

Islamic Finance Status Quo in the Light of Financial Innovation: Sukuk as a Model

الوضع الراهن للتمويل الإسلامي في ضوء الابتكار المالي: الصكوك كنموذج

Phd. Assia CHERFI

Dr. Kamel AMEUR

Local Sustainable Development
Laboratory

University of Medea, Algeria

University of Medea, Algeria
cherfi.assia@univ-medea.dz

ameurkamel@yahoo.fr

Received: 22/07/2019

Accepted: 17/03/2020

Résumé : Cette recherche vise à montrer la situation actuelle de la finance islamique, en particulier avec l'expansion du secteur de la finance islamique au cours des dernières années, définir l'innovation financière islamique. En se référant à Sukuk en tant que modèle dans le domaine de la finance islamique. Les statistiques montrent que le Sukuk est devenu le segment du marché de la finance islamique dont la croissance est la plus rapide. L'étude a conclu que le Sukuk est l'un des produits financiers islamiques les plus performants, il est devenu un instrument contemporain accepté par les musulmans et les non-musulmans.

Mots Clés : Finance islamique, Innovation financière, Innovation financière islamique, Sukuk.

Abstract: This research aims to show the current status of Islamic finance, especially with the expansion of the Islamic finance sector in the recent years, define Islamic financial innovation, with reference to Sukuk as leading model in the field of Islamic finance, as statistics show that the Islamic Sukuk has become the fastest growing segment of the Islamic financing market now. The study concluded that Sukuk is one of the most successful Islamic financial products; it became a contemporary instrument accepted by Muslims and non-Muslim.

Key Words: Financial innovation, Islamic finance, Islamic financial innovation, Sukuk.

JEL Codes : G21, G23.

* Corresponding author: Cherfi Assia (cherfi.assia@univ-medea.dz ; asya.cherfi@outlook.fr).

Introduction:

In light of the expansion of the Islamic finance industry and the development of interest in the Islamic economy, the need for innovative Islamic financial contracts has become, enabling Islamic banking to meet the needs of its customers and guaranteeing a market share that will help it continue.

Islamic banking in recent years has seen rapid growth and spread across the world, and its products have been accepted by Muslims and non-Muslims, but are still looking at developing products that can reduce the cost of its services. One of the most important financial innovation product is Sukuk.

Sukuk is a new financing tool, which is based on Islamic canon jurisprudence. Once it emerged, it became a contemporary instrument accepted by Muslims and non-Muslim and as a result, it spreads throughout the world.

Research problem: The success of Islamic banking in meeting the client's needs and their desires and achieving the desired objectives, needs a diversity of tools and financial products which are able to comply to local and global economic variables therefore this issues begs the following problematic question: What is the Islamic finance status quo under financial innovations?

Research importance: In the light of the enormous radical changes, the world has seen in the field of banking, just as the interdependence of international financial markets by the ICT revolution and with the emergence of the developing role of Islamic banks, particularly with the developing request for Islamic financial products, Islamic banks meet a total range of defies allied to competition in the global banking environment; these defies need investment tools innovation and advanced methods to meet clients' requests in line with Sharia.

Research methodology: depending on analytical descriptive approach to present the basic concepts of finance Islamic and financial innovation. In addition to the analysis based on some statics of Sukuk.

1. The context of Islamic Banking and Finance:

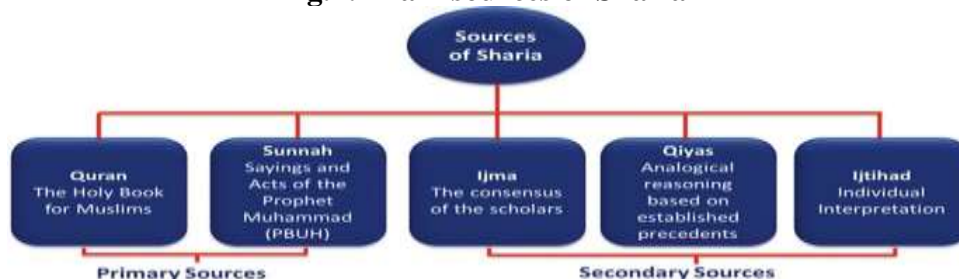
Over the last two decades, the notable global increase of Islamic banking and finance is taking much response all over the world, which has gotten the stage of its particular economic achievement. This achievement is also providing to be an entry for Middle Eastern petrodollar and Islamic banking investments into all great developing, emerging and developed markets. (Muhammad, 2018, p1).

