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- Bowersox, Donald J., Closs, David J., (1996), "Logistical Management." Tata McGraw, Hill, New Delhi.
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ISLAMIC FINANCE – CHALLENGING TIMES: A STUDY ON GROWTH AND SCUFFLE

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CREATIVE HEAD CONSULTANTS
JAIPUR

ABSTRACT

The present-day Islamic finance industry is now in its fourth decade and, during that period, has developed extremely rapidly. In the past few years, overall market growth has been estimated at between 15-20 percent annually although individual Islamic banks have reported even faster growth. The phenomenal growth observed in Islamic finance has prompted to make an attempt to decode and highlight the growth and progress of Islamic Finance. This research paper makes an effort to cover the journey of Islamic Finance and major challenges it has faced in recent times to grow and sustain. In addition to a brief review of the current state of Islamic Finance as well as the challenges it has faced in recent times, market development, expansion and growth of Islamic banking over a period of time, the examination of implications of shariah compliance on the configuration of Islamic finance transactions and financial product development is also undertaken so as to highlight the most salient benefits and drawbacks of Islamic Finance plus an effort has been made to see how Islamic finance grew even in the times when major traditional financial institutions were gasping for breath in altered economic situations.

KEYWORDS

Islamic Banking, Islamic Finance, Shariah Compliance, finance.

JEL CODES

G00, G01, G10, G15, G19, G20.

1. INTRODUCTION

As the world banking industry descends into gloom of receding economic activity, the more ethical, risk-sharing approach offered by the Islamic finance industry is attracting an increasing amount of attention. The little over five decades old discipline called "Islamic Finance" has been devised out of teachings of Islamic and had strong alignment with religious philosophies. Basic tenant is that the whole business and the financial institutions dealing with Islamic finance should pursue their line of business in a way that complies with sharia (Islamic rules) principles. The major ruling aspects of Islamic finance are the prohibition of interest-based transactions, adhering to Halal (Lawful activities) and Haram (Sinful activities) rules, the whole Islamic Finance business should be carried with some degree of risk, i.e. the free-of-risk type of investments are not found acceptable under Islamic business environment. To put simplistically it means the rewarding system under Islamic philosophy is based upon risk taking considerations, and no room exist for gaining financially without exposing oneself to some sort of business or financial risk.

Consequently, the Islamic financial and business institutions should structure their line of business to prescribed guidance, especially the areas of sources and uses of finance. The fact that Islamic institutions have a growing participation in banking business is due to the achievements that they made in last five decades. The hope of capturing the huge benefits that will accrue to Islamic Finance Institutions when they embark on global market expansion along with enlargement of activities makes them more lucrative for traditional financial institutions, though at present Islamic finance institutions might seems to be restricted to only Islamic countries and more strongly focused within the Arabic World, more and more traditional banks and financial institutions are either venturing or making an effort to make inroads into the Islamic finance territory.

2. OBJECTIVES OF THE STUDY

The Proposed study makes an effort to cover following objectives so as to analyse the journey of Islamic Finance Industry since the time of its inception to date and how it chalked out the path of success and key reasons for its current challenges.

1. To understanding the progress of Islamic Finance over the period of time.
2. To Study Contributions made by Islamic Finance in Global Finance Industry.
3. To Analyse how Islamic Finance Industry has performed with time.
4. To Scrutinize key reasons for success and current struggle of Islamic Finance.

3. RESEARCH METHODOLOGY

Presented study is a mix of Explanatory and Descriptive research designs and confirms to the model of qualitative research. Most of the data has been collected via informal interviews of officials working in Islamic Banking sector in UAE, Nigeria, United Kingdom and Few Professors working in Middle East and teaching Islamic Banking. Data Collection Methods were formal interviews and the substantiations has been incorporated by doing large scale table research under laboratory setting by a team of dedicated financial and academic professionals working with Statistical Department of large Europe based consulting firm.

The paper presented here is a synoptic representation of the study hence undertaken to detail out and understand the progress made by Islamic Finance Industry, Its initial phases, struggle, growth, market expansion, product and service expansion, global acceptability and recent challenges that the industry is facing and to make a complete analysis of the historical perspective and to understand various factors that acted for the success of Islamic Finance and changing environmental variables that led to current challenges.

4. ISLAMIC FINANCE (EARLY DAYS)

The prohibition of interest or Riba, as it is called in Islamic Finance - the ethical core of Islamic banking, derives from Islamic law, which is enshrined in the shariah. The word shariah literally means a waterway that leads to a mainstream, a drinking place, and a road or the right path. It is a term that encapsulates a way of life prescribed by Allah for his servants and it extends to every department of daily life, including commerce and financial activities of every kind (Fortune, 2002). Since the advent of Islam dates back to the seventh century, the application of ethical principles that were first established fourteen centuries ago to modern situations and circumstances can be a complex matter (Venardos, 2005). Till date in Middle East law is governed by shariah and so does the finance, all pervasive laws of Islam also covers or applies to investment matters, capital market instruments moreover are applicable to real estate markets and lending.

The classical sources of Islam contain numerous prescriptions that lend themselves to the construction of economic norms, and the religion's early history offers an array of lessons concerning economic behaviour and institutions. But the notion of an economic discipline that is distinctly and self-consciously Islamic is very new. The great philosophers of medieval Islam wandered freely beyond the intellectual confines of the Islamic scriptures furthermore none of their works, not even the celebrated *Prolegomena* of Ibn Khaldun (1332-1406 C.E.), gave rise to an independent discipline of economics. The origins of Islamic economics lie in the works of Savyid Abul-Ala Mawdudi (1903-79), a Pakistani social thinker who sought to turn Islam into a 'complete way of life'. In his writings, Mawdudi exhorted that Islam is much more than a set of rituals. It encompasses, he argued, all domains of human existence, including education, medicine, art, law, politics and even economics.

However, some traditional Islamic economists were quick to admit that in most of those realms the blossoming discipline has yet to make a significant contribution. They all in not so specific terms generally agreed that the fundamental sources of Islam harbor clear and definitive solutions to every conceivable economic problem (Iqbal, 1998). This early view of Islam as solution to major economic and financial problem has made it attractive thus resulting in growth of Islamic finance as an Industry to be recon with.

