



# Islamic banking and finance: on its way to globalization

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## Abstract

**Purpose** – The main objective of this paper is to highlight the unprecedented growth of Islamic banking and finance in the contemporary finance world. It captures the advancements of Islamic banking and finance industry across the tools, systems, sectors, markets and over 75 countries from Africa, Asia, Europe and North America.

**Design/methodology/approach** – The paper deals with the paradigm of Islamic banking and finance. It constitutes a general review that bears special features, facts and figures over the recent developments of Islamic banking and finance across the globe. It takes stock of the growing institutional and infrastructure support for the Islamic banking and finance system in Muslim countries and Western financial markets.

**Findings** – The findings of the paper hold that Islamic banking and finance industry has been making breakthrough improvements to become a truly viable and competitive alternative to conventional systems at the global level. Islamic banking and finance institutions have acquired booming grounds in the Middle East, South East and South East Asia. These growing Islamic hubs have been acting as a launching pad to promote Islamic banking in Western business and financial markets. There are some core factors contributing to the recent success of Islamic banking and finance, such as spiraling oil prices worldwide, prolonged boom in the Middle Eastern economies, product innovation and sophistication, increasingly receptive attitude of conventional regulators and information technology advancements that have been acting as a catalyst for the Islamic banking and finance industry to go global. Given all growth patterns, Islamic banking may be able to win over the majority of customers from the Muslim world that constitutes almost 24 per cent of the world's population (over 1.3 billion), and other ethical groups across the globe in times ahead.

**Research limitations/implications** – The paper takes stock of on-going developments in Islamic banking and finance industry worldwide. It deals with latest information, facts and figures, which however do not amount to a substantive volume to allow statistical testing and analysis to figure out the main factors and their actual contributions in making Islamic banking and finance emerge as the fastest growing industry of the global finance. This paper mostly bears a subjective outlook.

**Originality/value** – The paper aims to attract the global attention towards the fastest growing industry of the contemporary world of finance. It presents the case of the Islamic banking and finance industry in the most powerful, comprehensive and logical fashions to remove all misgivings about it in some circles, and let it be seen as an industry adding more ethical, competitive, flexible and diversified tools and systems to global financial markets. The paper highlights the increasing moral and material support that Islamic banking has been enjoying from Muslim governments and the public, and Western market players and regulators. It draws attention towards the growing number of products, systems, infrastructures and supporting institutions of Islamic banking over the recent years. The current trends of Islamic banking industry worldwide captured in this paper can tell all about its strength and weakness, future prospects and ambitions to become a truly innovative, competitive and integrated part of contemporary global finance.

**Keywords** Banking, Islam, Globalization, Finance

**Paper type** General review



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## 1. Introduction

Islamic vision of socio-economic justice is based on abolishing interest and all other exploitative elements from the economic sphere. The Islamic financial system facilitates lending, borrowing and investment functions on a risk-sharing basis. This allows market forces to determine the productivity of capital rather than fixing it in priori as an “interest rate” to sabotage the free market mechanism and encourage speculative use and hoarding of capital. The Islamic financial system ensures the optimal rate of capital formulation and its efficient utilization leading to a sustainable economic growth and fair opportunities for all. It is a value-based system that primarily aims at ensuring moral and material wellbeing of the individual and society as a whole (Naqvi, 1982; Zarqa, 1983; Ahmed, 1994; Siddiqi, 2000). The Islamic banking and finance discipline is nearly four decades old. The conceptual developments of Islamic banking took cognizance in late 1940s and in the next two decades, they got to a point of yielding a model which was adopted in the Middle Eastern countries to fulfil their aspiration of having their own banks. Many reputable Islamic banks came into being in 1970s that included Nasser Social Bank Cairo (1972), Islamic Development Bank (IDB) (1975), Dubai Islamic Bank (1975), Kuwait Finance House (KFH) (1977), Faisal Islamic Bank of Sudan (1977) and Dar Al-Maal Al-Islami (1980). In early 1980s, the nascent industry took the world by surprise when three Muslim countries, namely, Iran, Pakistan and Sudan decided to transform their economies and financial sector on Islamic lines. The Western financial market players such as Citibank, ABN AMRO, HSBC and others established their own Islamic windows or subsidiaries to attract petrodollars’ deposits from the Middle East and Muslims clientele in local markets. The Islamic banking and finance system continued to grow by seeking innovation and diversity of products, clientele and markets. It has been growing in areas such as *Sukuk*, Takaful, hedging funds, Mutual Funds, private equity and assets management, wealth management, real estate, corporate finance, liquidity management, treasury, derivatives, swaps, future and forward market, Islamic Stock Exchange and Dow Jones Islamic Index.

Islamic banking and finance activities are mainly clustered around three parts of the world that include the Middle East, South Asia and Southeast Asia. The Middle East, overwhelmingly populated by Muslims, is a motherland of Islamic banking and finance. Islamic banks enjoy strong support from rich individuals, governments and other state institutions in the Middle East. The majority of regulatory and other supporting bodies of the Islamic banking and finance industry are located in the Middle East. The Gulf countries have decided to merge their monetary and central banking systems by 2010. These developments will bear far-reaching impacts on the Islamic banking and finance industry in the Middle East and worldwide. Referring to South Asia, Islamic banking has been recently revived in Pakistan under the dual banking system. Bangladesh has been following more rigorous Islamic banking policies under the increasing market and public demands. India and Afghanistan may adopt Islamic banking operations in the near future. Three Southeast Asian countries, namely, Indonesia, Malaysia and Singapore are promoting the most comprehensive and advanced version of Islamic banking and finance in their region so as to attract Islamic business and finance from the Middle Eastern countries and elsewhere. The government of Sudan has recently adopted more pragmatic approach to promote the Islamic banking and finance practice in the region. Islamic banking and finance is gaining momentum in the USA and European countries. These countries are now more willing to bring changes to their banking and tax laws so as to allow the Islamic

banking and finance practice in their markets. The increasing number of ethically-based business organizations and individuals worldwide are dealing with Islamic financial institutions. The Middle East Southeast Asia and South Asia are the main emerging hubs of Islamic banking and finance. At present, there about 300 Islamic banking and financial institutions across 75 countries, holding a paid-up capital of over US\$13 billion, controlling assets worth US\$300-US\$500 and investments US\$500 billion-US\$800 billion, with an average annual growth of 15 per cent. It has been estimated that Islamic banking and finance industry will reach to US\$4 trillion by 2010. It will hold 40 per cent to 50 per cent of total savings of the Muslim population (estimated as large as 1.5 billion) worldwide within next eight to ten years (Alam, 2006; Arekat, 2006; Cader, 2007). The World Islamic Bank – Eamar International Bank – with a paid-up capital of US\$100 billion would be launched in 2008 (Kamil, 2007).

