ALTERNATIVE FINANCE. IT IS TIME TO REDEFINE CAPITALISM

PhD. Besarta Tafa*

* Canadian Institute of Technology, Faculty of Economy, Business Administration Department, Tirana, Albania
Corresponding author email address: b.tafa@cit.edu.al

Recently, there is an ongoing increased interest for the notion of Alternative Finance. It is a new concept, but it is becoming widely accepted from the market participants, especially in the financial market. Alternative Finance was first introduced after the financial crisis of 2008. Apparently, the it was thought to be a choice for the problems that the financial crisis caused. Many studies were conducted about the Alternative Finance, showing interesting results about it. Nowadays, more and more countries are using it in parallel with conventional finance. A special part of Alternative Finance is the Islamic Banking. It has a different way of operating from conventional Banking. The bank products are designed to fit a mutual incorporation with shared profits and risks, differing from those of conventional banks. They help their customers by financing their purchases or entering into different investing contracts to make profits.

Considering that it has been a trend recently in almost all the countries, many researchers have intended to further shed light on the idea of Alternative Finance. According to Schoon (2009) the industry of the Alternative Finance has been growing rapidly after the 2000s, while Siddiqui (2014) asserts that it is an industry of trillion dollars with several financial institutions participating. Scholars provide evidence for the expansion of the industry of Alternative Finance, revealing that its strong position in cash is the prevailing factor for its growth. They highlight the fact that many investment funds have adopted this way of making business as their framework of an ethical behaviour.

As far as the banks' capital adequacy is concerned, the studies question the rationale for Alternative banks to have restricted regulation for their capital requirements. The capital requirements should address the issue of liquidity risk for Islamic banks. Those need less capital requirements than conventional banks, since they act as agents on behalf of their depositors who rely on the trustworthiness of the banks' investment decisions in order to collect their money back.

ALTERNATIVE FINANCE FRAMEWORK

Alternative Finance is a way of making financial transactions, based on five principles which are:

1. Disuse of interest. According to the Alternative Finance the financial institution as well as other financial agents undertake money transactions with no interest included. The legitimacy under this principle is that the money itself must not generate money. It is believed that this restriction will eventually bring a more efficient allocation of funds and a more profitable use of them.

2. Profit/Loss sharing principle. According to this principle, all the parties in a contract/transaction must share the profits as well as the losses incurred by an investment. This is done by a predetermined ratio, agreed by all parties. It is much fairer for all, either if the investment results in profits or in losses and no injustice exists.

3. Asset backed transaction principle. The transactions or contracts between parties involved must be based on an underlying asset, which must be real and tangible.

4. Avoidance of uncertainty. This principle does not mean that the investment must not be risky at all. In the financial framework everything is risky and we cannot eliminate it. The meaning is that it must not have uncertainty in the terms of the contract arranged between parties.

ALTERNATIVE FINANCE VS. CAPITALISM

The core of capitalism is the free market economy represented by market forces. The match between the demand and supply is the equilibrium supposed to manifest this free will. However, these forces of capitalism are really put in question. Does it really promote free markets? Can the customers and the employees really express their free will? As most of the capital is accumulated on the hands of a minority, it is a driving force for uncontrolled profits which provide a monopoly system. The monopoly unless, freezing the market forces, will at list inhibit their natural functioning. As such, it is the capitalism pretending to promote the free market, which indeed destroys the natural process of the demand and supply. Alternative finance on the other hand promotes the free market and the law of the demand and supply. The only difference is that this system puts some limits on the operations of the free market. As everyone is free to join the market whether by demand or supply, and the equilibrium is again put on their match, the price that everybody should put on the something of value that he offers, has got some limits. Nobody can enter in a market with a very high profit margin by affecting the demand and supply as well as artificially increasing the price of the commodity. This arbitrary price does not represent the real value of the commodity; as such it creates a bubble which at explosion inevitably creates paralysis in the economy.

One of the main elements of the capitalism today is the use of the interest. The interest is thought to be the price of the money. As such, it reproduces money by the use of money itself. This technique is indeed the most dangerous one. First, it provides no added value in the economy. Second, it is not fair for the saver of the money. Moreover, this process provides a domino effect. As the borrower fails to pay the high interest put by the lender, he/she will acquire additional credits, over which he will pay additional interest. As such the risk of interest rate will continue to spread over all the lenders until making them fail. This is indeed what happened in the crisis of 2008.

Talking about justice, this scheme is unjust for the savers. In capitalism, the banks are the institutions which run this process. They give money to those who need them in return for the interest. First, the banks are not the owners of the money, so they are lending something that they do not own; rather they take in by individuals who might even put it in deposits for their future use. Such funds are used by the capitalists for further increasing their capital. So, they invest in profitable investment opportunities which might provide them huge rate of return. Compared to the rate that the bank turns to these individuals, there is a huge difference. As such, the capitalist exploits those individuals severs to whom it only gives a small proportion of his enormous profit.

The Alternative Finance proposes disuse of interest in lending. Money is only used as a means of exchange. Moreover, the bank enters in an investment as a partner with the entrepreneur. They put on this partnership complementary elements which make it possible the functioning of the business. The return derived by this partnership is then shared among parties according to their agreement. This form of the partnership might also work between many savers who put their money in the bank, and the entrepreneur. The bank in this case works as an intermediary. The profits realized by the partnership should be distributed among all the savers who invest the money in there and the ones who invest the effort.

Another important element in this analysis is the risk. The capitalist who undertakes an investment does not share the risk of this investment with the bank; neither does he share it with the savers who have put their money in the bank. As the capitalist asks for funds in the bank, it imposes an interest rate, based on the market, regardless of the amount of profit that he will generate on this investment. As such, the interest rate is predetermined while the rate of return is not sure yet. In case that the investment fails, the investor should bear all of the risk by himself. The bank or the savers will still take their rate of interest which in this case is lower than the total loss of the investor. As such this scheme is unfair for the investor as well.

According to the Alternative Economy there is no predetermined rate for the money rented to the entrepreneur. There is indeed an agreement between the provider of the funds and the entrepreneur to share every profit that the partnership will generate. As such both of them are partners regardless of what they invest in the common business. Moreover, even if the investment fails, the loss will not be totally bore by the investor. All the parties implemented in the investment will share part of this loss. This is the concept of the risk share promoted by the Alternative Finance. It is fair enough to treat all the parties equal and to avoid unfairness.

Karl Marx said “Capitalism will destroy the ones who invented it”. Apparently, it is time to think of Alternative Finance as a way for redefining the roots of capitalism which has had the greatest impact on the history of Economy.

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AUTHOR BIOGRAPHIES

Besarta Tafa has been a lecturer of Finance and Accounting at the Canadian institute of technology since 2014. Graduated in Finance and Accounting, with an experience as financier in NGO. Holding a PhD diploma in Business Administration from Charisma University, United Kingdom. Research associate at EMAT laboratory, University de Moncton, Canada. Author of the book titled “Islamic Finance, an alternative solution to financial crisis”, published by LAP publishing house, Germany. Author of some journal articles.