The impact of Islamization was especially widespread in banking. These developments were not occurring in an intellectual vacuum. A rapidly growing literature known as 'Islamic economics' seeking to guide and justify the ongoing reforms emerged. The prescriptions in this literature rest partly on economic logic and partly on the Quran and the Sunna, the latter consisting of recollections of the words and deeds of the Prophet Mohammed and his companions. Several research centers were established to promote Islamic economics. The exponents of this discipline, who call themselves 'Islamic economists', emphasized that it covers far more than *zakat* and interest-free banking. The discipline aims, they say, to provide a comprehensive blueprint for all economic activity (Kuran, 2004).

It was somewhere in the early 19th century that Muslims realized that the existing system of banking and economy was based on Riba or interest, which is Halal or forbidden in Islam and is categorically banned in all its forms whether earned by commercial or non-commercial means; the thought generated the need for an alternative system that conforms more proximately to the principles of Shariah. The philosophy evolved and the chief project that paved way for an encouraging future of Islamic banking was "Mit Ghamr" in Egypt. In the intervening time, another initiative was taken in the shape of "Tabung Haji" in Malaysia.

A foremost test in instituting Islamic banking was to develop Shariah compliant financial products, services and banking offerings, for the purpose Islamic banks setup Shariah Advisory Committees and Religious Boards, that legitimatized the products and services of the Islamic banks and whose foremost objective was to review whether the products, services and offerings follow the tenets of Shariah.

The undercurrents of Islamic finance industry that began with the formation of the Small Savings Association of Mitghamr (Egypt) in the year of 1963 have covered a wide territory both in operations as well as in geography today. Islamic finance industry has grown exponentially in the last fifty years escalating its vistas and operations in terms of products and region by reaching out to several global markets ranging from Arab countries to Middle-East to Asia besides Europe.

5. ERA OF CONSISTENT GROWTH OF ISLAMIC FINANCE (EARLY 1970S TO 2012)

The number of banks offering Islamic finance instruments had grown fast since the early 1970s and the market reached a size of more than USD200 billion. This is partly because supply grew to meet the demand for Islamic Finance; in part the pressure of funds looking for "halal" (lawful or "clean") investments drove this growth quite ardently. In other words, banks (or trading companies) or financial institutions that were able to propose Islamic finance to their clients gained a competitive edge; and those that tapped into Islamic financing markets obtained relatively low-cost capital due to increased trust and reliability of operations as perceived by Islamic customers. At the same time, banks involved in Islamic finance learned from the structures and techniques developed by their structured finance peers and adapted them for their own purposes so as to gain more access to funding.

From the trivial beginning in Egypt in 1963 it took time for Islamic finance to ultimately evolve to offer complete banking services as an Islamic Bank. The first Islamic Development Bank (IDB) came into existence in 1975. This was a milestone for the Islamic finance. Some countries including Pakistan, Iran, Sudan, Malaysia and Bahrain introduced efforts to undertake Islamic banking at a wider scale in their corresponding countries during 1980s.

In early 1990s some of the conventional banks and financial institutions adopted Islamic Finance. Traditional Banks also started offering Islamic banking products and services by operating separate Islamic banking units and divisions. After the establishment of Islamic banking in countries like Egypt and Malaysia, it became quite apparent that Islamic banking will have a vibrant future. Promptly after the institution of Islamic financial services by the conventional banks, Islamic banking started to make waves and leaving its mark on the global financial landscape. Riding on the high tide Islamic finance attracted several big players as the returns from Islamic way of banking were lucrative and trust of the customers' was high. Quite a few Islamic investment and holding companies were established besides many international and large-scale financial institutions also adopted Islamic financial services in the market portfolio.

The brilliant prospects for Islamic finance also encouraged some conventional banks to embark on the process of converting to Islamic financial institutions. In 2004, the Kuwait Real Estate Bank (KREB) announced that it was converting into a full-fledged Islamic bank. In December 2006, the Central Bank of Kuwait approved KREB's Islamic Banking license, complete with name change to Kuwait International Bank. The future seems to be very exciting for KREB as now they had the high probability to convince traditional or conservative client base by Islamic finance offerings, as well as to solicit potential customers with other conventional bank products.

5.1 QUICK PACE OF PRODUCT DEVELOPMENT AND INNOVATION

Development of markets and growth of investment avenues matured with time and most of the countries involved in Islamic finance worked on development of innovative financial models and instruments. The enthusiasm about Islamic finance has increased manifolds in recent times and even non-Islamic countries have accepted Islamic finance as a formal branch of financial operations and have started to offer Islamic products via their banking structure.

UAE being one of the most developed and open economies of the middle-east acted as a forerunner of Islamic finance. Lot of modernistic financial products was either adapted from west or were developed to suit Islamic financial needs and to cater to the needs of millions of Islamic investors. In addition to Sukuk there are several other investment instruments being offered by Islamic financial institutions today and most were developed in early 2000s. Securitization (structured finance) being no exception was also first introduced in the MENA region by UAE and the country has gone a step forward to bring in lot of innovation in the structured finance to suit Islamic legal mandate.

One thing can be assured that the developments that have taken place in Islamic finance and the phenomenal expansion and augmentation attained in this stream of finance along with continuously growing demand from Muslims for financial products, such as mortgages, real-estate securitization and innovative yet risky investment avenues along with modernistic instruments that comply with their religious beliefs.

5.2 PERFORMANCE OF GLOBAL ISLAMIC SUKUK ISSUES

What could be a better measure to benchmark the demand for Islamic finance than growth in Sukuk? Sukuk being a secured Shariah compliant debt (Bond) has always been considered as an ideal Islamic investment and much demanded by investors. Sukuk being the integral part of Islamic Finance and being primary medium for attracting investment plays a critical role in Islamic Finance. Their consistent rise in terms of volume and value plays a significant role as a leading indicator in tracking the rise in concentration or attentiveness world over in Islamic finance products especially The Sukuk.

