articulated a persuasive, broadly applicable, deep-dive fundamental analysis. Nor have the academics. That really is a question of how to handle the information, of how to convert business activity to numbers that provide a better guide to value. For example, strategy is important, but strategy must be translated to value, as Michael Mauboussin insists—otherwise we are in danger of speculating too much about the value in strategies. In my mind, that must be done through hard accounting numbers. Call it accounting for value”.

(Penman)

The creation of money without creation of value by the banks and stock exchanges produces speculative prices of shares ignoring the ground realities thus resulted in frequent market crashes which resulted in losses of trillion of dollars. Wilmarth [36] in his article “Does Financial Liberalization Increase the Likelihood of a Systemic Banking Crisis? Evidence from the Past Three Decades and the Great Depression, has taken a good stock of reasons of banking crises. One of the main reasons of these crises is creation of money without creation of value as being discussed here. He writes:

“More than 130 countries encountered serious banking problems during 1980-96, and East Asia and Russia experienced devastating banking crises in 1997-98. In many nations, financial crises occurred in conjunction with a boom-and-bust cycle in the general economy. In reviewing such crises, analysts frequently concluded that a poorly-supervised deregulation of the banking sector had encouraged financial institutions to pursue aggressive lending and investment policies, thereby creating an unsustainable economic boom. In many cases, a rapid growth in financing was linked to speculative valuations of illiquid assets (e.g., real estate and corporate securities) that banks used for investments or as collateral for loans.”

In Japan we have seen such crises in 1980 which was again due to irrational lending (i.e. without creating value). This in return created a bubble economy. “The Bank of Japan tightened its monetary policy significantly in 1990 to discourage further expansion of the “bubble economy.” In response to more restrictive credit conditions, the Japanese real estate and stock markets both collapsed in the early 1990’s, with values in each sector falling by more than two-third” [36].

United States is not an exception to such crises. The collapse of high-tech and telecom stock prices triggered a broad downturn in U.S. equity markets during 2001-02 [36]. “Between March 2000 and September 2002, the NASDAQ market index (representing primarily the stocks of high-tech and telecom firms) fell by more than three quarters, while the broader S&P 500 index declined by almost one-half. In the process, investors lost an estimated \$8 trillion in paper wealth” [36]. The Europe economy is also the victim of creation of money without value. Like their U.S. counterparts, European equity markets experienced a prolonged slump in 2000-02 [36].

When the prices in stock market are deviated with the basic fundamentals it creates bubbles instead of value. When these bubbles grow large enough, especially when they lead to crashes, the stock market can destabilize the real economy [10]. Even the fundamentals which are said to be determined the stock prices are debatable.

Jensen [16] has given a very good view of value creation. He states:

“Even though the single objective will always be a complicated function of many different goods or bads, the short answer to the question is that 200 years’ worth of work in economics and finance

indicate that social welfare is maximized when all firms in an economy attempts to maximize their own total firm value. The intuition behind this criterion is simple: that value is created—and when I say “value” I mean “social” value—whenever a firm produces an output, or set of outputs, that is valued by its customers at more than the value of the inputs it consumers (as valued by their suppliers) in the production of the inputs. Firm value is simply the long-term market value of this expected stream of benefits.”

At least this should be the criteria. However, unfortunately this is not being practiced in letter and spirit. Stakeholder theory plays into the hands of special interests that wish to use the resources of corporations for their own ends [19]. “By analogy, capital may be viewed as “energy” for the world of economics and finance as compared with “energy” as applied to the worlds of chemistry and physics. Continuing with this analogy, value represents a concentration of energy (capital) in objects” [14]. This is a very good argument in favour of capital as it will in return create energy for the humanity in the shape of goods and services. However, capital consist of bubbles instead of value have no energy and thus can not perform as it should be.

Both money and capital markets in the present form are mainly responsible for financial crises. As it is rightly observed [15], we have not learnt enough lessons to take corrective actions to prevent future financial crises. The bailout packages by the government cannot stop such crises. There is a need of major shift in economic and financial policies to stop such happenings again and again.

