

## **Islamic Financial Products**

### *Addressing the Needs of the Retail Market Using the Internet as a Platform*

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#### **ABSTRACT**

The retail market for Islamic financial products and services is growing at double-digit rates, as evidenced by the annual reports of Islamic and conventional banks that have entered the retail Islamic space. With more product choice and a proliferation of new distribution channels, retail customers are finally finding what they have been looking for. Nevertheless, the market for retail products and services remains extremely fragmented and inefficient. Customers in the Islamic world entering the retail Islamic space are currently offered the products provided by their primary banking institution. Outside the Islamic world, this choice is not available. This inequity has opened the door for the Internet as a global platform to aggregate, to introduce transparency into, and to streamline some aspects of the retail market. Thus, Muslims globally can now access competitive financial products that abide by the *shari'ah* yet do not compromise excellence in wealth management.

#### **I. INTRODUCTION**

With awareness of the Islamic finance industry expanding, and a widespread desire for growth in the industry, it is important to consider the issues and trends that it faces. Through an examination of the situation from the perspective of an Islamic finance practitioner, namely, iHilal, many of the issues and trends will become clear.

At present, the Islamic finance industry exhibits a set of clear characteristics. The industry is fairly large, with about two hundred or more institutions, and has been growing at 10-15% or 15-20% for the past five years, but is highly fragmented. The industry is largely illiquid with minimal secondary markets, with only a few exceptions. There is minimal collaboration between Islamic institutions on the retail side but considerable cooperation on the institutional side. No universal standards on *shari'ah* or accounting currently exist. Some \$200 billion is distributed among 200 institutions, averaging some \$1 billion per institution. This figure includes some giants, such as Kuwait Finance House, with \$7 billion. The industry has a lot of cross-border trading, so that products come from one country and end up being sold in another country. The client base is composed of individuals from all over the world, but seventy percent of the funds entrusted to Islamic financial institutions comes from the Middle East. At the moment, the industry suffers from low product visibility and an underserved retail sector.

#### **II. CURRENT NEEDS**

Due to security and accounting concerns post-September 11, some sort of regulatory environment is essential for businesses that plan to work internationally. Islamic financial institutions must work within regulatory constraints in order to be able to increase product selection to consumers in different geographic locations. They must also enable existing product providers to reach other markets through globally recognized cross-border "know your customer" and anti-money laundering procedures.

The industry needs to enable existing Islamic financial institutions wishing to expand their market coverage and streamline business procedures to have access to electronically-aided distribution, as iHilal has been able to do. This is due to its self-characterization as a specialized company with global reach. In order to create liquidity in the market, it is essential to have a centralized place with all products, and people buying and selling. Today all the markets which had this layout in previous decades, such as stock markets, are moving toward electronic distribution or electronic trading, and ventures such as iHilal apply these technologies and methods to the Islamic finance industry, and specifically, to business-to-business transactions in the industry. This application of electronically-aided distribution should streamline business procedures and expand market coverage.

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### III. THE INTERNET

Consumer investing via the Internet started in the late 1990s, mainly because of the bull market and the spread of Internet usage. Many people took advantage of the strong stock market and their Internet access to invest. For the most part they made money, until the beginning of the bear market and the end of the technology boom. Today we see that, with the exception of day traders, gamblers, and savvy investment professionals, people have ceased to invest online. It is very hard to make money selecting stocks unless one is a dedicated professional; even the latter do not always do it very well.

The Internet continued to be used in a somewhat different capacity after the technology bust: as an add-on tool by financial advisors to keep their investors informed about their portfolios and positions. There are several limitations when it comes to the Internet and consumers. Those limitations include brand, confidence, physical reach, trust, credibility, financial advice, asset allocation coordination, education and customer service. Even withstanding all of these limitations, however, the Internet is the greatest networking tool to emerge since the telephone. Large efforts are being made to moving distribution toward independent advisors using the Internet as a platform. The Internet is ideal because it shows advisors, banks and institutions a selection of products coming from all over the world. It makes it possible for the players to consider all of the possibilities and choose the “best of the breed” products.