1.1. Definition of Islamic Finance:

Islamic finance is a particularly interesting phenomenon because it presents itself as an alternative to conventional finance (Hans, 2009), to provide conformity between the financial intermediation and the tenets of society wanting to involve Islamic Sharia rules. (Amr & Graiss, 2015, p1).

Today, Sharia compliant financial assets are projected at roughly 2 USD trillion, covering bank and non-bank financial institutions. (Muhamed, Abdul & Turkhan, 2019).

Islamic finance defined as financial services mainly applied to conform to the main tenets of Sharia. (Alsadek & Andrew, 2007, p4), the main bases of which are the Koran, the Sunna, the Al-ijma' and Al-qiyas. (Simona & Asma, 2018, p2).

Fig.1: Main sources of Shariah

Source: Samir, 2017, p16

Definitions of Islamic finance range from the very narrow definition of “interest-free banking model” to the very broad one of “financial operations conducted by Muslims”. (Samir, 2017, p15). In accordance with Islamic law, Islamic financial products are founded on specific sorts of contracts: equity based contracts, sale based contracts, debt based contracts and charitable contracts. (Samir, 2019, p16).

Fig.2: Islamic financing technique and instrument

Source: Samir, 2019, p16

1.2. Islamic finance developments during 2018:

The Islamic finance sector has grown rapidly both globally and in the Arab world, although it still represents a modest percentage of global financial market activity. The Islamic financial and banking industry is expected to be well developed with the support of capital market products and the adoption of financial technology, particularly in terms of improving the quality of services and innovating new products to reach a wider customer base.

Within this framework, The Banker's magazine annual Islamic finance survey showed that global Sharia compliant assets rose from 1,509 USD Billion in 2017 to 1,624 USD Billion in 2018, an annual growth rate of 7.59%, compared to a growth rate of 4.74% 2017.

The year 2018 witnessed a quantum leap in the growth of Islamic assets around the world. Australia, Europe and the United States recorded the highest growth in total Sharia-compliant assets globally 20.2%, followed by Asia 16.3% and Sub-Saharan Africa 12.6%, Followed by the Middle East and North Africa (excluding the Gulf States) 6.3%, and finally the Gulf Cooperation Council (GCC) 5%. The Islamic

finance sector remains active in oil-exporting countries, with GCC countries accounting for about 50% of the sector's assets.

According to report Thomson Reuters 2018, prospective for the Islamic finance industry to increase to 3.8 USD trillion in assets by 2023, an average estimated increase of 10% per year.

However, despite this, on a global scale the industry is still small, representing just one percent of global financial assets. Most of these are only located in the seven Gulf Cooperation Council (GCC) countries, as well as Iran and Malaysia.

1.3. Overview of Islamic bank:

An Islamic bank is a financial institute, which usually proceed the functions of returns mobilization and profits generation in compliance with Sharia. (Mondher, 2014, p1).

In a small community finance in Egypt 1963, the modern Islamic bank movement started. (Faten, Chantal & Aldo, 2016, p74). original conception on the founding of Islamic banks internationally began in an OIC conference in Kuala Lumpur in 1969. The Islamic Development Bank (IDB) was established in 1973.

