ISLAMIC FINANCE CAN BENEFIT FROM GLOBALISATION

Globalisation is by no means a new phenomenon for the Islamic world. In fact, Islam itself has long been a powerful globalising force, long before the West could go on a globalisation spree. History bears testimony to the pervasive influence of Islam as a religion and as a way of life. The fact remains that Islam had spread in all directions through trading channels. Without a doubt, Islam has both contributed to and benefited from globalisation.

In a world currently dominated by Western capitalism, Islamic finance may appear as a novice, although it has a rich history as a facilitator of trade and economic transactions in the past. Islamic finance, eclipsed by the rise of Western colonialism and capitalism, remained dormant until the resurgence of Islam in recent times. Dramatic changes across the globe have compelled Islamic finance to reinvent itself. It is only in this sense that Islamic finance is a new phenomenon that has attracted growing attention of global proportions.

Islamic finance is now a big industry that is truly worldwide. There are over 90 Islamic banks spread across 35 countries, excluding those in Pakistan, Iran and Sudan. It is estimated that assets managed according to the Shariah principles by Islamic financial institutions, including Islamic banks, exceed US$200 billion. While Islamic finance is fully in place in Iran and Sudan, elsewhere it is making significant inroads, covertly challenging the well-established conventional system. In Kuwait and Qatar, for instance, Islamic banking accounts for over one-fifth of total deposits. Bahrain has emerged as a major Islamic financial centre that provides innovative Islamic instruments for money management. Meanwhile, a market for Islamic securities has developed in Malaysia. What is more, many big names in multinational banking, which include Chase Manhattan, Citibank, ANZ Amro, Grindlays and HSBC, are now offering Islamic financial products. HSBC's Amanah Finance, set up in 1998, was initially targeting its clientele in Saudi Arabia and Malaysia but is now going global by marketing its Islamic financial products in North America and Europe.

To be sure, Islamic banking is no longer confined to full-blown Islamic banks only. Conventional banks also offer Islamic financial products. Ironical as it may sound, it is conventional banks, rather than Islamic banks, which have given Islamic finance a greater outreach through their extensive branch networks. This is indeed the case in Malaysia where 14 conventional banks (10 local and 4 foreign) have 1,335 branches operating Islamic counters, compared to the 122 branches of Islamic banks in the country. What is more, 9 finance companies operate Islamic windows in some 730 branches in Malaysia. It is also of interest to note that there are 8 full-fledged Islamic branches belonging to conventional banks, in addition to 2 such branches operated by finance companies, in the country.

It may be simply profit motive that is driving these conventional banks and finance companies to sell Islamic financial products, because they see a growing demand for such products. These financial institutions may understandably lack the missionary zeal of Islamic banks in promoting Islamic finance. Nonetheless, it does appear that conventional banks may even overtake Islamic banks as the main providers of Islamic financial services, although concerns have been expressed that funds may get mixed up in the common "kitchen".

Evidently, Islamic finance is undergoing rapid transformation under the globalisation mode, a manifestation of which is the emergence of offshore Islamic financial centres serving international clients. Bahrain, the leading offshore centre, plays a key role in the Islamic money market, dealing in three-month government bills that were introduced for the first time in June 2001. Labuan in Malaysia also aspires to become another major offshore Islamic financial centre.

Globalisation throws a lot of challenges at Islamic banking. It calls for innovation and reinvention. It is time Islamic finance looked beyond such traditional modes as Murabahah (mark-up), Mudarabah (profit-sharing), Musharakah (partnership) and Ijarah (leasing). There is nothing sacrosanct about these instruments, notwithstanding the fact that these are unquestionably Shariah-compatible. In fact, some of these modes represent pre-Islamic practices, which were subsequently adopted only because they were in conformity with the principles of Islam. There is certainly a need to devise modern financial instruments that will conform fully to the Shariah law.

Care must however be taken to ensure that Riba (interest) is not admitted unwittingly through the back door in the name of financial innovation or in the process of Shariah reinterpretation. An interesting case in point is trading in debt based securities. While the Malaysian government has been offering Islamic bonds for more than a decade, the Gulf governments have been issuing papers which are not traded but held until maturity by commercial banks due to Islamic objections to trading in debt based securities. The main disadvantage of this is that it restricts the liquidity of bank assets and limits the scope for raising public funds. Bahrain has found a solution to this problem through Sukuk Al-Salam Securities which provide a fixed return calculated to reflect the real benefit the government expects from the use of the funds, with no reference to market rates.