FIGURE 1: GLOBAL ISLAMIC SUKUK ISSUE

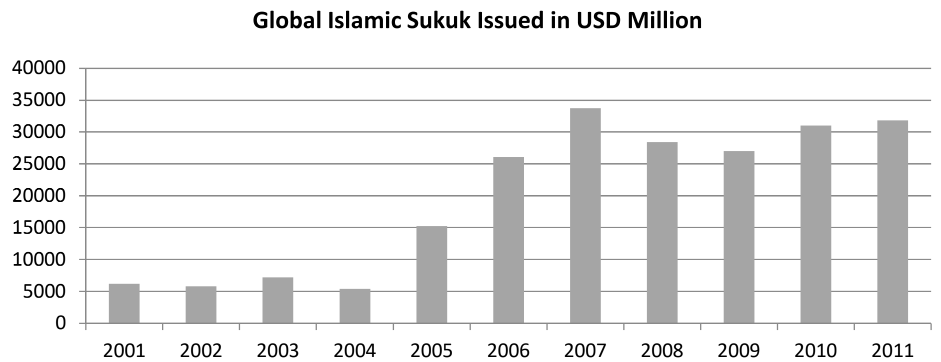


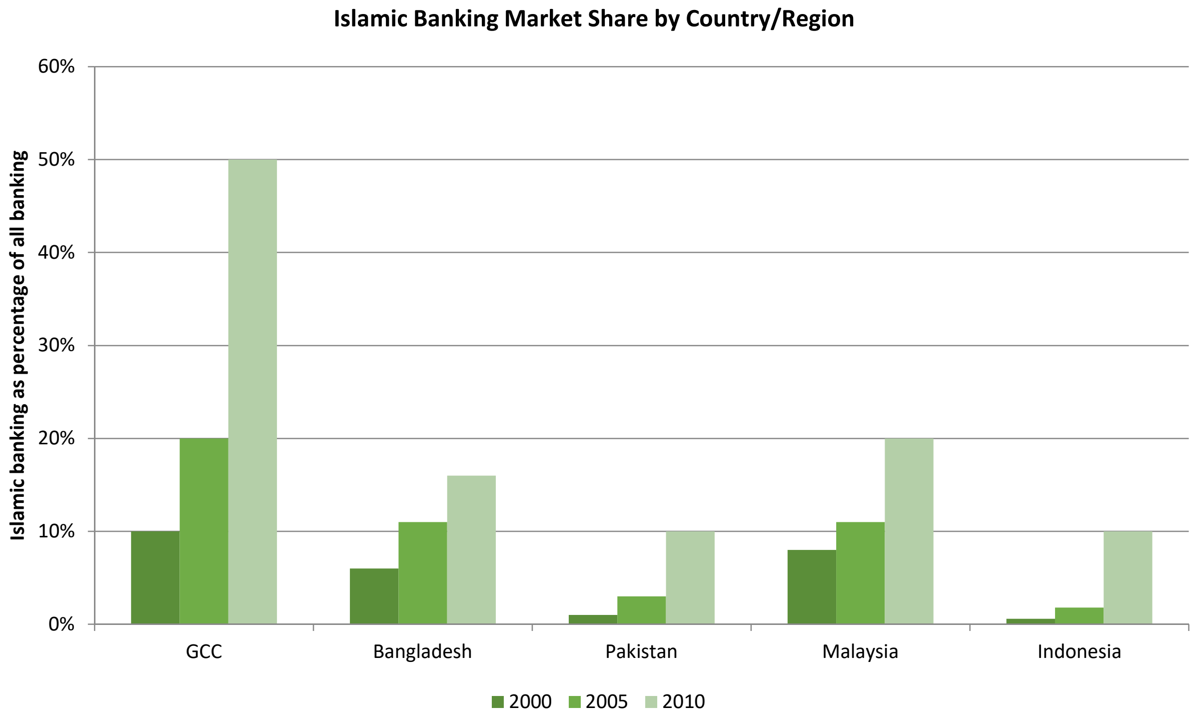
Figure 1 shows the rise in Islamic Finance in terms of issue of Sukuk (bonds based on shariah*)* at worldwide level. The look about data suggests that from the year 2001 to 2004 there was consistency in the level of business though a marginal growth was evident in the year 2003 when value of the issue rose though not very significantly. From the year 2001 to the year 2003 continuously the value of Sukuk issue was above USD 5000 million but the year 2004 saw minor correction as the value came down to USD 5000 million.

In the year 2005 there was a mercurial rise in the value of Sukuk issue as the demand for traditional Islamic financial product erupted and since then the demand for the Islamic financial products kept on rising accompanied by the response of the Islamic financial institutions to fulfill the same. The result is voluminous rise in global Sukuk issue; there was multifold growth as it is visible from the figure 1. USD 15000 million was the value of Sukuk issue in the year 2005 and this was 300% growth in comparison to the value of 2004 and thereafter the growth levels have never seen back, in the year 2006 the value of issue crossed USD 25000 million and crossed USD 33000 million mark in 2007 but financial shock of global crisis also had an impact on Islamic finance and the volume of Sukuk issue had a minor setback and in 2008 the value fall below USD 30000 million.

Although the 2008 global financial crisis withered financial systems throughout the world, Islamic financial institutions globally were relatively untouched, protected by their fundamental operating principles of risk-sharing and definitely due to the avoidance of leverage in addition to for not using speculative financial products. The era initiated in 2008 showcased the power that Islamic Finance had and kind of trust investors and global financial institutions have towards it. Sukuk Performance was though had minor dents but they were not deterred and started a stable rebound in the middle of 2009 and grew moderately in 2010 and 2011. The blow of global financial crisis on Sukuk issue was not severe and as observed the financial crisis made Islamic finance and Islamic banking products more lucrative and sought after Investment Avenue or options for parking funds. The year 2009 saw minor correction in the value of Sukuk issue but after that in the year 2010 and 2011 the trend of fall has been reversed and the growth in demand of Sukuk and rise in value of issue is plainly as well as clearly observable.