“Financial sector reform has gained center stage in current international economic policy debates” [11]. “The field of finance, until recently, had the following central paradigms: (i) portfolio allocation based on expected return and risk (ii) risk-based assets pricing models such as the CAPM and other similar frameworks, (iii) the pricing of contingent claims, and (iv) the Miller-Modigliani theorem and its augmentation by the theory of agency”[30].Corporate managers now face a period where a new economic framework that better reflects value and profitability must be implemented in their companies[35]. The value of a firm in lines with the aim of the owners of wealth maximization is normally measured by various value based methods. These approaches are economic value added (EVA), market value added (MVA), return on invested capital, and cash flow return on investment [27]. Weissenrieder [31] has insisted on a “Value Based Management” economic framework for companies based on Economic Value Added, Cash Value Added, Cash Flow Return on Investment and Shareholder Value Analysis. As noted by Khanna and Palepu (1999), “managers need to make a fundamental shift in their strategic orientation from growth now, profitability later to profitable growth now. That is growth should not be the input to strategic planning but the outcome of sound investment strategy that is geared to accepting value-creating projects”[27]. “A basic question that arises from the literature is whether managers dealing with an irrational market, or whether a rational market dealing with irrational managers, or both” [30].

However, when we talk about value we ignore the hard fact that it is very speculative and based on paper money instead of real value. Performance of a firm should be linked with creation of assets not with creation of money without any real value. On the one hand we are using worth less money in a very speculative way to get ownership of companies having some sort of assets which are being used in generation of real good and services. On the other hand the worth less money is creating more worth less money instead of value consist of goods and services. This status of money has nothing to do with the increase of real value of firms and hence will leave no impact on real economic growth rate. So here the core fact is being established that money without any value will correspondently create money without value. This is what we are exactly talking about. We need such type of mode of creation of money which itself have real value and create real value when it is used as capital.

Quran advise us to lead the depressed humanity to a prosperous future through Its guidance and practice as follow:

“And strive hard in Allah’s Cause as you ought to strive (with sincerity and with all your efforts that His Name should be superior). He has chosen you (to convey His Message of Islamic Monotheism to mankind by inviting them to His religion, Islam), and has not laid upon you in religion any hardship, it is the religion of your father Ibrahim (Abraham) (Islamic Monotheism). It is He (Allah) Who has named you Muslims both before and in this (the *Qur’an*), that the Messenger (Muhammad SAW) may be a witness over you and you be witnesses over mankind! So perform AsSalat (Iqamat-as-Salat), give Zakat and hold fast to Allah [i.e. have confidence in

Allah, and depend upon Him in all your affairs] He is your Maula (Patron, Lord, etc.), what an Excellent Maula (Patron, Lord, etc.) and what an Excellent Helper!"

(Surah Al-Hajj Verse 78) [25]

In Islam the validity of paper money is debatable. What is the fiq position of note? In this respect the scholars have different views [30]. "As compared to capitalism, Islam treats money as medium of exchange and a store of value but not as a commodity, since money by itself cannot perform any function. It becomes useful only when it is exchanged into a real asset or when it is used to buy a service" [21]. Diwany [13] has suggested Conversion of state issued fiat money into commodity money undertaken at market prices using a selected commodity or set of commodities as the new monetary medium "In Islam money has been accepted as a factor of production but its reward is not pre-determined or insured. Instead it is contingent on the result of production" [20]. "The fact that *zakah* is charged on monetary assets suggest that money has been treated as a factor of production as well. It has the potentiality to grow and create more value" [20]. The controversy basically rests, to a very large extent on three concepts which, if clarified, should be helpful in resolving the differences. These three concepts are given below: [34]

- (i) the Islamic concept of money and the position of paper currency;
- (ii) the Islamic position regarding the value of money; and
- (iii) the position of the Shari'ah on the index-basket.

Here our focus is not to validate the paper money or otherwise in terms of Islamic teachings. However, the money in the present form having no value at the background and actively involved in production of more money based on *riba* without any reference to creation of value is subject to a big question mark. We should not forget that the basic ingredient of present financial system is money. Hosein has very rightly advised that "Muslims should now lead the rest of the world in creating markets in which silver Dirhams would be used as the medium of exchange"[17].

There has been large-scale growth in Islamic finance and banking in Muslim countries and around the world during the last twenty years [38]. A significant trend in global finance over the last 15 years has been the rapid growth of Islamic banking and finance (IBF), which has gathered momentum to become a significant feature of the financial landscape in the twenty-first century [26] As we know that presently Islam is the fattest growing religion in the world. Similarly Islamic banking and finance has got momentum in the last few years through special windows in the commercial banks or separate banks. On the one hand the Muslim governments and business men has now a great interest to look for Islamic mode of finance in addition to conventional banking. On the other hand the non-Muslim communities, specially the business circles, are now in race to capture also the business of Muslim community who are or be interested in Islamic banking and finance.