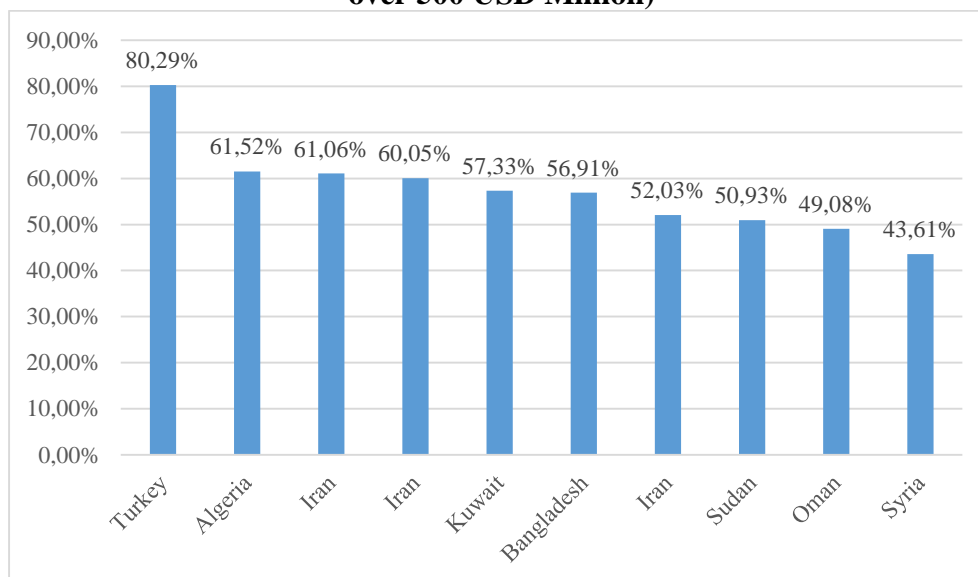
The first Islamic bank instituted was a private one built by a group of Muslim businessperson from different nations; the Dubai Islamic bank was established in 1975. After that, Islamic banks continued to be established In 1977, three banks were established: Faysal Islamic Bank in Egypt and Sudan, and Kuwait Finance House. Bahrain Islamic bank was established in 1979. Philippine Amanah bank was established in 1973 based a presidential decree. At the insider of the 1980's, Islamic banks spread throughout the world, even traditional banks opened windows and branches of Islamic dealings. (Imam & Fenny, 2015, p33).

Table 1 shows the top ten Islamic banks in the world in 2019 with assets of over 500 USD Million. Turkish bank ZiraatKatilimBankasi is the largest Islamic bank this year with an increase of 80.29%. The list of 10 fastest growing banks included three Iranian banks and one bank from Bangladesh and Turkey. The Arab region is emerging as a major asset growth market with five Arab banks: (from Algeria, Kuwait, Sudan, Oman and Syria) among the top 10 banks in terms of global asset growth, reflecting the superiority of Arab Islamic banks globally in terms of growth and expansion.

Table 1: The fastest growing Islamic banks in the world in 2019 (with assets of over 500 USD Million)

	Bank	country	Volume of Islamic assets	Growth rate
1	ZiraatKatilimBankasi	Turkey	3,776.18	80.29
2	El Salam Bank	Algeria	747.06	61.52
3	Gharzolhasaneh mehr Iran Bank	Iran	3,878.08	61.06
4	Export development bank of Iran	Iran	6,855.93	60.05
5	Warba Bank	Kuwait	5,868.81	57.33
6	Union bank limited	Bangladesh	1,614.65	56.91
7	Tourism Bank	Iran	6,312.99	52.03
8	Bank of Khartoum	Sudan	2,723.42	50.03
9	Alizz Islamic Bank	Oman	1,479.73	49.08
10	Syria International Bank	Syria	608.08	43.61

Source: UAB Magazine- Issue 462, May 2019

Fig.3: Growth rate of Islamic banks fastest in the world in 2019 (with assets of over 500 USD Million)

Source: Prepared by researchers based on the table 1 data

2. Scope of financial innovation:

The financial innovations have had a long history of advance. Also, can be categorized a financial innovations, that any financial instruments, any financial institutions and any financial markets. In the 17th and the 18th century, the new financial instruments-debt contracts together with high liquid markets were introduced to gather capital required to finance the oceanic expedition and trading voyage. Then, in the 20th century, the private equity companies emerged to analyze and finance high- tech investment project. Toward the start of the 21st century, the new form of investment companies is developing, the pharmaceutical corporations analyzing and funding the biotech innovative solutions. These are just a few examples of the new financial developments and their development.

Therefore, financial innovations are not a completely new issue. However, their significance has expanded as of late, as since the mid-1990's the increasing speed in the pace of innovations has been observed. (Joanna, 2011, p 17-18).

2.1. What is financial innovation?

After discussing some examples of the innovative financial developments and their evolution, let us have a closer look on it. Frame and White define a financial innovation as “something new that reduces costs, reduces risks, or provides an improved product, service, instrument that better satisfies financial system participants demands”. (W.Scott, Larry & Lawrence, 2018, p4).

Financial innovations defined as financial services which offering certain customers a new product. They also indicate to actions which objective at introducing or ameliorative financial instruments, making modifications in the organizational structure of the system and implementing modern technology and computerization. (Karolina, 2018, p60).

2.2. Definition of Islamic financial innovation:

Islamic financial innovation defined as the method of using Islamic lawful contracts in new means to evolve financial product that comply with Sharia. (Mumayon, 2003, p2). Sharia rules and regulation are the tenets of Islamic finance Product. (Hazik, 2019, p69).