5.3 ISLAMIC BANKING REGIONAL SPREAD

FIGURE 2: MARKET SHARE OF ISLAMIC BANKING IN SELECT COUNTRIES



The figure 2 indicates market share of Islamic Banking as percentage of total banking in some of the key countries which could be today considered as financial centres or key centres for Islamic banking. These countries have adopted and accepted Islamic banking as a very integral part of their financial activity and over the years comparison shows that Islamic banking is on a continuous rise in these countries when compared for over ten plus year's data. The countries under consideration are GCC (not a country but a regional, political and economic union of Arab State), Bangladesh, Pakistan, Malaysia, and Indonesia. These countries are pre-dominantly Islamic nations but are contributing significantly towards the growth of Islamic Banking.

The Gulf Cooperation Council (Arab States) boasts of several high flying economies i.e. Bahrain, Kuwait, UAE, Qatar and Saudi Arabia (all are pre-dominantly oil-rich nations) contributing significantly towards global financial wellbeing and generating lot of liquidity as well as oil revenue. The GCC showcased maximum growth in Islamic Banking as the share of Islamic banking increase from mere 10% of total banking in the year 2000 to 50% in the year 2010 and further went up to 53% in 2012-2013.

Malaysia and Bangladesh seems to be respectively second and third in conservation and in being growth fields for Islamic banking. Though Malaysia had 20% of its banking as Islamic banking in 2010 but this share increased in 2015 and more than 30% of its total banking business was with Islamic banking institutions. Where as in Bangladesh the Islamic banking business has grew by 125.64% in last 10 years, from being around 7.8% in the year 2000. In the year 2015 Islamic banking business as percentage of total banking stands at 17.6%. Surprisingly Pakistan and Indonesia being laggards in comparison to other three nations but it was just the matter of time and these economies soon picked up and were ready to accept Islamic banking as a key constituent of their financial environment. As of 2012-2013 both Indonesia and Pakistan had almost 12% of their banking business in the form of Islamic banking in comparison to 10% for both the countries in the year 2010.

To bring the point home it can be contested that the rise of Islamic banking and Islamic finance has been a major surprise to the keen supporters of traditional finance and to those who failed to understand the need of an operational financial model based upon religious laws. The financial product markets have become more volatile, vibrant and dynamic and the market dynamism has been felt in both the traditional Islamic finance centers and a number of other markets. According to Bank Negara Malaysia (the Malaysian central bank), the number of Islamic bank branches in Malaysia increased from 126 in 2004 to 766 in 2005. Elsewhere, new Islamic Financial Institutions (IFIs) were established rapidly in the industry's traditional markets that is the Gulf Co-operation Council (GCC) countries by the end of financial year 2011 the picture seems changed from being predominantly covered by traditional global players, the region had the largest number of Islamic bank branches operational in 2012-2013.

Islamic banks have more than 300 institutions spread over 51 countries, including the United States through companies such as the Michigan-based University Bank, as well as an additional 250 mutual funds that comply with Islamic principles. It is estimated that over USD822 billion worldwide sharia-compliant assets were managed. This represented approximately 0.53% of total world's estimated assets as of 2005. According to CIMB Group Holdings (regional universal bank operating in high growth economies in ASEAN), Islamic finance is the fastest-growing segment of the global financial system and sales of Islamic bonds may rise by 24 percent to USD25 billion in the year 2010.

5.4 ANALYSING THE IMPACT OF ISLAMIC FINANCE FOR THE PERIOD

How to gauge the impact of this new style of banking, especially in this extraordinary financial period is a complex task. The period was quite long and tedious from the perspective of waves of change and quite a few economic turmoil that traditional centres of Islamic finance and Islamic banking have faced in this tenure. To get a clear viewpoint on the impact analysis of basic data is essential and a clear understanding of the Islamic financial spectrum is necessary so as to provide a reliable global overview of this growing industry. This proposed analysis would reflect not only critical growth in assets and persistent rise in demand for Islamic finance products but also indicates kind of important improvement that were made by Islamic finance in terms of the level of disclosure, product innovation and services delivery when compared to traditional old-school institutions. While disclosure still has a long way to go across all types of Islamic financial institutions, the number of firms reporting sharia-compliant assets rose by 59 to 280 in the year 2009-2010, from 221 in the year 2008-2009, an increase of 26.69%. The global listing of Islamic banks and financial institutions stays at 500, the number of registered Islamic banks and financial institutions continues to grow and have reached to total of 614 in the year 2010, compared with 524 in 2009.

In analyzing the $639.1bn market, the six states of the Gulf Co-operation Council (GCC) i.e. Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates provided the largest regional segment and also the largest growth in the market. Institutions from the GCC grew by a staggering 47.5% to reach $262.7bn. The non-GCC states of the Middle East and North Africa (MENA) region, which are dominated by Iran, also expanded significantly, rising by 40.4% to reach $248.3bn. Together, the GCC and non-GCC MENA states account for an increasingly dominant share of the Islamic financial institutions market with 80% by the end of the year 2008. The growth of 12.87% per annum for the period also was noticed in non-GCC non MENA markets (rest of the world). From 2009-2012 the GCC market saw approximately 42% aggregate growth, where as its counterparts in rest of the world had witnessed 32.23% growth.

6. ISLAMIC FINANCE IN THE MODERN ERA (YEAR 2012 ONWARDS)

During the past five decades' Islamic financial institutions have evolved from mere concepts into full-fledged realities. Moreover, in recent years there has been a new dynamism as this fledgling financial industry has proved increasingly attractive, not only to the world's 1.86 billion Muslims, roughly 24.28% of world's population but also too many others who are beginning to understand the unique aspects of Islamic finance. Originally, the global financial services companies traditionally saw Islamic finance as a market for liquidity management and cheap short-term funding but this perspective changed over the time.

They now saw opportunities across the board from project finance to securities issuance to structured finance deals. Few years back, they saw a one-dimensional market; now they see it as a multi-dimensional market complete with opportunities in fund, asset and wealth management. The result of this changing perception was that more international banks started setting up Islamic finance teams and one would be hard-pressed now to find a bank not having the capabilities to intermediate the market and deal with Islamic Finance products.

