

Islamic Finance and Investment

A New Era

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ABSTRACT

Islamic banking is important because it provides a financial intermediation system that allows the global community to access the savings of Muslims worldwide and vice versa. The market for Islamic finance is currently estimated at US\$100 to \$150 billion, which represents approximately 20% to 30% of Muslims' savings and capital. The Islamic finance market is defined as the global pool of money that needs to be invested in a manner consistent with the *Shari'ah*. This "niche" global industry has the potential to grow to handle 50% to 60% of Muslims' savings worldwide within a period of ten years. Furthermore, Islamic finance is important to the global economy because it can complement the traditional system and overcome the conventional system's inability to integrate the Islamic markets and its participants into the global economy.

I. INTRODUCTION

The Islamic finance and investment industry can be a valuable ingredient in the development of more efficient and capable capital markets in the Muslim world and can hence contribute toward creating a more efficient world economy. Islamic banking can provide a financial intermediation system that allows the global community access the savings of Muslims worldwide and vice versa.

The lessons from the Islamic financial industry are two-fold. First, it offers us a model of how different segments of the global community can integrate efficiently even when cultures and value systems differ. Second, it also gives us a clear example of how to customize services for cultural and religious value systems.

If Islamic finance is useful to the global community, it is critically important to the Muslim world because it is a very important mobilizer of local and regional savings and an important provider of capital. While Islamic finance is small from a global perspective, it is very big in the Islamic world, especially in regions such as the Gulf, with market share ranging from 15% to 40% in different markets. It is also an important bridge to the global capital markets for many of those economies. Finally, it is a very important quickly growing regional industry that is sufficiently differentiated to be able to survive and prosper without "protection," and an industry that makes the Gulf region its home base.

Defining and clarifying some important terms and concepts will help in understanding this industry better.

II. DEFINITIONS

A. The Islamic Market

This is a global pool of money that needs to be invested in a manner that is consistent with the *Shari'ah*. It has no single location, but it is geographically concentrated. The largest contributions to this market come from the Gulf region, though other regions such as Southeast Asia, the Near East, and Turkey are growing in importance. Looking ahead, one can reasonably anticipate that contributions to this market would also come from the 16 million or more Muslims in Europe and America.

B. The Islamic Bank

An Islamic bank, by its own choice, complies with two sets of laws: the law of the land (jurisdiction) and Islamic law. This is why Islamic bankers have two types of legal counsel: traditional lawyers and *Shari'ah* councils.

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It is important to understand that a *Shari'ah* advisor is legal counsel and that the *Shari'ah* is a form of law. Furthermore, as is the case with any legal system, nobody has succeeded in writing down the book of law so that lawyers are no longer needed.

Shari'ah advisors like lawyers come in different areas of specialization. As such, it is not good enough to get the legal opinion of a respectable lawyer; he must also be a specialist in the relevant area of financial or commercial law.

C. Innovation in Islamic Banking

Innovation, like in other industries, is not the result of legal noncompliance but the result of creativity and strong legal compliance.

III. DEVELOPMENT OF THE MARKET

This market has grown from nothing to a US\$100 to \$150 billion market over the last 18 years. It is currently growing at around 10% a year. Within 8 to 10 years, this market will handle at least 50% to 60% of the total savings of Muslims worldwide.

This market is growing not only due to the growing awareness of Islam but also due to the fact that Muslims in the last 15 to 20 years have built significant wealth. Wealth in the hands of Muslims creates the need for Islamic banking services primarily because usury is a very serious sin in Islam.

The fact that Islamic banking is not the biggest (in terms of market share) in the most Islamically conservative markets supports this assessment. Rather it is prominent in those markets that have developed a significant middle income group and where economic development has made the need for banking services a must for convenient daily living. Compare Kuwait to Saudi Arabia—Kuwait has a market share penetration of Islamic banking of 30% compared to only around 10% to 15% in Saudi Arabia.

It follows that as national economies in the Muslim world develop, so too will demand for Islamic financial services grow. Another important factor supporting this growth in market share is that the industry is getting much more efficient and sophisticated, and transaction volumes have been steadily increasing.

The cost and quality of Islamic financial services is improving fast and closing the gap with the conventional market. This means that more and more Muslims are finding their needs satisfied and more and more are recognizing the value added and are hence willing to “buy” into Islamic banking. One can envision what the Islamic banking industry will look like when it can deliver quality and price at levels comparable to the conventional markets. That is to say, deliver the special design at no extra cost. At that time, which is not too far away, the Islamic market will be responsible for managing no less than 60% of the savings of Muslims worldwide.

IV. THE HOME BASE OF THE ISLAMIC BANKING INDUSTRY

The home base of this industry today is the Arabian Gulf region. That is where the major customers reside and where most international operators have based their own in-house Islamic banking units. The Islamic banking cluster in the Arabian Gulf is partly due to the sophisticated demand for these services and the wealth and status of those demanding these services. Bahrain seems to be the industry's most favored offshore center, with the key players coming mainly from Saudi Arabia and Kuwait. Saudi Arabia has the largest overall market, followed by Kuwait, which seems to be the most advanced in terms of market share penetration and sophistication.

V. CONCLUSION

Islamic banking was first allowed to exist because of political necessity and subsequently developed to the point where it was an “interesting experiment.” Now it has reached a stage where regulators and policy makers see it as an important local and regional industry and a niche global industry that deserves to be nurtured and promoted. Islamic banking has already made valuable contributions to the development of many Muslim countries and remains important for their future growth.

Islamic banking is important to the Muslim world because it is the intermediary of choice for anywhere between 20% to 30% of savings and capital, a figure that might possibly approach 50% to 60% in 8 to 10 years. It has also developed into an important regional and niche global industry. Already,

Islamic banks are some of the largest private sector financial institutions in the Islamic world, with growing regional networks.

Furthermore, Islamic finance is important to the global economy because it can complement the traditional system and overcome the conventional system's inability to integrate the Islamic markets and its participants into the global economy. Islamic banking is a better and more efficient way to link the Islamic world to the global market. For, if conventional banking is disagreeable to Muslims, Islamic banking, although different and abstruse to some, is not disagreeable to the rest of humanity. This fact alone indicates that it can become a key link between the Muslim world and the rest of world.

Value systems are an important source of energy and if used positively they are valuable assets that make for a better world. Realizing this allows us to approach social and economic development with an appreciation for the importance of culture and values. This will help us produce better results with fewer resources, and let concerned societies develop unique competencies and comparative advantages. This is an approach of a world that flourishes on variety and seeks to drive us to achieve our best, a world that makes use of differences to fashion a better and more interesting global community.