CHAPTER 23

Islamic Banking in Africa

Islamic finance: The next phase in Africa's financial revolution

With a predominant Muslim population of 490.92 million Africa holds a promising growth opportunity for Islamic finance.

Although the majority of people in the African continent still do not use banking services, the banking system in some countries is growing increasingly sophisticated. The low literacy rate is one of the key reasons why people do not to have a bank account. It is believed, however, that Islamic banking is a powerful reason to start utilizing banking services especially for the Muslims, who number about 446 million[252], or 43.3%[253] of the whole population of the continent.

With the new wave of Islamic banking in countries such as Kenya, the appetite for financial products that comply with the Shari'a is on the rise as the continent awakens to the ideological and practical richness and relevance of this form of alternative banking.

Similarly, the principles that drive the system are expected to appeal to many in the continent irrespective of their religious background. The avoidance of unethical investments, discouraging of exorbitant interest rates and prohibition of speculative practices are all virtues that should hold appeal well beyond the Muslim population of the continent. The system should equally be a powerful tool for enhancing access to development finance and empowering poor and vulnerable groups, particularly if Islamic banks extend their reach to rural areas, which are currently not effectively served by the conventional banking system.

Egypt, Algeria, Tunisia, Senegal, Gambia and Djibouti all have at least one Islamic financial institution. They all face similar challenges of operating in an environment that is not yet aligned to the requirements of Shari'a-compliant financial products. Among the major challenges is the fact that Islamic scholars are very few in numbers, and only a few countries have legislations that are conducive to Islamic banking.

Whilst progress is being made, there are several challenges that need to be addressed in order to enable more penetration of the product in the continent and to unlock the potential of this growing industry. However, the challenges may well be transitory in nature and typical of any new emerging industry. In reality, the prospects for Islamic banking in Africa overshadow the challenges, and the terrain seems naturally conducive since there is a high demand for Islamic financial services, both amongst potential customers and investors.

[252] October 2009, Houssain Kettani, Department of Electrical & Computer Engineering & Computer Science Polytechnic University of Puerto Rico, USA, 'Muslim Population in Africa'

[253] January 2010, Hussain Kettani, '2010 World Muslim Population'

23.1. Opportunities and a scramble for Africa

Project finance and bonds present a major investment opportunity in Africa. It is well suited for Islamic financial instruments, which need to be backed by physical assets. Gulf Finance House, an Islamic investment bank based in Bahrain, signed a US$ 1.4 billion deal in Morocco to fund two tourism projects in 2006. Senegal is said to be contemplating issuing a sovereign sukuk. It could be a 21st-century version of "the scramble for Africa". This time the Gulf is moving in and Islamic banking is prominent as a funding mechanism.

Islamic banks are stepping up investments in key markets in Africa - especially in regions that have long been dominated by Western banks. They may also recognize that there is an opportunity in consumer services and products, which current banks serve poorly, or not at all. Competition has heated up forcing Islamic banks to enhance their commercial entrenchment, develop relevant business models, strengthen their brands and provide innovative solutions to a growing number of clients attracted by the concept of Shari'a-compliant banking. Given the successful evolution of the industry as a whole, newcomers will intensify competition, forcing established players to explore new territories outside their local markets.

Gulf investors could help bridge the gap. Their hope is that the middle class, particularly in the Muslim north, will turn to Islamic finance, and that firms will raise money through Islamic bonds, known as sukuk. The first African sukuk product was issued by a Sudanese cement firm. The Sudanese government also tapped the market—selling bonds to Gulf investors to sidestep American economic sanctions over the massacres in Darfur. However Sudan's banking industry remains embryonic and few African countries combine the strong desire to promote Islamic banking with heavy demand from Muslim consumers.

There is a notable area of growth in Islamic banking in Africa, because many conventional banks in the continent are turning to the provision of Shari'a-compliant banking products through "Islamic Windows". Whether it is National Bank of Egypt, FinBank of Nigeria, Absa Bank of South Africa or First Community Bank of Kenya, conventional banks lining up to meet the demands of their Shari'a conscious clients. Trusted brands in association with a faith based offering are competing in recruiting both affluent and first time banking customers.

23.2. Market potential

"Average per capita GDP on the continent was as low as US$ 1,137 in 2007, but given the fact that Africa is host to the second-largest Muslim population in the world, the absolute size of its economic production reached US$ 469 billion in 2007," says Anouar Hassoune, a Moody's analyst and author of the report "Islamic Finance Explores new Horizons in Africa."