This paper looks at recent developments in the Islamic banking and finance world. It is composed as follows. The following section takes account of Islamic banking and finance activates in the Middle East. The third section describes the revival of Islamic banking and finance movement in South Asia. The fourth section explores the progress of Islamic banking and finance systems in Southeast Asia. The fifth section captures new Islamic banking and finance arrangements in the African country – Sudan. The sixth section highlights the growth of Islamic banking and finance practice in the European and Western markets. The final section provides summary and conclusions.

## **2. Islamic banking and finance in the Middle East**

The Middle East is the mainstream of Islamic banking and finance. Islamic financial institutions are making individual and collective efforts to develop a wide array of innovative, customer-oriented and competitive products services to their clientele. It is their core objective to get strong hold over the indigenous oil-wealth and discourage its outgoing to financial institutions in the European and Western world. Recent market developments suggest that the Islamic banking and finance industry is a big success and enjoys a very strong regional support. An increasing number of conventional financial institutions in the Middle Eastern markets are converting their operations either fully or partially on Islamic lines, which could pose a serious threat to a long-established legacy of conventional banking in the region.

### *2.1. Bahrain*

Bahrain is sitting on the top of Islamic banking affairs worldwide. It is the house of Islamic banking practice, regulations, research, innovation and scholarship. It hosts the largest number of Islamic financial institutions and other supporting bodies. In 1978, the first Islamic bank – Bahrain Islamic Bank – was established in the country. There are 351 financial institutions in Bahrain, out of which 33 are Islamic with a total capital of US\$2.24 billion (*Arab News*, 2006, p. 7). Islamic banking operations in Bahrain are undertaken by full-fledged commercial banks, offshore banking units and investments banks. A significant number of Islamic banks use Bahrain as a base to operate in the Gulf, European Union and North America. Bahrain hosts the biggest Takaful industry of the Islamic finance world. Presently there are 26 Takaful and three re-Takaful companies in Bahrain. Dubai International Financial Centre is promoting trade in *Sukuk* at regional and international levels. Bahrain plans to establish *Sukuk* Exchange Centre which will enhance the investment and liquidity options for Islamic financial institutions in the Middle East and elsewhere. The Islamic mortgage industry is

rapidly growing in Bahrain due to prolonged boom in its real estate sector. Business firms and individual investors in Bahrain are increasing their reliance on Mutual Funds. Islamic financial institutions have secured unprecedented growth in Bahrain in terms of income, assets and deposits over the years. They are expected to experience further growth down the track.

The Bahrain Monetary Agency has developed internationally recognized standards, regulations and infrastructure for Islamic financial institutions. It is very keen on increasing the co-operation among main players of Islamic banking in the Middle East and worldwide. It is actively contributing in the pool of Islamic banking training and research. It has developed a network of Islamic banking research and regulatory institutions such as Accounting and Auditing Organization for Islamic Financial Institutions, International Islamic Financial Market and Islamic International Rating Agency. These institutions are making significant efforts to strengthen the base of Islamic banking and finance and make it more dynamic and competitive in local and international financial markets. Bahrain is making worthwhile contributions to improve Islamic banking systems such as regulatory frameworks, accounting standards, capital adequacy, liquidity, asset management, hedging, corporate governance, etc. The country has assumed a key role in developing the Islamic financial market in the areas that include asset securitization, syndicated financing and credit, collective investment schemes, Mutual Funds, *Sukuk*, *Takaful*, etc. Islamic financial institutions in Bahrain enjoy greater community recognition and support. For example, 91 per cent of new staff appointments in 2001 consisted of citizens of Bahrain.

## 2.2. Iran

It is a novel feature of Islamic banking practice in Iran that it has been adopted at state level since the Islamic revolution 1979. In the early two decades of Islamic banking practice, the Iranian banking sector was highly centralized and did not share much from the pool of knowledge, experience and developments in global markets as well as Islamic banking world. After mid 1990s, however, the Iranian government showed some inclination towards adopting privatization and deregulation in the financial sector. In 1997, the central bank of Iran – Bank Markaz – issued licences to a number of credit cooperatives, interest-free Qardhul Hasan centres and three non-bank credit institutions to launch their operations in Iran. Since 1999 foreign banks have been working in the designated free trade zones of Iran. The private banking sector started to build up in Iran at the beginning of twenty-first century. In December 2001, the first private bank – Bank Karafarin – was granted a licence to commence its operations in Iran. Two private banks, Bank Eqtesdae-e Novin and Bank Parsian emerged in the Iranian market. The Iranian government denationalized its two banks, i.e. Bank Saderat and Bank Rfah-e Kargaran to enhance the diversity of private banking sector in the country. Presently, more than 44 applications for establishing private banking and financial institutions in Iran have yet to be decided by the Bank Markaz. The Iranian government has been working on evolving more flexible, competitive and innovative financial system in the country. The growing global exposure and deregulation of the oil-rich Iranian economy and financial sector may bear far-reaching implications on Islamic banking growth and development in Iran. The Iranian government should achieve greater integration of its Islamic financial sector with global finance as well as the Islamic banking and finance world.