Related to Islamic finance notably the world has now institutions like Islamic Financial Service Board (IFSB) and Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). "However, a complete Islamic financial system with identifiable instruments and markets is still at an early stage of evolution. Many problems and challenges relating to Islamic instruments, financial markets, and regulation must be addressed and resolved" [38].

Unfortunately so far our efforts are to make some how the unlawful/undesirable western commodities acceptable through Islamic coating. This is wrong and cause of our failure [6]. We are trying to Islamize the present financial system, based on *riba*, instead of evolving our own financial system through following the teachings of Quran and Sunnah. We have noted earlier that in the Quran Allah advised us "And strive hard in Allah's Cause as you ought to strive (with sincerity and with all your efforts that His Name should be superior) (Surah Al-Hajj Verse 78) [25].

Similarly we have role models of Sahabah and Caliphs (Radi Allahu un-huma) who have practiced Islam in all phases of life. Unfortunately we are not benefiting from their professionalism. Normally it is said that there was no business environment at that time like we have now due to industrial revolution and advancement of science and technology. Obviously an answer to this is that when and how the present banking system was emerged? We know that it was started by the gold smiths and they were the earlier bankers. Likewise the Islamic financial institutions may assume the role of trade houses in lines with true spirit of "*Muharabah*". Although it is a hard fact that what the community has finally gets out of this so called land mark achievement? "People who celebrate technology say it has brought us an improved standard of living, which means greater speed, greater choice, greater leisure, and greater luxury. None of these benefits informs us about human satisfaction, happiness, security, or the ability to sustain life on earth" [24].

Here a big question in front of Muslim Ummah is that why not we take our own start through copying Sahabah and Caliphs (Radi Allaho un-huma). Our aim should be to develop different disciplines which ultimately replace present theories and practices in the "exploitation oriented business world" so that the non Muslim may also benefit. We may not use the words like Islamic finance, Islamic accounting, Islamic marketing, Islamic trade and management etc. Our work should be of such nature that the non Muslim world should be obliged to embrace these disciplines similar to present situation that we have adopted their theories and practices.

I think that as a starting point, for discussion and research regarding evolving a new financial system in lines with Islamic teaching, we can take the Islamic concept of settlement in trade. We may call it "Principle of Equal Settlement". The study of this principle can not only give us a good start for evolving a new financial system but we can also discuss it in the context of development of a new accounting theory based on Islamic principles (specially in view of so called inherited characteristic of valuation of conventional accounting) and other management theories.

3- Principle of Equal Settlement and Value Creation- The Methodology

The principle is based on the Islamic concept of "*bay*" and was discussed in detail earlier [3]. Here some Hadith are presented to understand the concept of settlement of transactions in "*bay*":

Narrated Abu Said Al-Khudri and Abu Huraira:

"Allah's Apostle employed someone as a governor at Khaibar. When the man came to Medina, he brought with him dates called Janib". The Prophet asked him, "Are all the dates of Khaibar of this kind?" The man replied, "(No), we exchange two Sa's of bad dates for one Sa of this kind of dates (i.e. Janib), or exchange three Sa's for two." On that, the Prophet said, "Don't do so, as it is a kind of usury (Riba) but sell the dates of inferior quality for money, and then buy Janib with the money". The Prophet said the same thing about dates sold by weight. (See Hadith No. 506).

(Bukhari: Book 3: Volume 38: Hadith 499)[18]

Narrated Abu Said al-Khudri:

"Once Bilal brought Barni (i.e. a kind of dates) to the Prophet and the Prophet asked him", "From where have you brought these?" Bilal replied, "I had some inferior type of dates and exchanged two Sas of it for one Sa of Barni dates in order to give it to the Prophet; to eat." Thereupon the Prophet said, "Beware! Beware! This is definitely Riba (usury)! This is definitely Riba (Usury)! Don't do so, but if you want to buy (a superior kind of dates) sell the inferior dates for money and then buy the superior kind of dates with that money."