The changing view and emerging global acceptance of Islamic finance became evident from the table appended (Table 1) below that highlights Islamic banking assets, outstanding Sukuk and others financial assets of the Islamic finance portfolio as they stood tall in the year 2015-2016. These figures were not stand alone investments or deposits by Islamist population of the region but included contributions made by global investment flows within the realm of Islamic Finance, looking to venture into a safe territory along with taking the advantage of the economic growth prospects of the regions where Islamic Banking was at the helm in these years.

As indicated by the table 1 and very much visible by Figure 3, the testing time of recession (year 2008-2011) was over for Islamic finance and the industry emerged more stronger after the period of economic meltdown as they quite easily absorbed the jolts of small revenue and volume dents made by economic volatility of the period from 2008-2011. Consistent growth was visible from 2010 onwards and same trend continued for 2015 and 2016.

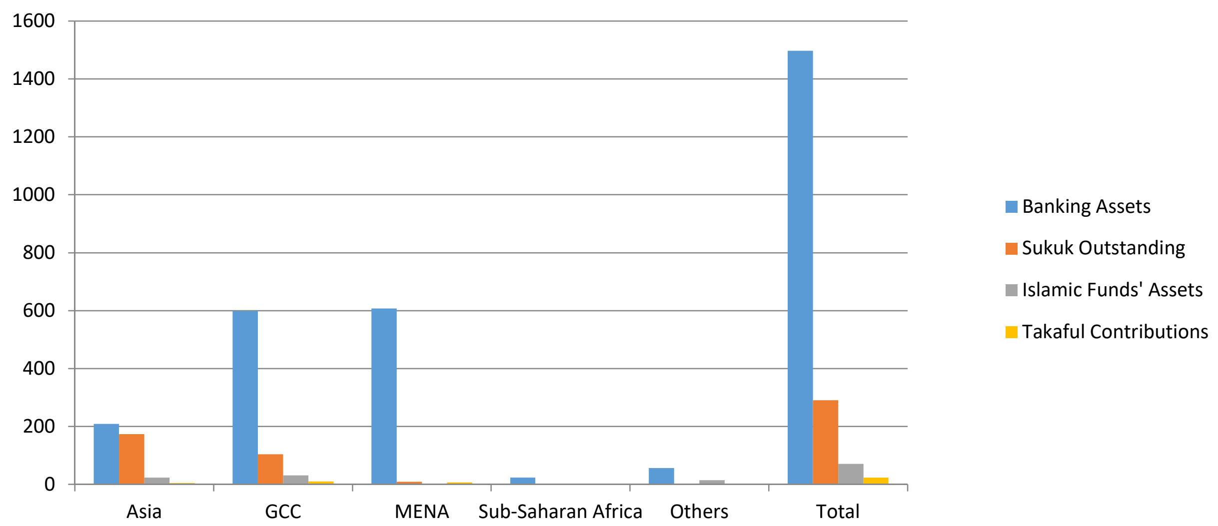
Key differentiator between the time before 2012 and post 2011 was the mix of participants in the Islamic finance domain that was earlier dominated by Islamic population and only banks and financial institutions of Islamic nations were involved in market. Same Market now had a wider participation from global players and financial institutions across the world and has attracted huge Chinese investments into the Islamic Finance domain after the year 2012.

Breakdown of Islamic Finance Segments by Region (USD Billion, 2015)

TABLE 1: BREAKDOWN OF ISLAMIC FINANCE SEGMENTS BY THE REGION

Breakdown of Islamic Finance Segments by Region (USD Billion, 2015-16)				
Region	Banking Assets	Sukuk Outstanding	Islamic Funds' Assets	Takaful Contributions
Asia	209.3	174	23.2	5.2
GCC	598.8	103.7	31.2	10.4
MENA	607.5	9.4	0.3	7.1
Sub-Saharan Africa	24	0.7	1.4	0.5
Others	56.9	2.1	15.2	
Total	1496.5	290.6	71.3	23.2

FIGURE 3: BREAKDOWN OF ISLAMIC FINANCE SEGMENTS BY REGION (USD BILLION, 2015)



Positive market forces and conducive environment for growth helped Islamic finance to grow substantially in 2012 to 2014 and attained new peak in the year 2015 and same trend continued in 2016. The Islamic finance industry has reverted to growth after a brief downturn caused by low oil prices and stumbling economies in some of its key markets, with total industry assets growing by 7% in 2016. Governance in particular made strong gains as governments saw the industry as one way to rekindle their economies. Islamic finance might be young at that stage in addition to was still tiny in comparison with the global financial industry, but the industry's rapid development suggested that Islamic Finance would continue to grow that too at rapid pace. Another key finding of the period was recession resistance of the Islamic finance industry that gives investors and depositors a more dependable option to park their funds and secure returns without being bothered about dynamism of economic cycle.

According to *The Economist* magazine (2016), "about 24% of the world's population is Muslim, but Islamic finance represents only 1% of the world's financial instruments. This gap rather unfulfilled gap could be seen as an opportunity for further growth." The world saw great growth prospects in the Islamic finance and the stage was well set for the rapid expansion of the Islamic Finance.

Islamic banking centers have been developed in places such as Dubai, London, Kuala Lumpur, Singapore, and Bahrain. According to Standard and Poor's, Islamic banking grew by about 10.8% per year (on an average) for the past decade. Number of the world's largest banks and financial institutions has begun to offer Islamic financial services, including Citigroup and HSBC. Dow Jones has even created the Dow Jones Islamic Market Index, signifying the importance of this growing financial niche.

The key developments in Islamic finance over the past few years have been the growth in new institutions, especially Islamic investment banks, in the Gulf and also in London. Institutions such as Noor Islamic Bank in Dubai and Al Hilal Bank in Abu Dhabi, both opened with large capital bases, as well provided the new face of Islamic finance. But the influence of this new financial form was spreading well beyond the Middle East and Muslim countries. Not only were there new institutions springing, such as European Finance House and Gatehouse Bank, setting up in London but HSBC Amanah, the Islamic subsidiary of global giant HSBC, also jumped to 10th place in The Banker's table by 2016.