### 2.3 Jordan

Jordan Islamic Bank has been dominating the Islamic banking practice in Sudan since 1978. Presently, it operates through 64 branches and cash offices established across the country. It also offers mutual insurance funds and products in the financial market of Jordan. It held 10.8 per cent of total investment facilities of the local Jordanian banking industry in 2005 (Jordan Islamic Bank, 2005). In March 1997, another Islamic bank – Islamic International Arab Bank – was established in Jordan. It has 12 branches that offer a wide range of products and services to their customers. Its assets and income amounted to JD4.02 billion (US\$5.71 billion) and JD2.357 million (US\$3.348 million), respectively, at the end of 2004 (Islamic International Arab Bank, 2004). Takaful or Islamic insurance services and *Sukuks* are becoming popular in business and finance spheres of Jordan. Jordan's Investment House for Financial Services (Investhouse) has decided to establish an Islamic financing company in the country. Recently, the government inserted the Articles 50-59 in the Banking Constitution of Jordan so as to provide proper legal cover to Islamic banking activities in the country. The government of Jordan aims to use Islamic banking and finance as a tool to attract business and investments from regional and international players of the Islamic banking world.

### 2.4 Kuwait

Kuwait hosts the largest number of Islamic financial institutions. It has been ranked as third in terms of holding the Islamic banking assets of worth US\$22.7 billion. It is estimated that Islamic financial institutions in Kuwait will manage funds about US\$56 billion by 2010 (Khojah, 2006). The establishment of KFH in 1977 laid down the foundation of Islamic banking in Kuwait. KFH has made great success over time and presently, it has been successfully competing with 12 conventional banks and three specialized government banks in the Kuwaiti financial market. The National Bank of Kuwait and some other conventional banks also offer a wide range of Islamic financial products and services in Kuwait. In early 2006, Kuwaiti Parliament gave approval for the establishment of two new Islamic financial institutions, namely, Jaber Islamic bank and Jaber Funds in the country. A new Islamic bank, Boubyan Bank, will launch its operations very soon in the country. Kuwait Retail Estate Bank has decided to gradually transform itself into a fully dedicated Islamic entity.

Islamic finance and insurance activities have also rapidly grown in Kuwait. Currently, five Takaful and one re-Takaful companies are operating alongside 18 conventional insurance companies in Kuwait. They hold a 14 per cent share of the Kuwaiti insurance market (*Islamic Finance news*, 2006b, p. 15). There is an increasing demand for *Sukuk* in the corporate and real estate sectors and the government is working on developing proper regulatory framework for *Sukuk* market. The FTSE Doha International Financial Exchange (DIFX) Kuwait 15 *Shariah* Index, comprising 15 *Shariah* compliant stocks of Kuwaiti companies, has been recently listed at DIFX. The use of Islamic funds has become more rampant in the financial market of Kuwait. Towards the end of 2006 the Standard Chartered Bank introduced first Islamic derivatives in the Kuwaiti financial market by entering into US\$150-million three-year Profit Rate Swap with the Kuwait-based Aref Investment Group (Chowdhury, 2006). The Kuwaiti Ministry of Awaqaf and Islamic Affairs provides full guidance and supervision to the Islamic *Shairah* supervisory boards at Islamic financial institutions. The Central Bank of Kuwait introduced Islamic banking laws in 2003 and has ensured highly regulated and transparent Islamic banking and finance practice in the country.



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### 2.5 Lebanon

The Islamic banking institutions are passing through an embryonic stage in Lebanon. The Lebanese Parliament passed Islamic banking laws in February 2004 which legitimized Islamic banking operations in the country. By the end of 2006, four Islamic banks emerged in Lebanon, namely, BLOM Development Bank, Arab Finance House, AlBaraka Bank Lebanon and Credit Libanie. Four applications for establishing new Islamic banks were looking for the government's approval at the same time. Conventional banks in Lebanon are encouraged to establish fully dedicated Islamic banks but not permitted to establish their own Islamic window. Presently, Islamic banking assets amount to US\$60 billion, with a growth rate of 10 per cent per annum. The Central Bank of Lebanon expects that Islamic banking will be able to secure 5-10 per cent of the total financial market of Lebanon within next three to five years (*Arab News*, 2006a, p. 6). The Central Bank of Lebanon aims to introduce *Sukuk* and *Takaful* products so as to gradually expand the base of Islamic banking and finance in the market. The government embarked on the Islamic banking project to enrich its market with Islamic business and finance from its next-door countries.

### 2.6 Qatar

Qatar is another hot spot of Islamic banking and finance affairs in the Middle East. There are four major Islamic banks in Qatar, namely, Qatar Islamic Bank (established in 1983), Qatar International Islamic Bank (established in 1991), Doha Islamic Bank (established in 2006) and Al Rayan Bank (established in 2006). Other Islamic financial institutions that include First Finance Company, Investment House, Al Jazeera Islamic Company and Islamic Financial Securities are delivering Islamic retail products and brokerage services in the country. Qatar Islamic Bank has decided to establish Islamic Investment Bank of Qatar with US\$1 billion capitalization at Qatar Financial Centre (QFC) (Taib Research, 2006). Al Safa Islamic Bank, a subsidiary of a conventional bank, plans to offer Islamic products in retail and corporate finance sectors in Qatar. Recently, Qatar International Insurance Islamic Company and Qatar International Islamic bank have established a joint Islamic entity – Tasheelat Company – which will specialize in meeting the financing needs of individuals and business enterprises in Qatar. Presently, the share of Islamic banking practice represents 30 per cent of the Qatari financial industry, and is expected to grow up to 50 per cent in the coming years (Jaidah, 2006).

Islamic finance and insurance activities have registered a rapid growth in Qatar. In 1994, Qatar Islamic Insurance Company was established which has now become one of the leading insurance service providers in the country. First, *Sukuk* were issued in 2003 and at present they constitute 20-35 per cent of the total project financing in Qatar (*Islamic Finance News*, 2006d, p. 6). The FTSE DIFX Qatar 10 *Shariah* Index is listed at DIFX. Islamic Mutual Funds are becoming a popular choice in the Qatari capital market. Qatar Islamic Bank is the main sponsor of Mutual Funds in Qatar. Doha Securities Market is playing a key role in promoting Islamic capital and secondary markets in the country. The QFC is also performing an extremely imperative role in promoting Islamic finance at regional and international levels. Qatar is the smallest but richest region of the Arabian Gulf due to a mammoth inflow of oil-wealth in its economy over the recent years. The Qatari government is ambitious to take up infrastructure and development projects worth billions in the country. Islamic financial institutions can play very effective role in economic growth and development of Qatar.