"This is not insignificant, as it is on par with the combined GDP of Saudi Arabia and the UAE, two of the dominant economies of the Muslim world," he continues. Moody's believe that the potential value of Islamic banking in Africa is huge. The depth of Shari'a-compliant intermediation reached was only US$ 18 billion at the end of 2007, equating to a market share of less than 8%. More than half of the assets were located in Sudan, with Egypt ranking second with a 20% market share.

"Provided that the continent continues to grow at its current pace, which is the fastest in decades, incremental wealth creation will make it easier for the Islamic financial services sector, including Islamic commercial banking but also Shari'a-compliant insurance, investment and microfinance, to develop," says Hassoune.

"Islamic banking tends to do better in markets that have an established financial market infrastructure and appropriate enforcement mechanisms," adds Anouar Hassoune of Moody's, "such as South Africa and Kenya."

Other Potential Frontiers for Islamic finance in Africa include:

Tanzania
Zanzibar
Uganda
Malawi
Mauritius

23.3. Islamic retail banking: Mauritius

In the case of Mauritius, the former Mauritian Finance Minister, Rama Sithanen, believes that there is a potential demand for Islamic banking and finance in Mauritius, from both Muslim and non Muslim citizens.

"By enlarging the spectrum of financial products, the Shari'a-compliant products should interest all bank customers and will therefore bring healthy competition for existing conventional banking products," he states.

According to him, Islamic banking will be a completely new concept that can potentially redefine the financial services landscape.

"Islamic finance has proved its compatibility with conventional finance worldwide. It embraces principles of justice and cooperation. It will work in Mauritius and can promote economic growth, efficiency, investments and capital access," he added.

Not all countries in the African continent are equally positive or proactive but major banks such as Absa and Barclays, are likely to target countries with a high Muslim percentage as part of their Africa growth strategy. Trusted brands in association with a faith based offering are compelling in recruiting both affluent and first time banking customers.

According to the Governor of the Bank of Mauritius, Rundheersingh Bheenick, there are over 20 existing commercial banks in Mauritius which may opt to offer Islamic banking through a special window, or by launching a fully fledged Islamic bank. HSBC Amanah was the first to launch an Islamic banking window in Mauritius in May 2009, offering a current account and long-term investment account.

23.4. Islamic banking: Egypt

Egypt has been offering Islamic finance since the 1970s, but from a continental perspective, Islamic banking is still in its infancy with only 37 Islamic financial institutions serving 78 million inhabitants[254]. South Africa was the first sub-Saharan African country, other than Sudan, to start Islamic banking.

A fact little known to many people in the world is that it was Africa that paved the way for Islamic banking as an industry. The first modern experiment with Islamic banking was undertaken in Egypt under cover, without projecting an Islamic image, for fear of being seen as a manifestation of Islamic fundamentalism which was anathema to the political regime. The pioneering effort, led by Ahmad El Najjar, took the form of a savings bank based on profit-sharing in the Egyptian town of Mit Ghamr in 1963. This experiment lasted until 1967 by which time there were nine such banks in the coun-

[254] 2009 CIA World Factbook

try. These banks, which neither charged nor paid interest, invested mostly by engaging in trade and industry, directly or in partnership with others and shared the profits with their depositors. Thus, they functioned essentially as saving- investment institutions rather than as commercial banks.

Although Egypt as a major country has not kept up its pioneering momentum, the new wave of Islamic banking in countries such as Kenya the appetite for financial products that comply with the Shari'a is on the rise as the continent awakens to the ideological and practical richness and relevance of this form of alternative banking.

In Egypt there are 13 conventional banks with Islamic windows, and Islamic finance products are offered through 128 branches of these banks.[255]

23.5. Islamic retail banking: Kenya

In countries such as Kenya, the appetite for financial products that comply with the Shari'a is on the rise as the continent awakens to the ideological and practical richness and relevance of this form of alternative banking.

Kenya authorised two Islamic banks in 2008 – Gulf Arab Bank and First Community Bank, following the introduction of an Islamic banking law.

Kenya is one of the most populous in Eastern and Central Africa, and it has the largest economy in that region. Kenya made history as the first country in Eastern and Central Africa to allow the operations of Islamic banking when the Central Bank of Kenya (CBK) formally approved First Community Bank (FCB) on May, 29th 2007 to operate as a full-fledged Shari'a-compliant commercial bank. This achievement was the culmination of concerted efforts spanning more than 20 years fronted by Mr. Nathif Adam, FCB's Chief Executive Officer.