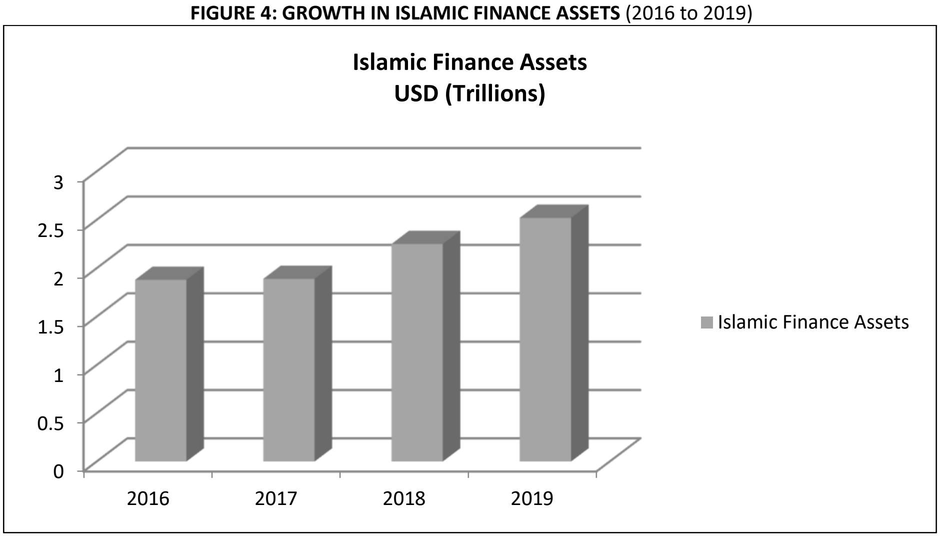
Though it seems everything was good for Islamic finance but there were undercurrents of growth stagnation. Year 2015 onwards the dream run of Islamic finance started to seem like coming to an end as the industry started to observe some slowdown in growth along with consolidation of the market and players. The industry's total worth, according to key industry stakeholder organizations, across its three main sectors (banking, capital markets, and TAKFUL), was estimated to be USD 1.88 trillion in 2016 but as discussed above this scenario changed fast.

7. JOURNEY FROM THE YEAR 2017-2019

The global Islamic finance market started mounting judiciously in the year 2016, it happened because of the strong investments in the Halal Sectors, infrastructure, besides heightened investment in Sukuk bonds, exclusively through electronic modes in almost all of the products and services. The crucial factors driving the growth of the market was directing investment that was channelizing due to the marvelous growth opportunities and prospects visible in the hopeful Islamic Finance sectors.

Growth in Islamic Finance Assets

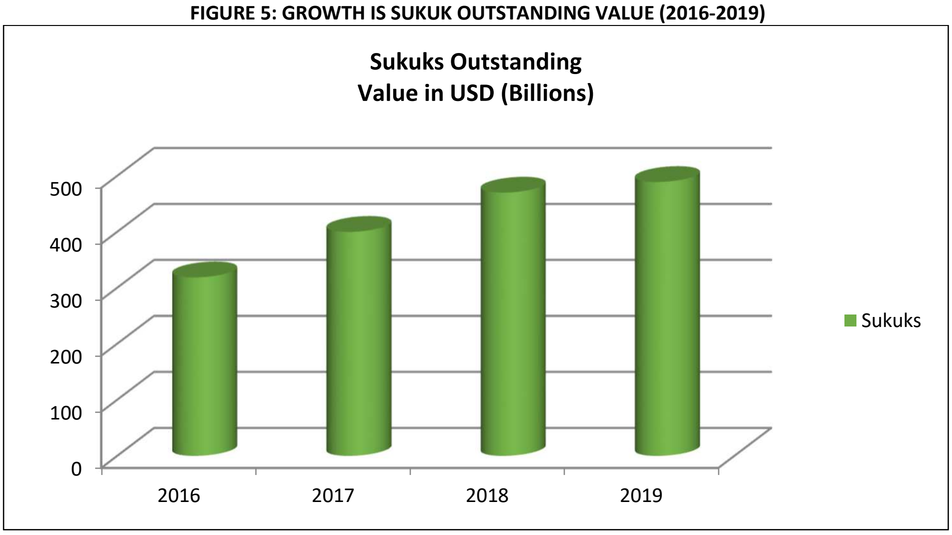
FIGURE 4: GROWTH IN ISLAMIC FINANCE ASSETS (2016 to 2019)



The industry's total value, rendering to significant industry stakeholder organizations, through its 3 foremost sectors i.e. banking, capital markets, and TAKFUL, were appraised to be US Dollar 2.25 trillion in 2018, marking an approximate growth of 19% in assets in US Dollar terms, and withdrawing the trend of previous two years of assets' growth stagnation (2017: USD 1.89 trillion vs. 2016: USD 1.88 trillion).

Sukuk Outstanding Value (2016-2019)

FIGURE 5: GROWTH IS SUKUK OUTSTANDING VALUE (2016-2019)



The trend of phenomenal growth was quite evident in 2017 as global Sukuk segment as the valuation of outstanding Sukuk increased by 25.6 percent to value almost at US Dollar 399.9 billion as at end of the year 2017 same time last year [2016] this value was US Dollars 318.5 billion. This surge in value encompassed unveiling entries into the sovereign Sukuk market by countries like Saudi Arabia and Nigeria, along with the pan-African multilateral development finance institution, and Africa Finance Corporation.

Islamic finance assets under management grew by almost US Dollars 3 trillion or 12% in 2018 so as to amount US Dollars 2.52 trillion whereas the Sukuk maintained the momentum of growth and continues with strong growth, registering 17.6 percent increase over 2017 in the year 2018 to touch the valuation of US Dollars 470 billion. This growth is backed by continuous improvisation by developed markets as they continue to revise Islamic finance regulations and frameworks. Within Traditional Religious financial segment of Islamic Finance, modern day technology (FinTech) has also gained momentum with the issue of block-chain-based micro-Sukuk and several other technological advancements in the U.K. and U.S. markets. Total valuation of outstanding Sukuk globally has reached US Dollar 489 billion. Global Sukuk issuance was flat at US Dollars 115.0billion in the year 2019.