When it comes to institutional investing via the Internet, the best way to allow the customer to have choice is actually not for him or her to move directly to the Internet, but to come to a financial institution. That financial institution, be it a bank, financial advisor, or a money manager, should be asked about the best places to invest. Accordingly, that financial institution needs to have choice and selection when it comes to investment opportunities. The Internet and its derivative electronic distribution network fill those needs perfectly. Due to this capability there are moves being made toward providing electronic access and distribution through a dedicated sales force. Financial institutions are moving toward giving financial advice and sophisticated asset allocation services with the assistance of the open architecture platform inherent in the Internet. With this move, they are able to offer “best of the breed” products to their clients much more easily. Today’s customers prefer to buy without the hassle of signing papers and sending them off, as had traditionally been the case with the off-shore space.

Many institutional players, especially in the Middle East, are currently maintaining their own proprietary product range and are reluctant to offer third party products. This is a problem in that it hinders the exposure customers to the “best of the breed” products.

There are many barriers for financial institutions wishing to enter the Islamic financial space. These barriers include cumbersome business processes, lack of quality product sourcing and acquisition, a lack of marketing and sales know-how, and a failure to adopt electronic signatures. If these barriers were lifted, it would be far easier for new financial institutions to join the marketplace and engage in transactions.

### IV. THE INTERNATIONAL SCENE

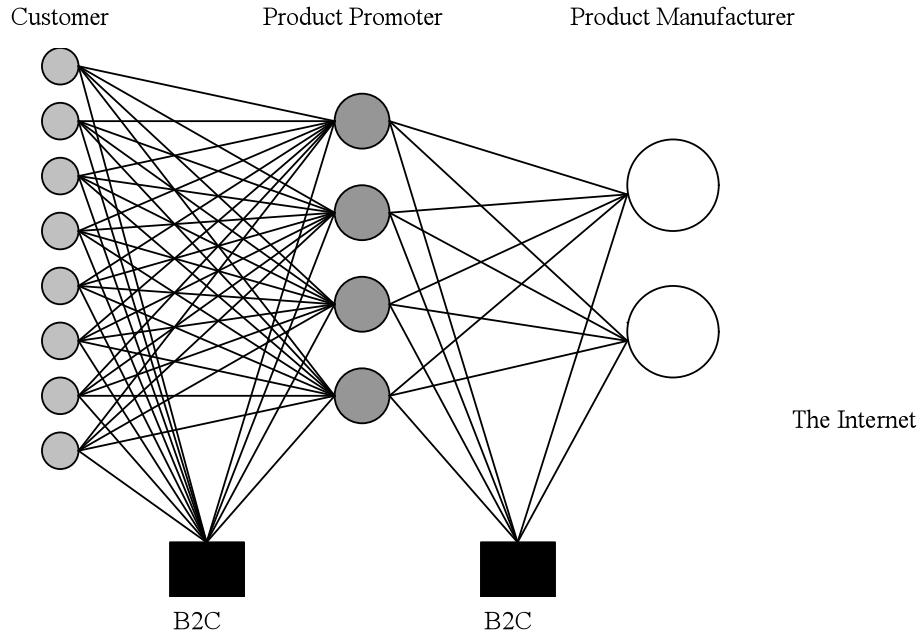
There are many differences and complications when dealing with different inter- and intra-national operations. The rules and typical procedures that one operates under in the United States are not always applicable in off-shore markets. Likewise, the rules and procedures that one operates under in off-shore markets are not always applicable in the United States, such as the Know Your Customer anti-money-laundering procedures, which differ from one country to the next. Thus practices that are sufficient in one country may not be sufficient in another.