It is noteworthy that the market response to the three issues of Sukuk Al-Salam Securities thus far has been overwhelming, as these were hugely oversubscribed. This success with government securities has led three banks (Kuwait Finance House, the Dubai Islamic Bank and the Bahrain Islamic Bank) to establish a liquidity management centre in Bahrain for trading in Islamic corporate securities.

Globalisation does not necessarily mean competition only. It also offers space for cooperation as well, as shown by the extent of cooperation between Malaysia and Bahrain. The opening of an Offshore Banking Unit in Bahrain by Malaysia's Maybank is a case in point. This offshore unit, which operates an Islamic banking window, in addition to conventional banking, markets Maybank's Islamic products. There are signs that Labuan (Malaysia) and Manama (Bahrain) may cooperate in jointly developing the International Islamic Financial Market for trading in Islamic bonds and bills so that both can profit from the difference in the time zones. This, however, calls for not only identical trading systems but also identical software platforms, which may take time to evolve.

Globalisation can help integrate the segmented markets for Islamic financial products through standardisation of regulations. Islamic banks may eventually be subjected to the scrutiny of international monitoring agencies like the Bank of International Settlements (BIS). Going by the BIS criteria, most Islamic banks have comfortable asset ratios. For example, Al Baraka Islamic Bank in Bahrain has a capital adequacy ratio of 22 per cent, while the corresponding ratio is 16 per cent for the Jordan Islamic Bank, way above the BIS bottom-line of 8 per cent, even though Islamic banks need less capital cover than conventional banks. After all, the investment deposits with the former are not guaranteed under the Mudarabah mode, quite unlike that of the latter.

The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), based in Bahrain, plays an integrating or harmonising role in terms of accounting and auditing practices and norms. Reference should also be made to the Islamic Financial Services Board (IFSB) which was established early this year with headquarters in Kuala Lumpur. Basically, IFSB is seen as an association of institutions charged with the regulation and supervision of the Islamic financial services industry that would undertake research and provide training and technical assistance.

As mentioned, the Islamic financial markets are highly segmented with considerable national differences due mainly to differences in Shariah interpretation, legal systems and differentiated financial instruments. Globalisation can bring about standardisation of financial products. Adherence to international regulations from designated Islamic institutions, such as AAOIFI and IFSB, and, where relevant, secularist institutions such as the IMF and BIS, would place Islamic finance on par with conventional finance in the pursuit of best practices.

With globalisation, Islamic financial instruments add considerable variety and choice not only to the Muslim clientele but also to the non-Muslims as well, giving Islamic finance a truly pluralist flavour. Religious orientations aside, all those who do care about the ethical content of their financial transactions are likely to be inclined towards Islamic finance. For, there is much more to Islamic finance than the mere elimination of Riba or interest. Islam prohibits transactions of fraudulent nature. To be truly Islamic, the financial instruments must be free from all forms of deceit, exploitation and ambiguity. Indeed, such universal values mean a lot to a lot of people regardless of their religious backgrounds. The number of non-Muslims using Islamic financing is on the rise. Thus, for example, about one-fifth of the HSBC Amanah financing in Malaysia is catered to non-Muslims.

Under globalisation, threats to Islamic banks and financial institutions would come mainly in the form of foreign takeovers. Islamic banks in this sense are vulnerable, because they are small. Nearly two-thirds of them are below what is considered the critical minimum, i.e. US$500 million in assets. The assets of the largest Islamic bank are no more than a tiny fraction of that of the largest conventional bank in the world. Such considerations underscore the need for mergers and strategic alliances. Already there are some bold initiatives in this direction. These include the recent merger of the Faysal Bank in Bahrain with other group affiliates to form the Shamil Bank. There have been talks of an impending merger of the Al Baraka Islamic Bank in Bahrain with a major financial house in Kuwait.

Globalisation is also likely to narrow the differences in the yields of Islamic financial instruments between countries, due to freer flow of funds. This convergence in the rates of return is by no means a bad thing, but this does suggest that Islamic financial institutions will become less and less autonomous under globalisation. Competitive pressures and client expectations may push the rates of return on Islamic financial instruments closer to that of secular markets, notwithstanding the fact that higher risks associated with Islamic finance would warrant higher returns. The important point is that even if the rates of return between Islamic and secular modes are equalised, the distinctiveness of Islamic finance will still remain.

Finally a word of caution is in order. Under the globalisation mode, there will be a strong tendency for Islamic banks and financial institutions to focus on the rich who are flush with cash and to walk away from the small and the poor who are likely to be marginalised by the globalisation process. To be sure, Islamic finance is not about just Riba-free sharing of profits and risks. The spirit of Islamic finance demands that it reach out to the masses in a caring manner. This indeed is a big challenge for Islamic financial institutions, as returns may not jive well with risks in all instances.

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