Notwithstanding the strained global economic environment and slow rate of growth that has marred the industry, it could be observed that the dynamics within the financial industry are all set to change. Sukuk are leading the industry's growth, with global issuance since their inception surpassing US Dollar 1 trillion in the year 2018 and still going strong.

The Islamic finance industry has stretched promptly within the past decade, growing at a consistent pace of 10% -12% per annum. Sharia-compliant financial assets are projected at US Dollar 2.5 trillion, inclusive of bank and non-bank financial organizations, capital markets, money markets and insurance.

Progress in the industry's principal sector that is none-other than Islamic banking has slowed and was lowered in any comparison and recorded at 2% in the year 2018, fundamentally in-sync with sluggish growth for the global economy. Islamic banking assets totaled US Dollar 1.76 trillion in the year 2018 accounted for 70% of the industry's total assets, whereas industry's smallest sector — Islamic Insurance or Takaful grew at the rate 1% to value US Dollar 46 billion. Total global Islamic Finance growth became sluggish in 2018 and was recorded at 3% in comparison to 7% in the year 2017.

Changes in growth patterns has forced the Islamic finance industry to change and adopt technological innovations to provide better services and maintain the trust that it's loyal customers world over has shared over time. Keeping with economic dynamism several Islamic banks are also undertaking alterations through either reorganization or consolidation. In spite of the sluggish growth, several new players are trying to penetrate the market, as seen in countries like Ethiopia, Algeria and Afghanistan. There are several other innovations being adopted such as new liquidity tools are being tested to benefit the growth of existing Islamic banking players by facilitating long-term sustainability, as visible in countries like Oman, the UK and Pakistan.

As discussed Takaful operators (Islamic insurance) and other Islamic financial institutions (OIFIs) sum up for the residual share of Islamic financial assets, that are roughly US Dollar 46 billion and US Dollar 143 billion as reported for the year 2018-2019. Both mentioned sectors are seeing transformational activities in their main markets, which should help them to generate robust and sustainable growth in the near future, predominantly in countries of Kingdom of Saudi Arabia and the United Arab Emirates.

Even after holding the above premise and accepting the stringent Islamic laws the Islamic financial and banking business is continuously booming and seems all set to outperform the traditional banking business around the world. It is estimated that over $500 billion in assets are managed around the world in accordance with Islamic principles. With an estimated 1.3 billion followers of Islam, many in areas of the world where excess funds have been recently accumulating; increased interest has been generated in Islamic finance.

8. THE EXUBERATED PRESENCE AND INTENSELY COMPETITIVE TERRITORY

The volume, size and robustness of the Islamic finance institutions as an industry has currently reached to more than 720 plus banking and financial bodies and institutions having widespread operations in more than 92 nations with the cumulative gross assets worth little over 2.4 trillion US dollars that is likely to have another 3% - 5% growth by the end of year 2021.

The growth rate within the Islamic finance industry stands at approximately 12% per year. Maximum of the Islamic finance bodies and institutions comprising of Islamic banks and other lending institutions or bodies with similar roles have outpaced and outperformed their conventional finance colleagues. The traditional interest based banks (both Nationalized and Private) and financial institutions plus mainstream global banks even after adoption of modernistic technology had an asset growth rate of 17.76% in the period of year 2008-2015 (though the effects of economic recession and other environmental influences affecting the performance and putting more pressure on margins was very much visible) whereas Islamic Banks and Islamic Finance institutions with the assets growth rate of approximate 20.6% with growth in assets standing at voluminous US Dollar 478 billion approximately for the same period.

This glittering long-term performance of Islamic Banks and Institutions, as reflected in the growth rate, displays the capabilities and astounding advancement made by Islamic Finance Institutions. This performance becomes more audacious especially when compared with the estimated rate of 12-15% per annum, as forecasted by most of the financial business analysts globally.

As on date though the Islamic Finance market seems to be reaching saturation and some of the doomsday Projectionists are predicting a deep impact of global economic slowdown on the industry. Several analysts opine that the days of tremendous growth attain in past by Islamic financial markets and institutions is over and could no longer be attained or sustained. Still one has to agree that the Islamic finance industry has not reached the stage of maturity and global Islamic finance market is fragmented due to intensive competition amongst several large players, some of the are global giants, vexing hard to seize a substantial amount of the volume of business being generated in developing markets.

In specific regions, like Asia and Africa, Islamic Finance Industry is abstemiously budding with the existence of several local players, these markets also boast of limited by formidable presence of some international players. Though, Gulf Cooperation Council is an extremely competitive market due to the existence of several large international players, to name a few Bank Al-Rajhi, Dubai Islamic Bank, and Kuwait House Finance, are amongst the major players present in the region that present an intimidating picture of presence of the Islamic finance industry within the region.

FIGURE 6: COUNTRY SPECIFIC DISTRIBUTION OF ISLAMIC BANKING

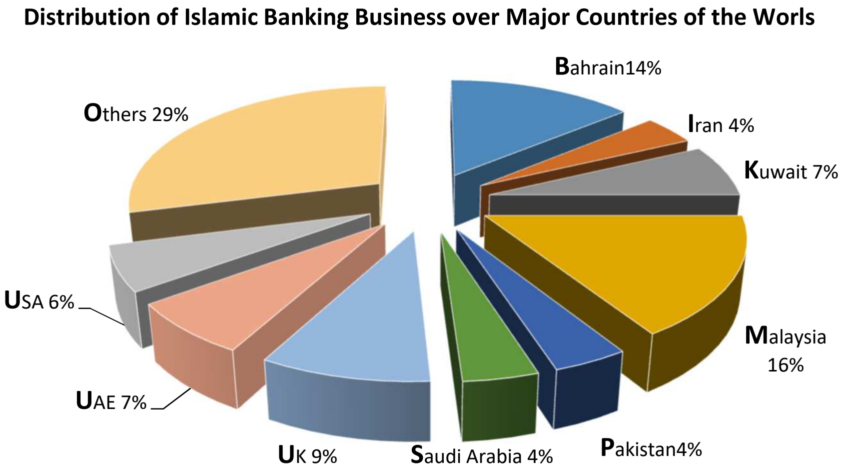


Figure 6 given above presents the exuberated or expounded global presence of Islamic finance industry. Islamic finance is also on the rise in new markets such as Syria, Lebanon, Morocco (it has made significant progress in last 5 years and has one of the most fiercely progressive industries as on date), the U.K., Turkey and Canada.