The large homogenous economy of the United States is atypical when compared with the smaller economies in Europe or the Middle East. Those economies are often very fragmented in terms of jurisdictions and regulations. When dealing with international operations, it is important to realize that multiple regulatory constraints will have to be handled. A player in the Islamic financial space dealing with two hundred institutions all over the world, must know the regulations that apply in different parts of the world. Aside from knowing the regulations themselves, it is also important to work with regulated distributors in each country. This may complicate things for the player, but is absolutely essential in such a fragmented and diverse world. At present, several nations, especially in the Middle East, do not allow independent distribution channels—this barrier must be broken down for there to be full access to “best of breed” products. Lack of open access to “best of breed” products in many countries benefits “suitcase financial advisors and money managers,” but only hurts consumers. Along both intra- and inter-national lines, the Internet can assist Islamic financial institutions greatly in their very important goal of opening up access to “best of breed” products for their clients.

V. CONCLUSION

iHilal is an independent, specialized company in the Islamic financial space. It works in between buyers and sellers, assists players in the Islamic finance industry in structuring themselves and their operations, and aggregates the industry into the supply and demand sides. Operating in the manner that it does, it is able to assist individuals, private banks and financial institutions. In applying cutting-edge technologies and methods to the Islamic financial space, iHilal is helping to bring the “best of the breed” products to consumers and is helping stabilize the growth of the industry as a whole. With practitioners, such as iHilal, working closely with academics and *shari‘a* scholars, the growth and success of the industry as a whole can be assured.

FIGURE 1: THE SUPPLY CHAIN



**FIGURE 2: PRODUCT AND SERVICES OPEN PLATFORM**

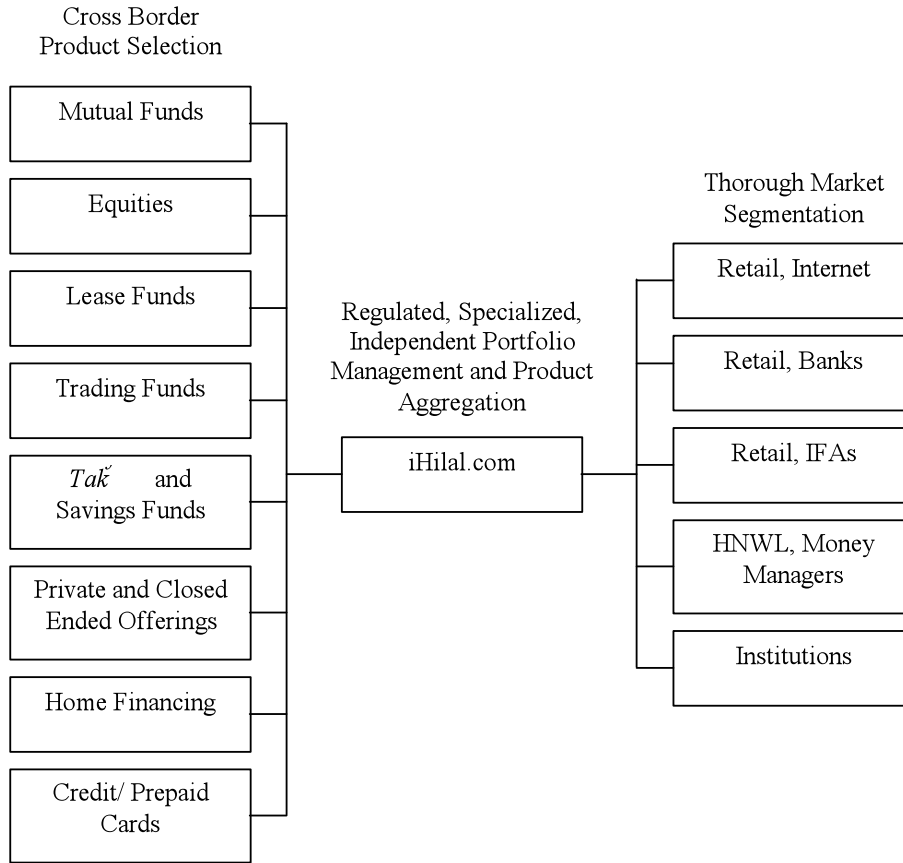


FIGURE 3: IHILAL BUSINESS MODEL