FCB, currently one of the two fully fledged Shari'a-compliant banks in the country, is a private East African business initiative owned mainly by business entities including major trading houses in the oil and petroleum industry and by individuals in different professional fields. The Bank kicked off with an initial paid-up capital base of US$ 15 million which, however, is expected to be doubled shortly as a result of the quick growth of its business perspectives and balance sheet.

According to the bank's official website[256], it has made impressive growth during the short span of its operations in the country. Since its official launch about 16 months ago, the bank has made great strides in many aspects. It has opened more than 18,000 accounts in the short span of time of its existence and has seen an impressive growth in its deposit book which grew from over 1 billion Kshs (Kenyan Shillings) at the end of September 2008 to over 3 billion Kshs at the end of September 2009. This shows the level of confidence that the Bank drives in the market place".

FCB provides different deposit accounts for its clients, namely current accounts, savings accounts and fixed maturity accounts. The Bank also offers accounts dedicated to different types of clientele such as women, children as well as large and small business clients. The Bank also serves all people irrespective of their religious backgrounds. To this extent, the bank confirms that almost a quarter of its client base comprises of non-Muslim Kenyans.

To make a quick mark across the country, the bank fast tracked the opening of its branch network and by the end of its full year of operation; the Bank had ten branches located in different parts of the country. 7 more branches are currently under preparation and it is planned that the bank will be running with at least 17 branches by 2010. The bank expects to continue its reach across the country through other methods such as mobile banking and agencies. A number of these branches are located in the newly formed districts of the country particularly in Muslim dominated Northern Eastern Province of the country which is currently largely underserved with regard to banking services.

The bank is also in contact with counterparts in other East African capitals with the intention of rolling out branches into those countries as well in the very near future.

The bank has also made a quick move into the financing aspect of its business using the main Shari'a contracts of murahaba, mudaraba and diminishing musharaka. These contracts are used by the bank to meet all the financing needs of its clients including personal finance, business finance, bridge finance for construction projects and trade finance.

Similarly the bank recently embarked on micro-credit finance through a dedicated product known as "BORESHA". The product which in Kiswahili means (EMPOWER) has received overwhelming response from clients particularly from women groups who for long have waited for this kind of Shari'a-compliant initiatives.

During the year 2008, the bank also made very important strategic link-ups with development oriented government institutions such as the Youth Enterprise Development Fund which selected FCB as one of only four banks in the country to work with the Fund in the dissemination of the Fund's financing portfolio. FCB's participation in the Fund aims largely at ensuring that the financing support available from the Fund reaches Muslim youth in the country in a Shari'a-compliant manner. "We are a bank conscious of the development of the youth and we discovered that since the formation of the Fund about 2 years ago, not many Muslim youth benefited from the same because of its interest based nature. Accordingly, we approached the management of the Fund and we managed to agree with them on a Shari'a-compliant structure through which the Muslim youth in the country can now benefit from the Fund" said Mr. Adam who urged Muslim youth in the country to come forward with practical business ideas to take advantage of what the Fund has to offer.

FCB has recently been authorized by the CBK to launch FCB Capital, which will offer Islamic asset management business and capital markets products especially sukuk. Gulf African Bank which got Central Bank Kenya approval later in 2007 is the second full-fledged Shari'a-compliant bank in Kenya. The bank is owned by a consortium of largely foreign investors including Bank Muscat International and Istithmaar, a Dubai government agency. Other investors of the Bank include PTA Bank of Kenya. The Bank currently has 8 branches in different parts of the country.

In Kenya, as a precursor to the licensing of full-fledged Islamic banks, the Central Bank of Kenya had earlier in 2005 allowed Barclays Bank of Kenya to run with an interest-free current account. The account which was titled "LA RIBA" was designed to address the sensitivities of the customers of the bank who adhere to the Islamic faith.

Other conventional Kenyan banks also followed the Barclays example and have since established interest-free current accounts – particularly so in the light of competition from the new Islamic Banks. These banks include:

Kenya Commercial Bank
National Bank of Kenya
Imperial Bank
Dubai Bank
Chase Bank

23.6. Islamic banking: South Africa

The Muslim population in South Africa is relatively small, but both affluent and influential. There is no statistical information on religious groupings in the country, but Muslims are believed to number between 1 and 2 million people, about 2% of the population[257].