### 2.7 Saudi Arabia

Islamic banking is making good headway in Saudi Arabia despite the fact that there are no separate Islamic banking laws in the country. There are two major players of Islamic banking in Saudi Arabia, namely, Al Rajhi Banking and Investment Corporation and Bank Al Jazira. Conventional banks are also serving the Islamic banking clientele by establishing their own Islamic window or subsidiary. The Saudi financial sector comprises of 14 commercial banks and five credit unions and holds assets of worth over US\$20 billion. Islamic banking operations capture 64 per cent of the total market share in Saudi Arabia (*Arab News*, 2006b, p. 7). There are increasing numbers of products at Saudi banks which are based on Islamic principles. A large number of banks in Saudi Arabia are restructuring their operations on Islamic lines. Bank Al Jazira has recently completed its gradual conversion into a fully Islamic entity. The National Commercial Bank has decided to convert itself into a fully dedicated Islamic bank in the next five years. Saudi British Bank has recently increased its range of Islamic banking and finance products in the country. In 2006, Saudi Investment Bank established an Islamic arm to offer Islamic products in retail and corporate banking in the Saudi financial market. The National Commercial Bank has decided to re-shift its retail operations on an Islamic basis. Saudi Investment Bank has recently opened ten fully dedicated Islamic branches which represent more than 50 per cent of its total operations (*Arab News*, 2006b, p. 7). Al Bilad is a new comer in the Islamic retail banking market in Saudi Arabia. Amlak Finance and Dallah Al Baraka of Saudi Arabia have established an Islamic Company to look after financing needs of the real estate sector of Saudi Arabia. The first Takaful company – SAAB Takaful Company – has recently emerged in the Saudi Arabian insurance market. There is a tremendous scope of growth for insurance services in the country. It is estimated that Takaful company services will be able to secure 15 per cent annual growth rate in Saudi Arabia over the next 15 years, with a gross premium income reaching to US\$1 billion (Jaffer, 2006). The Saudi Stock Market and Capital Market have experienced growing demand for the *Sharai* compliant stocks, bonds and instruments. Banks and financial institutions are increasing their reliance on *Sukuk* to meet financing needs of the real estate sector in Saudi Arabia. In July 2006, SABIC signed the underwriting agreement for its debut *Sukuk* issuance for a total amount of SAR 3 billion (US\$799.98 million), the first public issuance in the Saudi market under the new Capital Market Law (Al-Humaidi, 2006). In early 2006, the first Islamic private equity fund – AlTawfeek – was successfully launched in the Saudi financial market. Saudi Arabia hosts the IDB which is performing a very crucial role in promoting Islamic banking practice in the Muslim world.

### 2.8 Syria

The entry of Syria into the Islamic banking club is one of the most recent developments of the Islamic banking world. The Syrian Parliament approved Islamic banking laws in 2005. By the end of 2006, the Syrian government permitted three Islamic banks, namely, Al-Sham Bank, Saudi Dalat Al-Baraka's Al-Baraka Bank and Syrian International Islamic Bank to launch their operations in the country whereas six applications for establishing Islamic banks were under its consideration. Moreover, three Takaful companies, namely, Aqeelah Insurance Company, Al-Nour Insurance Company and Syrian-Qatari Company are planning to launch their operations after seeking their licenses from the Syrian Insurance Supervision Committee. Al-Qatar Islamic Insurance Company plans to establish its subsidiary in Syria. Syrian

International Islamic Bank along with its Qatari partners has applied for launching one Takaful company in Syria. Islamic financial institutions and investors from the Middle East are underwriting share capital of new Islamic banks and Takaful companies in the country. Islamic banking and finance institutions may help in integrating the Syrian financial market with mainstream Islamic banking and finance systems which are rapidly growing across the Middle East region.

### 2.9 United Arab Emirates

The worldwide Islamic banking practice originated in the UAE when the first biggest Islamic bank – Dubai Islamic Bank (DIB) – came into being in 1975. Presently DIB has established a network of 30 branches across the country which is expected to expand to 57 branches by the end of 2007. There are four other fully dedicated Islamic banks in the UAE, namely, Sharjah Islamic Bank, Emirates Islamic Bank, Abu Dhabi Islamic Bank and Dubai Bank. Conventional banks also offer Islamic products either through an Islamic window or subsidiary. Presently, the Islamic banking assets amount to Dh750 billion (US\$204.234 billion), comprising 10 per cent of total banking industry in the UAE. They are expected to grow to 30 per cent of total banking in the country by 2010 (*Islamic Finance news*, 2006c, p. 5). Islamic banking and finance institutions in the UAE are experiencing increasing growth patterns in their profits and assets. More frequently in the UAE than elsewhere in the Middle East, conventional financial institutions have been converted on Islamic basis, partially or completely. For example, Dubai Bank, National Bank of Sharjah (Sharjah Islamic Bank), Middle East Bank (Emirates Islamic Bank) and Amlak Finance transformed themselves on Islamic lines over recent years. The complete conversion of the Dubai Financial Market into an Islamic entity is also included in the UAE's government plans.