Geographical analysis of the Islamic Banking growth suggests that out of the leading 10 banks, six, led by Bank Melli, come from Iran; the others are Bank Saderat, Bank Mellat, Bank Tejarat, Bank Sepah and Bank Keshavarzi. Where as in UAE Dubai Islamic Bank moved up to eighth from ninth place and the UK's HSBC Amanah moved from 14th position on the tally to 10th.

Presence of HSBC Amanah and other players do make UK a very special market for Islamic Finance. In the U.K., following the authorization in the past seven years of the Islamic Bank of Britain and the European Islamic Investment Bank the recently proposed changes to U.K. tax law should help to remove the tax disadvantage which U.K. Sukuk issuance would previously suffered. U.K. Sukuk issuance is now looking like a valid financing option to be explored by businesses in UK that want to be Shariah compliant as well as by other businesses which want to diversify their investor base or benefit from the ongoing infrastructure investments within the Middle East. More significantly these tax changes help to signify that Islamic finance can play an important role in western economies. The changes in the U.K. are very likely to be replicated in other countries thereby creating an enabling framework for the rapid global development of Islamic finance.

Changes coming in UK are validated by the data provided in figure 6, as the data supports the fact that Islamic banking and Islamic finance is fast spreading its wings and growing to be a world-wide phenomenon. It is very much evident from the figure that Islamic banking business has been now distributed world over and even countries like UK, USA, and several others (including Australia and Canada) are contributing significantly into the total share of Islamic Banking and Finance.

Several governments also played critical role in developing roadmaps and enacting supportive regulations to facilitate the advancement of the complete Islamic Finance industry or at least of a particular sector within their supporting ecosystems. Indonesia's Master plan of Sharia Economy 2019-2024, which encompasses a development framework, strategies and action plans for the country's Islamic finance industry is one perfect example of supportive ecosystem that has played critical role in boosting presence of the industry in the region.

Regulatory frameworks are also being enhanced and countries like UAE and Malaysia are currently working to improve Shariah oversight, while Morocco, the Philippines and Bangladesh have introduced new Islamic finance regulations in 2019 to support Islamic banking and Islamic finance markets in a big way so as to provide sufficient scope for the growth of this nascent industry so as to help it to effectively face the tough challenges expected to be thrown at it by the severely altered economic situations in the time to come.

9. REASONS FOR ISLAMIC FINANCE APPETITE

While the credit crunch creates turmoil throughout the global banking industry, the impact of certain risks and risk management strategies have been highlighted during last economic meltdown. The effects of taking excessive risks have led to horrendous losses suffered by many traditional age-old banks. With risk sharing being a fundamental tenet of Islamic finance, the credit crunch situations during last recession has highlighted the core differences in financial philosophies of two kinds – Traditional banking versus Islamic Finance or Banking, leading many to believe that Islamic finance represents not only a flight to quality credit and liquidity management but also a more ethical approach to banking.

The attraction of Islamic finance is growing in the non-Islamic as well as the Islamic world, and the global credit crunch has helped to stress its advantages in terms of lowering risk and creating alternative financing structures. What is more important is the interest in Islamic finance by the major global financial institutions that has helped to bring Islamic Finance Markets and Industry into the mainstream. This can be easily seen in the Bloomberg league tables for Islamic finance (including both Islamic bonds and loans) where almost half of the leading 20 Islamic Finance players are none other than major international institutions.

10. CONCLUSION

Islamic finance has been one of the fastest growing segments in the financial services industry. Fueled by increasing income streams in oil rich countries, a rise in Islamic faithfulness, and a growing middle class in Muslim countries, this segment of the financial services market is expected to grow at record breaking levels. Based on sharia, or Islamic law, Islamic finance prohibits certain types of investments and the paying of interest. With the requirement that risk be shared among parties to a financial transaction, some have proposed that Islamic finance is a safer alternative than traditional Western finance and could protect markets from economic failure. As Islamic finance continues its expansion and diversification into new markets and products, there is a real impetus to understand more clearly how it can fit into the global banking sector.

The rise of Islamic banking may indeed be one of the most important developments in the global financial services business in last few decades as certainly these institutions help to integrate and expand worldwide economic development, which is never a zero-sum game. As the discussion indicates, there is a strong appetite for growth and diversification both among regional Islamic banks and global majors. Looking ahead, the growth in Islamic banking along with the absence of serious damages in Islamic financial business from the global credit crunch further creates impetus for the growth besides proves that Islamic Finance is a recession proof sector of global financial markets as same was observed during last economic crisis of 2007-2008.

Islamic Finance provides some assurance that high growth rates of sharia-compliant assets approaching 30% of total financial products could be sustained in long run though at present extremity of annual growth rate of 2% - 3% would soon disappear and peak rates would soon return as the normal course of business commences and would be maintained in long run. Although even with lower projected growth rate of 20%, which seems justified by the data collected from upcoming Islamic countries like Ethiopia, Nigeria and Morocco. It could safely be assumed and this growth only reflects modest expansion in the industry, the future upside could be considerably more. Future prospects might improve further as Islamic finance may appeal to non-Muslims as well, in that some socially responsible investors may like the idea of avoiding investing in "sinful" industries, and feel that their investments are safer in an Islamic style investment arrangement.

At present, however, there remain a number of barriers to overcome, including human capital shortages, differences in Shariah interpretation, and a lack of consistency in financial reporting. While the prospects for growth and diversification look good, it appears there is still much work to be done to fulfill the core ambitions of the sector. Even with the limited number of qualified advisors, and other shortcoming, issues as well as concerns, Islamic finance is, nevertheless, expected to continue to grow in the years ahead.

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