(Bukhari:: Book 3 :: Volume 38 :: Hadith 506) [18]

Narrated Abu Al-Minhal:

"I used to practice money exchange, and I asked Zaid bin 'Arqam about it, and he narrated what the Prophet said in the following: Abu Al-Minhal said", "I asked Al-Bara' bin 'Azib and Zaid bin Arqam about practicing money exchange. They replied, 'We were traders in the time of Allah's Apostle and I asked Allah's Apostle about money exchange. He replied, 'If it is from hand to hand, there is no harm in it; otherwise it is not permissible."

(Bukhari :: Book 3 :: Volume 34 :: Hadith 276) [18]

Narrated Abu Said Al-Khudri and Abu Huraira:

"Allah's Apostle appointed somebody as a governor of Khaibar. That governor brought to him an excellent kind of dates (from Khaibar)". The Prophet asked, "Are all the dates of Khaibar like this?" He replied, "By Allah, no, O Allah's Apostle! But we barter one Sa of this (type of dates) for two Sas of dates of ours and two Sas of it for three of ours." Allah's Apostle said, "Do not do so (as that is a kind of usury) but sell the mixed dates (of inferior quality) for money, and then buy good dates with that money."

(Bukhari :: Book 3 :: Volume 34 :: Hadith 405) [18]

"Malik b. Aus b. al-Hadathan reported: I came saying who was prepared to exchange dirhams (for my gold), whereupon Talha b. Ubaidullah (Allah be pleased with him) (as he was sitting with 'Umar b. al-Khattib) said: Show us your gold and then come to us (at a later time). When our servant would come we would give you your silver (dirhams due to you). Thereupon 'Umar b. al-Khattib (Allah be pleased with him) said: Not at all. By Allah, either give him his silver (coins). or return his gold to him, for Allah's Messenger (may peace be upon him) said: Exchange of silver for gold (has an element of) interest in it. except when (it is exchanged) on the spot; and wheat for wheat is an interest unless both are handed over on the spot: barley for barley is interest unless both are handed over on the spot; dates for dates is interest unless both are handed over on the Spot"

(Muslim :: Book 10 : Hadith 3850) [18]

“The Apostle of Allah (peace_be_upon_him) said: Gold is to be paid for with gold, raw and coined, silver with silver, raw and coined (in equal weight), wheat with wheat in equal measure, barley with barley in equal measure, dates with dates in equal measure, salt by salt with equal measure; if anyone gives more or asks more, he has dealt in usury. But there is no harm in selling gold for silver and silver (for gold), in unequal weight, payment being made on the spot. Do not sell them if they are to be paid for later. There is no harm in selling wheat for barley and barley (for wheat) in unequal measure, payment being made on the spot. If the payment is to be made later, then do not sell them. “

(Dawud :: Book 22 : Hadith 3343) [18]

“Abu Nadra reported: I asked Ibn Umar and Ibn Abbas (Allah be pleased with them) about the conversion of gold with gold but they did not find any harm in that. I was sitting in the company of Abd Sa'id al-Khudri (Allah be pleased with him) and asked him about this exchange, and he said: Whatever is addition is an' interest. I refused to accept it on account of their statement (statement of Ibn 'Abbas and Ibn 'Umar). He said: I am not narrating to you except what I heard from Allah's Messenger (may peace be upon him). There came to him the owner of a date-palm with one sa' of fine dates, and the dates of Allah's Apostle (may peace be upon him) were of that colour. Allah's Apostle (may peace be upon him) said to him: Where did you get these dates? I went with two sa's of (inferior dates) and bought one sa' of (these fine dates), for that is the prevailing price (of inferior dates) in the market and that is the price (of the fine quality of dates in the market), whereupon Allah's Messenger (may peace be upon him) said: Woe be upon you! You have dealt in interest, when you decide to do it (i. e. exchange superior quality of dates for inferior quality) ; so you should sell your dates for another commodity (or currency) and then with the help of that commodity buy the dates you like. Abu Sa'ad said: When dates are exchanged for dates (with different qualities) there is the possibility (of the element of) interest (creeping into that) or when gold is exchanged for gold having different qualities. I subsequently came to Ibn 'Umar and he forbade me (to do it), but I did not come to Ibn 'Abbas; (Allah be pleased with them). He (the narrator) said: Abu as-Sahba' narrated to me: He asked Ibn Abbas (Allah be pleased with them) in Mecca, and he too disapproved”

(Muslim :: Book 10 : Hadith 3875) [18]

Yahya related to me from Malik from Abdullah ibn Dinar from Abdullah ibn Umar that Umar ibn al-Khattab said, "Do not sell gold for gold except like for like. Do not increase part of it over another part. Do not sell silver for silver except like for like, and do not increase part of it over another part. Do not sell some of it which is there for some of it which is not. If someone asks you to wait for payment until he has been to his house, do not leave him. I fear rama for you." Rama is usury.