There is an increasing demand for Takaful or Islamic insurance services in the UAE. Major Takaful companies in the UAE include Abu Dhabi National Takaful, Dubai Islamic Insurance and Re-insurance Company (AMAN), Islamic Arabic Insurance and Re-insurance Company (SALAMA) and Insurance Islam TAIB. In June 2006, Swiss Re launched Family re-Takaful services in the UAE insurance market. In 2005, Takaful or Islamic insurance companies held 2 per cent of total insurance premium income of the insurance market in the UAE (Aquil, 2005). *Sukuk* are becoming the backbone of corporate financing in the UAE. The funding needs for the UAE's real estate sector are largely met by Islamic mortgage and *Sukuk* issues. DIB is the biggest dealer of the global *Sukuks* market. It has issued *Sukuk* worth more than AED33 billion (US\$9 billion) which comprised 20.80 per cent of global market share in 2006 which also include the raising of AED12.932 billion (US\$3.52 billion) *Sukuk* for the Nakheel Group at the end of 2006. Moreover, it holds AED36.74 billion (US\$10 billion) *Sukuks* in the pipeline which will be issued to the European and US companies from the oil and gas, infrastructure and telecoms sectors (Razak, 2006a). The demand for Islamic retail finance and private equity funds has gradually increased in the UAE over the time. In 2006, DIB and Dubai World launched US\$5 billion private equity funds (Razak, 2006b). The Dubai International Financial Centre (DIFC) and Dubai International Financial Exchange (DIFX) are encouraging trading in Islamic securities, equities, derivatives, funds (such as Exchange Traded Funds (ETFs)), depositary receipts and other instruments. The UAE is the key sponsor and contributor of Islamic banking and finance seminars, conferences, training and other intellectual activities.



### 3. Islamic banking and finance in South Asia

The South Asia region holds enormous potentials to become a hot spot of Islamic business and finance activities. The majority of Muslim population in South Asia inhabit in five countries – Afghanistan, Bangladesh, India, Maldives and Pakistan. Muslims are the sovereign in four countries and form the largest minority in the fifth country – India. The economies of India and Pakistan have experienced an accelerated growth over the years. A large number of wealthy investors and Islamic financial institutions from the Middle East are interested in undertaking business and investment activities in Indian and Pakistani markets. Presently, Islamic banks are functioning in Bangladesh and Pakistan only but there are bright chances that they will take root in Afghanistan and India in the near future. Afghanistan may find Islamic banking as a tool to attract huge sums of donation, qard-e-hasanah and venture capital from Islamic business and financial institutions worldwide. The top officials at Afghanistan International Bank have been working to develop a feasibility report on launching a fully dedicated Islamic bank in Afghanistan. Since the Islamic banking and finance industry is a rapidly growing segment of the global finance, it may offer enormous business and finance opportunities to India. A number of foreign and local financial institutions that include Citibank, Grindlays, Standard Chartered, HSBC, ICICI Bank India and Kotak Mahindra are already offering limited Islamic banking products and services to Indian Muslims. Recently, the Reserve Bank of India (RBI) has undertaken a feasibility study on establishing a fully dedicated Islamic bank in India, which findings are yet to be publicly known. Taking note that over 120 million Indian Muslims and their growing desire to do faithful banking, the RBI should provide wholehearted support for the development and growth of Islamic banking practice in India.

#### 3.1 Bangladesh

The Islamic banking affairs in Bangladesh started to build up in early 1980s. The first Islamic bank – Islami Bank Bangladesh – was established in 1983. The development and growth of the Islamic banking industry in Bangladesh took a very steady course over the years. Right now there are six Islamic banks working alongside 43 conventional banks in Bangladesh. They include Islami Bank Bangladesh, Oriental Bank Bangladesh, Al-Arafah Islami Bank, Social Investment Bank, Shahjalal Islami Bank, Export Import Bank of Bangladesh and Bank Al-Falah. A number of conventional banks in Bangladesh offer Islamic banking products through their own Islamic windows. In 2005, the Islamic banking deposits accounted for 13 per cent of the total banking deposits and its investments represented 5 per cent of total investments in the banking sector of Bangladesh (Rana, 2006). Recent developments and innovations in the Islamic banking and finance industry have not yet received a serious notice in Bangladesh. In 2005, however, the government of Bangladesh established a high-powered committee to suggest amendments into existing Insurance Act to introduce Islamic insurance operations in the country. Some Bangladeshi Islamic banks are interested in promoting *Shariah*-compliant securitization financing in the corporate sector of Bangladesh. The people of Bangladesh hold reservations over the government policies on Islamic banking. The Islamic *Shariah* supervisory councils in Bangladeshi Islamic banks should be made an autonomous body to oversee the *Shariah* compliance of Islamic banks in Bangladesh. The government should establish separate regulatory and institutional systems for Islamic banking practice and share the experience and resources of the international Islamic banking industry to promote

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truly innovative, competitive and *Shariah* based Islamic banking practice in Bangladesh.

Islamic banking  
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### 3.2 Pakistan

The Islamic banking movement originated in Pakistan in 1980. The efforts for transforming the economy and financial sector of Pakistan on Islamic lines were made over 22 years but all in vain. However, Islamic banking activities have been revived in Pakistan under the dual banking system since 2002. Currently there are six fully dedicated Islamic banks which run their affairs through more than 52 branches established across 16 major cities of Pakistan. They include Al Baraka Islamic Bank, BankIslami Pakistan, Dubai Islamic Bank Pakistan, Emirates Global Islamic Bank, First Dawood Islamic Bank and Meezan Bank. In addition, there are nine conventional banks that have set up a total 62 fully committed Islamic banking branches across the country (Akhtar, 2006). In 2006, Islamic banking held assets valued at US\$1.3 billion and its operations accounted for 2.2 per cent of the overall financial market of Pakistan. The Islamic banking deposits are expected to worth US\$13 billion, 10 per cent of the total banking deposits in Pakistan by 2014 (Al-Refai, 2006).

A number of domestic and international financial institutions such as Askari Bank of Pakistan, House Building Finance Corporation of Pakistan, National Bank of Pakistan, Qatar International Bank and Standard Chartered Bank are committed to open new or more Islamic branches or subsidiaries in Pakistan. All conventional banking branches are required to open Islamic windows under the recent directives from the State Bank of Pakistan. Islamic insurance and finance activities are taking shape in Pakistan. The Securities and Exchange Commission of Pakistan has been engaged in developing a proper regulatory framework for the Islamic insurance industry in the country. Two Islamic Insurance companies, i.e. Takaful Pakistan and First Takaful Insurance Company are ready to start their operations in Pakistan.