Islamic banking was first introduced in South Africa in 1989 by Albaraka, a niche bank operating with a limited branch footprint. This was the only Islamic offering until 2002, when First National Bank, one of the four major national banks in the country, launched an Islamic vehicle finance product followed by an Islamic cheque account. Most recently, they started offering their Islamic products through their branch in Botswana.

In 2006 Absa, the largest retail banking group in South Africa, launched the first comprehensive Islamic offering. This included a cheque account, vehicle finance, transactional savings account, contractual savings account and Islamic wills. This offering was supported by the full range of access support from the largest ATM and branch network in the country, as well as cell phone and Internet banking. For the first time in South Africa, Muslims were offered a broad range of Islamic banking products that are comparable to those of a conventional bank offered at the same cost and with the same level of convenience.

The up-take of this offering was swift and Absa Islamic Banking grew within three years to a respectable number of customers. Only about 5 – 10% of the total Muslim population in South Africa utilize Islamic finance, leaving a significant potential growth opportunity for Islamic banking in the region. Additionally, this opportunity is increased by the growing number of Muslim foreign nationals coming into South Africa as traders and asylum seekers. There is no existing research on Islamic banking customer numbers, but the current market size is estimated to be approximately 150 000 customers.

Muslim banking customers in South Africa tend to be value seekers and few are prepared to sacrifice value and convenience to bank according to the dictates of their faith. Once offered the full package, however, they are keen to follow the dictates of the Shari'a. The market has grown to recognizable level at which the Shari'a compliance of the products is no longer questioned, and there is eagerness for additional offerings.

In addition to the products already mentioned, Shari'a-compliant products on offer include takaful short term cover for businesses, home and vehicles, (which is underwritten by Absa), travellers' cheques, foreign bank notes, international cash debit cards and Western Union money transfers. There are variations on the savings account offerings which target specific groups such as youngsters or people saving for Hajj. There are also products suitable for the small, medium and micro-enterprise market.

There is growing popularity in Shari'a-compliant ETFs listed on the Johannesburg Stock Exchange. The Shari'a New Gold and the Shari'a Top 40 ETFs are truly groundbreaking products in Shari'a financial offerings in sub-Saharan Africa.

South Africa's banking system is world class and the Shari'a-compliant products offered all operate at that standard. However, product development is slow due to the need to comply with Shari'a as well as local laws and banking regulations. Each Islamic bank has a Shari'a supervisory board that provides guidance and oversight throughout the product development and delivery process and most South African Islamic offerings adopt the AAOIFI standards and guidelines as well as their Shari'a governance process.

There is a growth in demand for product offering as customers become used to being able to bank according to their faith. Development projects underway to fulfil this demand include a long term home loan, a credit card, and a range of business and investment products.

Other asset management product in South Africa:

Oasis Asset management offers broad range of Islamic mutual funds
STANLIB (STANLIB Shari'a Equity Fund A)
Element Investment Managers (Element Islamic Equity Fund)

23.6.1 Comparison

Islamic banking products are comparable to conventional products in price, value creation and convenience. The added advantage for Muslim customers is that the income is permissible for them to consume. The range of Islamic banking products may not be as broad as that of conventional products but that is a short term situation which is being addressed.

Islamic banks have far lower attrition rates due to the sentimental value of Islamic products. This is positive for profitability.

23.6.2 Trends

Islamic banking in South Africa is developing from the initial Shari'a-compliant products to Shari'a based prod-

[255] The Banker, 'Top 500 Islamic financial institutions', November 2009

[256] http://www.firstcommunitybank.co.ke/

[257] Pop. Data - 2009 CIA World Factbook

ucts that have equity rather than debt characteristics.

Some of the keenest African custom for Islamic products is in countries like South Africa, where Muslims are a small minority, as it provides Muslims with a way of affirming their cultural heritage. Hamza Farooqi, who heads South Africa's CII Holdings, a diversified business group, has gradually been moving his own and his company's finances from conventional banks to Absa's Islamic division. CII Holdings asked Absa to help finance the first "dry" five-star hotel in Cape Town.

23.7. Islamic retail banking: Nigeria

Nigeria is not only the most populous country in West Africa, with a population of 150 million people, of whom about 65% are Muslims, but it is also the largest economy.[258]

In response to the demands by Nigerian Muslims to have a bank that meets their religious, moral and ethical aspirations, concerted efforts are in progress by a number of corporate bodies, individuals and Islamic organizations to achieve this goal. And with the release of the regulatory frame work of Islamic banking by the Central Bank of Nigeria in February 2009, all is now set for the first Islamic bank in Nigeria to commence full commercial operation as soon as possible.