(Malik :: Book 31 : Hadith 31.16.35) [18]

Narrated Ibn Shihab:

“that Malik bin Aus said, I was in need of change for one-hundred Dinars. Talha bin 'Ubaid-Ullah called me and we discussed the matter, and he agreed to change (my Dinars). He took the gold pieces in his hands and fidgeted with them, and then said”, "Wait till my storekeeper comes from the forest." 'Umar was listening to that and said, "By Allah! You should not separate from Talha till you get the money from him, for Allah's Apostle said, 'The selling of gold for gold is Riba (usury) except if the exchange is from hand to hand and equal in amount, and similarly, the selling of wheat for wheat is Riba (usury) unless it is from hand to hand and equal in amount, and the selling of barley for barley is usury unless it is from hand to hand and equal in amount, and dates for dates, is usury unless it is from hand to hand and equal in amount'”

(Bukhari :: Book 3 :: Volume 34 :: Hadith 382) [18]

Narrated Abu Said Al-Khudri:

“Allah's Apostle said, "Do not sell gold for gold unless equivalent in weight, and do not sell less amount for greater amount or vice versa; and do not sell silver for silver unless equivalent in weight, and do not sell less amount for greater amount or vice versa and do not sell gold or silver that is not present at the moment of exchange for gold or silver that is present. “

(Bukhari :: Book 3 :: Volume 34 :: Hadith 385) [18]

“Abil Qiliba reported: I was in Syria (having) a circle (of friends). in which was Muslim b. Yasir. There came Abu'l-Ash'ath. He (the narrator) said that they (the friends) called him: Abu'l-Ash'ath, Abu'l-Ash'ath, and he sat down. I said to him: Narrate to our brother the hadith of Ubada b. Samit. He said: Yes. We went out on an expedition, Mu'awiya being the leader of the people, and we gained a lot of spoils of war. And there was one silver utensil in what we took as spoils. Mu'awiya ordered a person to sell it for payment to the people (soldiers). The people made haste in getting that. The news of (this state of affairs) reached 'Ubada b. Samit, and he stood up and said: I heard Allah's Messenger (may peace be upon him) forbidding the sale of gold by gold, and silver by silver, and wheat by wheat, and barley by barley, and

dates by dates, and salt by salt, except like for like and equal for equal. So he who made an addition or who accepted an addition (committed the sin of taking) interest. So the people returned what they had got. This reached Mu'awiya. and he stood up to deliver an address. He said: What is the matter with people that they narrate from the Messenger (may peace be upon him) such tradition which we did not hear though we saw him (the Holy Prophet) and lived in his company? Thereupon, Ubida b. Samit stood up and repeated that narration, and then said: We will definitely narrate what we heard from Allah's Messenger (may peace be upon him) though it may be unpleasant to Mu'awiya (or he said: Even if it is against his will). I do not mind if I do not remain in his troop in the dark night. Hammad said this or something like this."

(Muslim :: Book 10 : Hadith 3852) [18]

"Ubida b. al-Simit (Allah be pleased with him) reported Allah's Messenger (may peace be upon him) as saying: Gold is to be paid for by gold, silver by silver, wheat by wheat, barley by barley, dates by dates, and salt by salt, like for like and equal for equal, payment being made hand to hand. If these classes differ, then sell as you wish if payment is made hand to hand."

(Muslim :: Book 10 : Hadith 3853) [18]

These are few Hadith which tell us that how certain few business transactions are to be settled. We may call this "Principle of Equal Settlement and creation of value". As every such transaction is subject to financial impact, this plus other Islamic teachings on riba and Islamic mode of finance like "*musharakah*" and "*mudharabah*" can lay down a solid foundation for a new financial system.

Furthermore through studying the Hadith on the subject initially the following questions which may come to our mind:

- i- Is the definite amount which we are spending on a financial transaction under conventional financial system getting equal value in exchange?
- ii- Is the amount which we are spending with the purpose of getting an equal amount of value under conventional financial system, itself carries the equal value?

Unfortunately the answer to these questions may be pessimistic. However, the search to make the answer to these questions positive may lead in result of a new financial system which entirely change the present scenario of creation of money without creating value. The answers to such question can be searched in the teachings on "*bay*".