*Sukuk* are becoming a viable funding source for development projects in Pakistan. The first international *Sukuk* of worth US\$600 million were issued by the Government of Pakistan in 2005. The local Wapada *Sukuk* Ijarah of worth PKR11 billion (US\$181.36 million) were issued in early 2006. Quite recently, Emirates Global Islamic Bank Limited has agreed to arrange PKR20 billion (US\$329.75 million) *Sukuk* issuance for Pakistan Development and Management Company that will undertake infrastructure development (*Khaleej Time*, 2007, p.15). The first Islamic equity index has also been launched to promote the Islamic business and finance activities in the Stock Exchange Market of Pakistan. Recently, the government has promulgated new prudential regulations to revive *Mudarabah* companies in the country. Pakistan is the home of over 150 million people, with Muslim representation about 97 per cent. The Islamic banking and finance industry should experience a very promising growth in this overwhelmingly Muslims dominated country. The Islamic banking and finance industry in Pakistan faces two core challenges at the moment. First, the government needs to restore the shattered confidence of people by undertaking truly pragmatic and devoted efforts in promoting the Islamic banking system in the country. Secondly, Islamic financial institutions need to prove a point that their products and services are truly competitive and based on Islamic *Shariah* principles.

### 4. Islamic banking and finance in South East Asia

The Southeast Asian countries host the fastest growing economies in the world. The Southeast Asian financial markets are very liberal, competitive and globally

integrated. The Islamic banking industry is becoming a vital segment of the Southeast Asian financial markets. Indonesia, Malaysia and Singapore aim to use Islamic banking and finance as a powerful tool to attract business and investments from the Middle East and Muslim world. These countries can play a very crucial role in promoting Islamic banking and finance in global financial markets.

#### 4.1 Indonesia

Indonesia, the biggest Muslim populous country of the world, embarked upon the Islamic banking venture with the establishment of Islamic bank – Bank Muamalat Indonesia – in 1992. The bank achieved steady progress and at the present it is one of the pioneer institutions of Islamic banking worldwide. There are two other fully dedicated Islamic banks in the country, namely, Syariah Mandiri and Bank Syariah Mega Indonesia. The central bank of Indonesia – Bank Indonesia – has recently permitted local conventional banks to offer Islamic banking products and services in the Indonesian financial market. The Islamic banking assets have increased on average 60 per cent in the last four years. They rose from US\$1.498 billion (1 per cent of the total banking assets) in 2004 to US\$2.6 billion (1.8 per cent of the total banking assets) in 2005. Bank Indonesia has devised a roadmap to ensure that the Islamic banking industry has a share up to 6 per cent of the total Indonesian banking market by 2011 (Hairsman, 2006). There are 30 Takaful and Re-Takaful companies in the country. In 2005, Takaful industry held 1.5 per cent of total insurance market which was expected to increase to 2 per cent by the end of 2006 (*Islamic Finance news*, 2006a, p.18). There are growing opportunities to invest in Islamic stocks, bonds and money market instruments in Indonesia. The Indonesia Stock Exchange offers 242 *Shariah*-compliant stocks and Jakarta Islamic Index of 30 Islamic securities to Muslim and other investors. Jakarata Stock Exchange has observed a rapid growth in *Sukuk* trading over the years. The Indonesian government plans to issue the debt sovereign *Sukuk* by the end of 2006. The Commerce International Merchant Bankers (CIMB) Group recently launched the first Islamic unit trust funds to provide investment opportunities to Indonesian investors in the *Shariah* compliant stocks, bonds and money market instruments. The Indonesian government rejuvenated its Islamic banking policies towards the end of 1990s. It has been working on improving Islamic banking regulatory framework, *Shariah* faculties and staff qualifications, which may ensure the worldwide competitiveness and exposure of its Islamic banking and finance industry.

#### 4.2 Malaysia

Malaysia is the second biggest hub of Islamic banking and finance. The first Islamic bank – Bank Islam Malaysia Berhad (BIMB) – was established in Malaysia in 1983. The Malaysian government introduced the dual banking system in the country by 1993. Presently, there are 12 fully-dedicated Islamic banks, 35 commercial banks, ten merchant banks and five development banks in Malaysia which offer Islamic banking products and services. The Islamic banking assets worth RM117,393 million (US\$32.06 million), representing 11.8 per cent of total assets in the Malaysian banking sector with a growth rate over 27 per cent in the last ten years. The Malaysian government has set up a target of 20 per cent of the total banking share for Islamic banking by 2010. A large number of key players from the domestic and international Islamic finance have commenced their operations in Malaysia. The Bank Negara issued licences to 10 fully committed Islamic banks in 2006 (*International Herald Tribune*, 2007, p. 3).

The Takaful industry took birth in Malaysia in 1989 and presently it holds assets of worth RM6.5 billion (US\$1.77 billion). The Malaysian government has recently announced a ten-year tax exemption (from 2007 to 2016) for Takaful industry to encourage its growth in the country. The *Sukuk* and capital market flourished in Malaysia in 2001 and it has experienced a tremendous growth over recent years. Malaysia hosts the first international *Sukuk* centre which transacted business of over RM110.064 billion (US\$32 billion), representing 52 per cent of the Malaysian capital market in 2006 (Alvi, 2006). In 1983, Malaysia developed the first money market which recorded a monthly turnover of RM135.2 billion (US\$37.36 billion) in 2006 (Othman, 2006). In 1995, Malaysia established the first Islamic inter-bank market to improve the liquidity risk management strategies of the Islamic banking industry. Presently, there are more than 70 Islamic unit trust funds to offer many and varied investment and risk management options to Malaysian and international investors. In 1994, Malaysia launched BIMB securities and Managed Funds and thereby became the first Islamic stock broker of the first Islamic equity market of the Islamic finance world. Later on, another Islamic Index comprising more than 179 permissible stocks was introduced at Kuala Lumpur Stock Exchange. The Malaysian government added two more Islamic indices in 1999 and 2005, respectively. There are 886 *Shariah* compliant Islamic securities representing 85 per cent of the total Malaysian Stock Market (Securities Commission, Malaysia, October 2006). The Malaysian Islamic wealth management industry has also rapidly grown over the years.