JAIZ Islamic Bank is the first fully fledged Islamic bank in the country and its Managing Director, Alhaji Mohammed Mustapha Bintube, recently confirmed that the bank will now commence full operations in Nigeria before end of 2009.

Nigeria is one of the largest and richest of the African economies. Its Islamic financial sector is expected to flourish within two years, after the Central Bank of Nigeria passed legislations permitting the establishment of Islamic banks in the country in 2009. This legislation is expected to have a significant impact on growth in Islamic banking in this part of Africa.

Some countries, such as Nigeria, with almost 70 million Muslims and a booming banking sector should be fertile ground.

23.8. Islamic retail banking: Tunisia – Zitouna case study

Banque Zitouna, a fully-fledged Islamic bank, is to open at the beginning of 2010. Its head office will be situated in Les Berges du Lac, near the country's capital, Tunis. The chairman of the board of directors is Mohamed Sakhr El Materi, a well-known businessman in Tunisia and the owner of Princesse El Materi Holding, which specialises in the automotive industry, cruise and port management, real estate and media broadcasting. He is also a son-in-law of Tunisia's current president, Zine El Abidine Ben Ali.

Princesse El Materi Holding will have a 51% stake in the new venture. Other shareholders include Groupe La Carte (insurance provider), Groupe Poulina Holding (a group of companies that covers the agricultural, food, industrial and service sectors), Groupe TTS (tourism services group), Groupe Délice-Danone (an agro-food company), Groupe UTIC (distribution) and Groupe Bouchamaoui.

Zitouna's authorised capital is US$ 22.8 million. It was granted a banking licence by the Central Bank of Tunisia in January 2009 and was expected to open in early November 2009. However, due to some technical problems with the computer network the official opening has been postponed to March 2010.

All banking products and services offered by Zitouna will be fully Shari'a-compliant and will focus on lending and deposits. They will be based on various PLS mechanisms, including murahaba, ijara, mudaraba and musharaka.

[258] Pop. Data - 2009 CIA World Factbook

CHAPTER 24

Road to Islamic Finance in India

Islamic banking and financial services currently has a presence in over 75 countries worldwide; these include the secular countries of Europe, North America and South East Asia.

India too, having sensed the momentum and industry buzz globally, has got off the ground with its own activity. Indian regulators, unlike much earlier when they were averse to entertaining anything vaguely 'Islamic', have started to look at the positive side of such an undertaking, and have allowed schemes that lay claim to Shari'a compliancy. Figure 113 below gives us a glimpse of the important actions that the Indian Government and its important institutions have taken most recently. These actions are seen to have important ramification for the Islamic finance business in the country.

These actions indicate a cautious but systematicddd approach by Indian policy makers in allowing Islamic financial products and services in the country. Many players from the private sector have come up with Shari'a-compliant products abroad as well as in India. A leading private sector player has created an entire vertical for distributing Shari'a-compliant products. Financial institutions like HSBC, Benchmark, TATAS, Taurus, UTI, Kotak, Reliance, Bajaj Allianz, all have some kind of Shari'a-compliant product already available in the market or in the pipeline.

24.1. The potential of Islamic finance in India:

Muslims constitute 13.4% of India's total population - In absolute terms this number translates into the second largest Muslim population in the world, after Indonesia. One current official estimate puts this figure close to 175 million Muslims. 60% of this population is below the age of 25 and over 35% of them live in urban areas;

ACTION	YEAR
Establishment of Anand Sinha Committee under the Reserve Bank of India for studying Islamic financial products	2005
Appointment of Justice Rajinder Sachar Committee to report the social, economic and educational status of Muslim community of India	2005
Raghuram Ramrajan Committee recommends Islamic banking for financial inclusion of Muslim community in India	2008
Government of India calls for bid in connection with reconstruction of National Minority Development Finance Corporation (NMDFC) on Shari'a principles	2008
SEBI permits India's first Shari'a-compliant Mutual Fund	2009
SEBI permits India's first Shari'a-compliant Venture Capital Fund	2009
GIC (Re), a government of India owned company, appoints TASIS for Shari'a advisory	2009
Government of the state of Kerala announces the launch of an Islamic Investment company	2009

Figure 113: Indian Government action for the Islamic finance development