The subject matter of "*bay*" is very vast. In Taqreer-e-Tirmizi, which is a set of speeches of famous religious scholar Mufti Taqi Usmani [33] on "*mamalts*", more than fifty chapters has been included under the heading of "*Abwab-ul-Bayu*". In this book important matters related to business, including finance, facing in the present era has been discussed. The matters include riba(interest), gharaar(speculation), installment sale, loan, brokerage, credit, mortgage, money, sale & purchase of share and holding etc. Similarly in the context of "*bay*" some important financial matters like credit & debit cards, insurance, leasing, copy rights, good will, royalty, trade mark and shares has been discussed by Hafiz Zulfiqar Ali in his book "Dur-e -Hazir Key Mali Mamlat Ka Sharai Hukm"[1]. A detailed account of Hadith on "*bay*" has been given in the paper "Exploring "*Bay*" in Search of New Dimensions for Accounting Theory and Standards" [2]. This include 17 chapters from Sahih Bukhari, 6 from Muslim, 5 from Malik, 6 from Dawud and 67 from Jamia Tirmizi.

In nut shell every business transaction which is a result of interaction among stakeholders as stipulated in Islamic teachings comes under the scope of "*bay*". The transactions in "*bay*", as based on Devine Guidance, are carried out in a way that these are settled in a justified manner which in return also creates value. So we may extract a principle of settlement of financial transaction out of the concept of "*bay*" which may be called the "Principle of Equal Settlement and Value Creation" or simply "Principle of Settlement of Transaction in Bay". In the context of developing a new financial system, the concept, can be tested with the religious scholars in lines with "*Usul al Deen*" (Principles of Deen).

4- Findings

We have seen that the present financial system is creating money without creating value correspondently. This resulted improper valuation of firms and hence resulted in stock market crashes which in return not only causes billions of dollars in losses but also have left no progressive impact on production of goods and services and thus on real economic growth is being achieved. In nut shell what to

talk about increasing welfare of mankind it has increased suffering of humanity. So there is a dire need to look for a financial system with create values instead of manufacturing money only. The best answer is to design a new financial system on Devine guidance. Islam is a complete *Deen* (code of life) and the humanity should take advantage of it. Presently in the West (for example Waddock, [34]) itself there is cry for revolutionary changes in the business world.

Before going to design a new financial system we have to go first for a conceptual work. Our bench mark for decision making should to be to please Allah. Similar to defining management [6] our override objective behind this system should be pleasing Allah, The Sole Authority". This dictates the following two (2) basic principles:

- I. Pleasing Allah.
- II. Allah is the Sole Authority.

We can derive a number of concepts out of these two (2) principles [6]. These may be:

- I. Halal Business.
- II. Interest Free Financial System.
- III. Principle of Equal Settlement.
- IV. Musharakah and Mudarabha as mode of finance.
- V. Humanity as a Stakeholder.
- VI. Accountability of all Stakeholders.
- VII. Maximization of Resources for Mankind instead of Maximization of Wealth of Owners.

For inventing a new financial system the above concepts and principles can set our tone of direction. More over, the fear of Allah, key of wisdom and knowledge, should be the core principle at the backdrop of the new financial system. The new financial system should have the following features.

- 1- The foundation of a new financial system which may create value may be kept on the concept of "Equal Settlement" of Islam. This should be the core principle of every financial transaction. This is mainly based on Islamic injunctions regarding sale transactions.
- 2- We should create such institutions which deal in goods and services instead of money having no value. Such institutions should work on the Islamic concepts of "*Mudarabah, Musharakah, Ijarah, Salam and Istisna*".
- 3- We may look for a new system of money creation which carries equal real face value. The government of the country would have the main role in this respect.
- 4- The performance of business may be linked with the creation of goods and services and increase in net worth.

5- Proposed Action Plan

As a first step we may constitute a task force consist of Shariah scholars, accounting & finance professionals, entrepreneurs and government representatives from Muslim Umaha to do home work for creation of a new financial system based on Islamic teachings as discussed. The immediate job of this task force should be to do the ground work and give its recommendations on financial legal and accounting framework for creating such institutions which as a core function deals in purchasing of assets instead of paper money on the basis of Islamic concept of equal settlement as discussed. These will replace present financial institutions. Thus in this way the creation of credit and in result the manufacturing of money would insha-Allah be stopped. The entrepreneurs may get these assets either on rental (*ijarah*) basis or on ownership basis through "*mudarabah*" or "*musharakah*" mode of finance. This may also pay the way for a new form of business organization without having feature of limited liability. The new business form should give a new look of management & ownership relationship based on Islamic teachings. The task force may work under an institution like Islamic Financial Service Board or a new financial institution be created for the purpose.