The Malaysian government is a staunch believer that efficient financial system is the key to stimulate savings, investments and economic growth in the country. The country has made major contributions in the recent developments, innovations, regulations and standardization of Islamic banking and finance world. However, the Islamic banking practice in Malaysia bears some limitations and reservations as well. The Middle Eastern Islamic scholars and others are of the view that Malaysian Islamic scholars are too liberal in their interpretations of Islamic *Shariah* principles over banking and finance affairs. Furthermore, Islamic financial institutions in Malaysia do not have satisfactory support and participation from the general public. The Malaysian government should educate its people about Islamic banking and remove their concerns and reservations against it. The real essence and success of the Malaysian Islamic banking practice come from serving people at the grass roots.

#### 4.3 Singapore

Singapore has been actively involved in promoting Islamic banking and finance operations in Southeast Asia for some time. The country entered into the Islamic banking arena by launching its own *Sukuk* in 2001. The country foresees its future in special areas of Islamic finance such as hedge funds, property investment, *Sukuk*, Takaful and wealth management. It wants to undertake a collaborative role with big Islamic financial institutions to add value, innovation and specialization into the international Islamic finance world. It aims to attract business firms and rich investors from the Middle East by offering them attractive business and investment avenues. Islamic banking and finance activities are gradually acquiring shape in the Singaporean financial market. In 2005, Malaysian Islamic bank – Maybank Singapore – launched its operations in Singapore with the *Shariah* compliant saving accounts. In the same year OCBC Bank, one of the Asia's leading financial services groups and largest financial institutions in the combined Singapore–Malaysia market, started to offer Islamic banking services in Singapore under the guidance of its own

Islamic *Shariah* advisory council. KFH is keen on opening its branch in Singapore and also interested in making huge investments in the Singaporean real estate sector. DBS Bank, the largest bank in Southeast Asia, is interested in setting up a fully dedicated Islamic bank in Singapore. Calyon has decided to offer the Islamic deposit schemes to the Singaporean Muslims. CIMB's Singapore plans to introduce Islamic unit trusts in its product streams.

The Takaful industry in Singapore holds assets of worth more than US\$500 million. HSBC Insurance and NTUC Income provide Islamic insurance services in Singapore. In 2000, Singapore launched its own *Sukuk* worth US\$45.652 million for property development. DBS Bank introduced *Ijarah Sukuk* of worth US\$38 million in 2001 and now working on developing Islamic bonds for wakaf assets and property management for Singaporean Muslims. There is high scope of investing Islamic funds in the Singaporean real estate industry. In 2005, the Singapore Stock Exchange introduced the first Islamic index, "Lion 30", composed of 33 companies whose operations were fully *Shariah* compliant. In February 2006, the Singaporean Stock Exchange launched the first FTSE-SGX Asia *Shariah* 100 Index. The index composed 100 stocks of companies across the Asian region which operations were in a full compliance with the Islamic *Shariah* (Venardos, 2006). The Monetary Authority of Singapore is committed to learn about Islamic *Shariah* principles on banking and finance. It has been working to introduce changes to its tax and regulatory systems to ensure proper growth and development of Islamic financial institutions in the country. It has sponsored the training programme of indigenous Islamic scholars who will develop Islamic banking and finance products for the Singaporean market.

### 5. Islamic banking and finance in Sudan (Africa)

Sudan started the journey of Islamic banking in 1977 under the dual banking system. The first Islamic bank – Faisal Islamic Bank Sudan – was established under the patronage of Saudi Prince Muhammad Bin Faisal Al Saud. In 1983, three more Islamic banks, namely, Tadamon Islamic Bank Sudan, Sudanese Islamic Bank and Islamic Cooperative Bank were established in Sudan. Afterwards the government of Sudan passed the Islamic *Sharaih* Act of Banking 1984 which required the whole banking and finance sector to be transformed on Islamic lines by 1 July 1984. However, due to economic crisis and political chaos over the decades the government made little success in implementing the Islamic banking system in the country. In 2002, the Islamic banking movement took another twist in Sudan at the wake of new political developments. The newly formed coalition government decided to adopt the dual banking system in the country from 2004. In Northern Sudan, where Muslims are in vast majority, the Islamic banking system was to be adopted. Whereas in Southern Sudan which holds Christians in the majority the conventional banking system was to be practised. Both financial systems were to be operated under the same monetary and fiscal policies devised by the Central Bank of Sudan. Presently, the banking and finance sector of Sudan comprised 26 banks, including three foreign banks. New Islamic banks in Sudan include *Al Salam* Bank Sudan and Emirates and Sudan Bank. Sudan took the initiative of introducing Takaful products and services in the Islamic business and financial world. The first Takaful company – Islamic Insurance Company Sudan – was established in Sudan in 1979. It may be aspired that the economy and political system of Sudan may become stable with the passage of time so as to provide environments conducive for the development and growth of Islamic banking and finance activities in the region.



## 6. Islamic banking and finance in European and Western countries

Islamic banking and finance has been promoted in the Western countries by their own financial institutions such as Citibank, ABN AMRO, Goldman Sachs, Kleinwort Benson and others. These institutions have established either Islamic units or “Islamic windows” or subsidiaries to attract oil-wealth from the Middle East and Muslim clientele from local markets. Small local financial institutions have also recently started to offer variety of Islamic banking and finance products in the Western markets. The growth of Islamic banking and finance practice appears to be very promising in the Western financial world.

### 6.1 Australia

Islamic banking and finance activities are in a nascent stage in Australia. The Muslim Community Cooperative Australia (MCCA) has been offering Islamic saving and investment opportunities to Australian Muslims since 1989. MCCA currently manages assets worth AUS\$28.536 million (US\$ 23.09 million) and it has over 8000 members. It is actively involved in Islamic finance activities in the property and real estate sector. On average, MCCA annually transacts home mortgage contracts worth AUS\$100 million (Sharif, 2006). Another conventional-based financial institution – APV Sydney Finance – also provides Islamic finance services to Australian Muslims. It approves the Islamic property loans from AUS\$50,000 (US\$40,453) to AUS\$200,000 (US\$161,812). National Australia Bank is developing its own systems to introduce Islamic banking and finance products in Australia. Moreover, Oasis Group Holdings and AmInvestment Group are interested in engaging in Islamic finance activities in Australia. There is a good opportunity for promoting genuinely Islamic and competitive banking and finance products for Australian Muslims.

