April 2019

The Rise of Islamic Banking

Islamic finance is the fastest growing sector in global banking and its potential for further growth is only increasing by the minute. As Islamic banks continue to expand in both their traditional market and into the West, what will be their key to success and what does this mean for longstanding global banks?

When we think of global banking brand names, we predominantly think of western banks with an established brand and decades, if not centuries, of history behind them. These behemoths keep growing, albeit slower than they would like, and constantly face the dual challenges of technology and regulation as they try to take market share from each other in an increasingly competitive global market space. However, there are two other major challenges rising quickly that are currently centered in Asia and the Middle East, but with global aspirations.

Emerging competition

The first is the meteoric rise of the Chinese banking sector—a sector with strong balance sheets and market capitalization. To put this into perspective, of the ten largest banks by market capitalization, five are Chinese. These firms also have the technology to be competitive with global brand names when and if they choose to do so. In many cases, Chinese firms are leading in the FinTech race.

The second is Islamic finance, which is the fastest growing sector in global banking. While the principles of Shari'ah law apply to how these firms do business, they will gladly open their doors to customers who do not follow the principles of Islam.

So, what's the issue? You are probably thinking that it is a niche and will likely stay that way. This perspective may have been true a decade ago, but the facts and figures are showing that globally, Islamic banking is growing quickly in both its traditional markets and in the West.

What are the growth opportunities for Islamic banks?

The potential in traditional markets is huge. Unlike the western markets, where access to banking products and services is taken for granted, this is not the case for much of the population in Asia and Africa. The rapid deployment of internet banking services in these countries is opening segments of the population in geographical areas, which were previously deemed unreachable by conventional branch-based banking. The key to growth will be how well the organizations tackle these opportunities. However, it could be argued that, even if they on-board a fraction of the population, they will enjoy meteoric growth. Countries like Indonesia (with the world's largest Islamic population), Bangladesh, Egypt, India, Kenya, Malaysia, Pakistan, Turkey, Xinjiang province in Western China, the Southern

Caucus states of the former USSR, and, of course, the MENA (Middle East North Africa) regions all provide opportunities. The key to success will be their products and offerings, and not their labels. However, there are several reasons for global banks to be wary.

As noted in a recent interview with Ibrahim Al Mheri, CEO of Mashreq Al Mheri Islamic Bank, Islamic banks are open to all customers. “The key for Islamic banks is not just to position themselves as providers of Shari’ah compliant solutions, but also to provide all the banking services for which international banks are known.”

This message is backed by action in the sector. For example, you can now avail of Islamic crypto currencies from regulated providers in Bahrain. Morocco is establishing Casablanca Finance City as the epicenter of Islamic finance in Africa. The Global Sukuk Market is undergoing a major overhaul to standardize the issuance process, which will help grow the market for corporate financing. Home loan products, which can fix your outgoings for the duration of a loan, are making inroads into the traditional mortgage market across the world. Shari’ah funds are available in almost all global pension products by popular demand. Some markets are already mostly Islamic, with Malaysia, for example, having 61% of its capital markets defined as Shari’ah compliant stock—this is approximately $450B of value. Malaysia now has Islamic wholesale funds, private retirement schemes, unit trust funds, ETFs, and REITS.

Lastly, China has reached out to the UAE to help link Islamic finance to their “One Belt One Road” initiative, as they see Islamic financing as integral to their strategy of linking the economic growth of 60 countries.

Add to this the fact that the banks following Islamic banking principles have a mission statement that will resonate with all customers globally in a post financial crisis world, where many clients no longer have faith that the western banks put the customers’ interests first. Islamic banks ask all staff to follow ethical values of Shari’ah, including haqq (truth and right), qist (equity), and ‘adl (equilibrium and justice). From a consumer perspective, it is hard to argue with a banking proposition that integrates these principles within their business model.

The other obvious engine for growth lies in Islamic banking’s entrance into new markets in the West. This provides them with a ready-made customer base, as those who follow Islam may be more comfortable switching to a bank that is seen to specifically cater to their needs. This covers 4.5% of the UK population, or a potential 2.7M. In knowing this, it’s little wonder why more than a dozen providers in the UK have sprung up to take advantage of this opportunity by presenting themselves as having a Shari’ah compliant division or complete focus. We’ve listed some of these firms below:

- Al Rayan Bank, United Kingdom
- Bank of London and the Middle East (BLME), United Kingdom
- Barclays Capital, United Kingdom
- European Islamic Investment Bank (EIIB), United Kingdom
- Gatehouse Bank, United Kingdom
- HSBC, United Kingdom
- Islamic Bank of Britain, United Kingdom
- QIB UK, United Kingdom
- Rosette Merchant Bank, United Kingdom
- Royal Bank of Scotland, United Kingdom
- Standard Chartered, United Kingdom

Future outlook

The regional banks of the GCC view this as an opportunity, and several of the larger players are tentatively entering markets outside the GCC with both an Islamic and a non-Islamic footprint. This will surely have an impact on the local competitive environment. With several large bank mergers occurring in the GCC, merged banks will become very large and search for new markets. While there are many specialized positions in the Shari'ah banking sector, the core operational and front office jobs are extremely similar in nature, causing Islamic banks to continue to compete for talent within the non-Islamic sector.

This segment will keep growing and expanding. While larger banks may not have viewed the Islamic sector as obvious competitors in the industry, these regional institutions most definitely have their eyes on their customer base at every level of financial services.

What should you be doing?

Clearly, not all banks can suddenly open an Islamic banking arm—it takes a deep commitment to the principles of Shari'ah law and many levels of accreditation by scholars to be accepted. However, traditional banking firms should certainly be evaluating the risks to their customer base and the challenges faced when seeking to expand into emerging markets.

Middle East banks are going through a swath of mergers to boost balance sheets and fund expansion. They often have a Shari'ah compliant and a traditional bank operating side by side, thereby covering all angles. In knowing this, traditional banks operating in global markets must ensure their product offerings are competitive. The growth agenda of this segment targets customers with an offering based on great products and great service, which might also happen to be Shari'ah compliant.

To learn more about the rise of Islamic banking, its potential impact, and what this means for global banks, please contact our team.

Author Contact Information

Martin McGuigan
Partner, McLagan
Aon
+971 4 389 6355
martin.mcguigan@mclagan.com

About McLagan

McLagan provides tailored talent, rewards, and performance expertise to financial services firms across the globe. Since 1966, we have partnered with the largest and smallest financial services firms to help them make data-driven decisions to hire, retain, and engage the top talent for keeping the global economy running. Our compensation surveys are the most comprehensive, in-depth source of rewards data covering over 150 countries from more than 2,500 clients. Our consultants work with hundreds of firms annually to design total rewards programs and benchmark financial performance for boards of directors, executives, employees, and sales professionals. McLagan is a part of Aon plc (NYSE: AON). For more information, please visit mclagan.aon.com.

About Aon

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.

For further information on our capabilities and to learn how we empower results for clients, please visit http://aon.mediaroom.com.