After doing homework for creation of new financial institutions the implementation responsibilities may be entrusted to the institution under whose command the task force was working. Upon completion of this task successfully by this new institution, another task force can be formed to invent a new form of instrument of exchange replacing present form of money in lines with Islamic teachings. In this respect we should give due thoughts to the suggestions of Diwany [13] regarding commodity money. This instrument

of exchange may work as single instrument in all over the Muslim countries and non-Muslim countries who want to be circulate it in their countries too. Again the implementation responsibility will be vested with the institution under which the task force was working.

While implementing the recommendations of the 2nd task force with the help of governments of Muslim countries the institution will work as a central institution of Muslim Ummah with branch offices in all the Muslim countries and non-Muslims countries who want to embrace the new financial system.

In order to solve the problem of settlement of international transactions with non-Muslim countries, not adopting the new financial system, the exchange may be done through bullion, silver or a commodity like crude oil etc.

While discussing the conceptual work for a new financial system we emphasized the need of replacing the present concept of “maximization of wealth of owners” with “maximization of resources for mankind”. We should also remember that the real owner of all the resources in the world is Allah. And He has entrusted the trusteeship to mankind to use the resources to the human under certain agreement which is subject to some compulsions and guidelines. Naturally if some one is not acting according to the agreement, it is amounting to breach of it and thus he has no more right to use these resources. Keeping in view these facts, the problem of funds for the government for the budget instead of deficit financing and “Qarze-Hassana” can be solved. In addition we should trust the promise of Allah “Allah will destroy RIBA (usury) and will give increase for Sadaqat (deeds of charity, alms, etc.) And Allah likes not the disbelievers, sinners.”(Al-Baqarah. Verse 276)[25].

When the government of a country need of funds he should get it through legitimate means as allowed by Islam instead of printing money so that it may not create miseries to the people. For this purpose we have to follow the practices of era of Mohammad (Sallallohu Alaihe wa Sallam) and Caliph.

6- Conclusion

“People who celebrate technology say it has brought us an improved standard of living, which means greater speed, greater choice, greater leisure, and greater luxury. None of these benefits informs us about human satisfaction, happiness, security, or the ability to sustain life on earth” [24]. So it is high time to think about the welfare of whole humanity instead of certain minority groups. For this purpose we have to abandon the present financial system which create money instead of value and responsible for the present suffering of the humanity. We should have a financial system which creates value instead of simply manufacturing money. The Islamic teachings encourage a financial system which create value. I propose that the foundation of a new system can be kept on the Islamic concept of equal settlement as discussed.

As outlined in the action plan The immediate task in front of us is that an existing institution or a new one may assume the responsibility. The taskforces may be formulated and start their job. The whole process should be run on the basis of Islamic concept of “*shura*”(consultation). Islam has a unique system of counseling to run the affairs of life. We should take a benefit of it in this respect also. In Quran while describing the qualities of “*Muminun*” (believers) it is said that “who (conduct) their affairs by mutual consultation”(Verse 38 Ash-Shura)[25].

The Muslim Ummah has wasted a lot of time (May Allah forgives us). However, for Muslims the doors are open till death to beg forgiveness from Allah. So we should now go for developing a financial system of our own instead of making the present financial beautiful through Islamic coating. This would be equally useful for other communities and hence for the whole humanity. One of the greatest challenges for the twenty-first century would be to develop the vision of an alternative economic order which is free from interest on capital [21]. The submission here, although may have certainly limitations, is an initial effort in this respect. May Allah give us the strength to end the suffering of depressed humanity just to please Him.

In a broader picture it is again emphasized that “our aim should be to develop different disciplines which ultimately replaces present theories and practices in the “exploitation oriented business world” so that the non Muslim may also benefit. We may not use the words like Islamic finance, Islamic accounting, Islamic marketing, Islamic trade and management etc. Our work should be of such nature that the non Muslim world should be obliged to embrace these disciplines similar to present situation that we have adopted their theories and practices” [4].

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