### 6.2 United Kingdom

Islamic banking and financial institutions have had a little success in making inroads into the UK financial market. The scenario, however, dramatically changed over the recent years. The UK's Financial Services Authority (FSA) aims to develop London as a centre of Islamic finance and investments from the Middle East and other Muslim countries. The FSA removed double stamp duty provision on Islamic mortgage contracts from November 2006. Necessary changes to the UK Tax Law were introduced through the Finance Act of 2003, 2005 and 2006, which removed hurdles in practising *murabahah* and *Ijarah* mortgages, and diminishing *musharakah*. The UK's Treasury and the FSA hold some more regulatory and tax changes in the pipeline to launch *Sukuk* in the domestic market of the UK (Amin, 2007). There are over 2 million Muslims in the UK. The Middle Eastern Islamic banks want to use the UK market as a gateway and base to operate into European markets where Muslims clientele represent a significant part. However, prudential regulations in the UK do not permit an Islamic bank to operate in the country on risk-sharing and *murabaha* basis. Keeping in view the ground realities, Islamic Bank of Britain (established in 2004) and European Islamic Investment Bank (established in 2006) have emerged in the UK financial market to specialize in some areas of Islamic finance that include Islamic securities, treasury and capital markets, asset management, trade finance and capital-protected structured products. Local and international financial institutions such as Friends Provident International, HSBC Amanah, Lloyds, Lloyds TSB, Mortgage Insurance UK, United National Bank have established Islamic windows or subsidiaries that offer a wide range of Islamic finance and insurance products and service such as fund

management, retail and commercial property investment, consumer finance, saving products, credit cards and Takaful to Muslims in the UK. Islamic mortgages are expected to grow at average of 47 per cent per annum to reach US\$2.8 billion by 2009 (Croft, 2007). It is very important for Islamic financial institutions to offer truly *Shariah* compliant, innovative and competitive products and services to their Muslim clientele so as to win their moral and material support.

### 6.3 United States of America and Canada

Islamic banking and finance industry is gaining momentum in America and Canada where Muslim population is estimated to be 10 million. Islamic financial activities amount to US\$1.5 billion and US\$86.1 million in the USA and Canada, respectively (Ranzini, 2007). Islamic banking and finance has older and stronger roots in the USA. First and foremost, American Finance House LARIBA, a locally established financial institution in California, has been engaged in financing of autos, home mortgages, medical clinics and small businesses based on Islamic joint venture or leasing model since 1987. HSBC was also one of the pioneers of Islamic financing for home and automobiles in the USA but it has recently quit the market for different reasons. Some financial institutions have recently entered into the Islamic banking and finance market of the USA. University Bank of Michigan established the first Islamic banking subsidiary – University Islamic Financial – in 2005 which offers *Shariah* compliant products and services that include deposits, home finance and Mutual Funds to Muslims in the USA. Devon Bank, a community bank in Chicago suburbs, has started to offer commercial and personal loans for real estate and automobiles and other assets on *murabaha* and *Ijarah* basis. Anchor Finance Group USA has been engaged in offering *Shariah* compliant services in commercial and industrial markets that include fund establishment, project financing, real estate financing, venture capital and syndication. Moreover, Guidance Financial Group offers Islamic home financing products to Muslims in 32 states of the USA. It has developed worth US\$900 million *musharakah*-based home financing transactions since its inception. Another Islamic financial institution, Saturan Capital's Aamaa Mutual Fund Group is the biggest dealer of Islamic equity and Mutual Funds, worth US\$525 million, in the USA (Ranzini, 2007). *Shariah* Capital is acting as Islamic financial consultants in the USA over the recent years. It has been engaged in developing and promoting Islamic hedge funds, *Sukuk*, and venture capital instruments for local and international parties. Islamic banking and finance activities have recently emerged in Canada. United Muslims Financial Ontario has entered into a partnership with local Credit Union of Canada to provide Islamic mortgage financing worth US\$86.1 million in the last one and half year. There is a good scope of growth for Islamic instruments that include credit, saving and investment, hedge funds, private equity, *Sukuk* and Takaful or Islamic insurance.

## 7. Summary and conclusions

The Islam banking and finance system offers more ethical and efficient alternative to the interest-based conventional financial system. Islamic banking and finance institutions emerged in the Middle Eastern financial markets in early 1970s, based on models developed by Islamic economists over the past decades. Other Muslim countries also followed the suit and launched their own Islamic banking institutions. Three Muslim countries that include Iran, Pakistan and Sudan embarked upon the project of adopting the Islamic banking order at the state level. Some Western banks also launched Islamic banking and finance products to serve their Muslim customers.

The Islamic banking and finance industry made persistent advancements in its early period. Over the recent years, however, it has registered unprecedented growth due to core factors that include consistent high oil prices worldwide, booming economies of the Middle East, increasing diversification of Islamic banking products, clients and markets, and other changes in the world of politics. The governments of the Middle East and Asian countries have become very proactive in promoting Islamic banking and finance activities that are largely instrumental in further strengthening the regional business and finance links. The success of Islamic banking and finance in the Middle East and Asian regions bears profound impacts on global financial markets. The increasing numbers of Western financial institutions are using Islamic banking and finance as an opportunity to add innovation and diversity to their operations and attract oil-wealth and local Muslim clientele to their doors. Islamic financial institutions are becoming partners with Western market players to promote Islamic banking and finance products and services in European and Western markets. The Western market environments have turned up more conducive for Islamic banking and finance practice. These developments are very encouraging and have given the Islamic banking and finance industry a window of opportunity to become truly competitive and integrated part of international financial markets.

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