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## The Composite Risk-Sharing Finance Index: Implications for Islamic Finance

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### Abstract

In policy-making, assessment of where a country stands relative to other countries is important to achieve desired goals, to understand how much the current policy implementation diverts from the target, and to understand main obstacles on reaching at the ends in the light of the comparators and the benchmark. This study evaluates relative standing of countries with respect to their financial system's friendliness for risk-sharing finance, the concept which forms the core foundation of Islamic finance. A composite risk-sharing finance friendliness index is developed to compare and rank the countries with regard to their level of their support and adoption of risk-sharing finance. Although, there have been attempts to develop such index, this study is novel in the Islamic finance literature in the sense that it brings the factor analysis and non-linear weights into the picture to come up with an objective and convincing composite index with objective weights. The composite index also allows us to look into the relative contribution of components, namely, Institutional Scaffolding, Governance and Legal Environment, Financial Sector Development and Inclusion. The results and ranking of the countries reveal important information about the potential of developing risk-sharing finance and financial products in different countries. The results also reveal that the OIC countries are far away from meeting the basic requirements of setting-up risk-sharing finance and thus a framework for comprehensive development of Islamic finance.

**Keywords:** Risk-sharing, composite index, factor analysis.

**JEL Classification:** C43, D32, D81

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