2.3. Some Islamic innovation:

Islamic bankers are developing innovations and workarounds that enable them to bring Sharia-compliant services into the digital age.

Table 2: innovators in Islamic finance 2019

Company	Innovation
ADIB Egypt	Covered cards Renewals
Boubyan Bank	iMal
CIMB	Exchangeable Sukuk
CIMB	Wakala Sukuk
QIB	Instant Finance
Noor Bank	Trade Biz Accelerator

Source: Gilly, June 2019

- Boubyan Bank Completes iMAL Islamic Core Banking Platform Upgrade the Boubyan Bank system upgrade demonstrates how Path Solutions' combination of consulting expertise, technology excellence, proven

implementation methodology, and deep industry knowledge delivers significant results.

- Qatar Islamic Bank (QIB) has officially announced the launch of ‘Instant Financing’ – the fastest and simplest way to obtain personal financing in Qatar. The service enables existing customers of the Bank to get top up financing instantly, in a completely paperless and digital manner without the need to visit the branch.
- Abu Dhabi- based ADIB advanced a renewal process that lets clients renew a card without having to re-sign, and keep the same card number, so that recurring automated payments are not interrupted.
- Noor Bank, a leading Shari’a-compliant bank in the UAE, announced a significant partnership with Microsoft that will drive Digital transformation within the bank’s operations to engage customers, empower employees, optimize operations and transform products and services. It also launched the Noor Trade Biz app, which gives small and medium-sized enterprises discounted services and access to information about third-party financial products. Noor has structured digital platforms to provide Shariah-compliant working-capital finance against accounts receivable.
- Jakarta-based CIMB Group acted as bookrunner, lead manager and dealer for a wakala sukuk for the Republic of Indonesia. The deal included a five-year green tranche and a 10-year conventional tranche. The green tranche is the world’s first sovereign green sukuk offering, and the first under Indonesia’s newly established Green Bond and Green Sukuk Framework, whereby proceeds are to be used exclusively for eligible green projects. CIMB was also, in January 2018, the bookrunner on the first-ever exchangeable trust certificates offering exposure to the Chinese financial sector for Khazanah Nasional Berhad, Malaysia’s sovereign wealth fund. To date, it is also the only equity-linked transaction in the Asia-Pacific region to achieve a sizeable exchange premium at the point of pricing (40%). As Shariah adviser, CIMB structured the deal around an innovative trust certificate, with cash-only settlement, that enabled Khazanah to monetize its holdings in China’s CITIC in a Shariah-compliant manner—the first of its kind in the global markets. (Gilly, June 2019).

2.4. Phases of the history of Islamic finance and its innovation:

The history of innovation in Islamic finance is divided into eight phases. We summarize the phases of innovation Islamic finance from the sixteenth century to modern days.

Table 3: Summary of the eight phases and development of financial innovation

Historical phase	Financial innovation
Phase one: 622–661	<ul style="list-style-type: none"> • The development of the profit sharing contract within the Islamic context. • Currency Exchange. • Credit Sale and Mortgage. • Murabaha Sale. • Forward Sale. • Transference of a debt from one person to another. • Business by proxy • Partnership. • Wakfs
Phase three: tenth to thirteenth century	<ul style="list-style-type: none"> • Reform of the tax system. • The refinement of the Islamic
Phase four: thirteenth to six- tenth century	<ul style="list-style-type: none"> • Trade finance was appeared
Phase five: sixteenth to nine- tenth century	<ul style="list-style-type: none"> • The reform of the export sector and financial tools • The establishment of first national banks in Egypt and Turkey. • New business practices
Phase six: nineteenth century to 1970	<ul style="list-style-type: none"> • Financial development in order to foster economic dealings with foreigners and Western Europe helped the establishment of the commercial courts
Phase seven: 1950s to 1960s	<ul style="list-style-type: none"> • Deployment of surplus liquidity from selling oil
Phase eight: 1970s to present	<ul style="list-style-type: none"> • The emergence of Islamic banking

Source: Samir, 2017

3. Sukuk:

Innovation in the Sukuk market is a part of innovation within Islamic finance industry. The structuring of Sukuk is a typical sort of financial engineering. (Muhammad al-Bashir, 2012, p6).

In late years the Sukuk market has developed profoundly, it has turned out to be one the fastest growing sectors in Islamic finance industry. (Ahcene & MKabir, 2018, p1).

3.1. What is Sukuk?

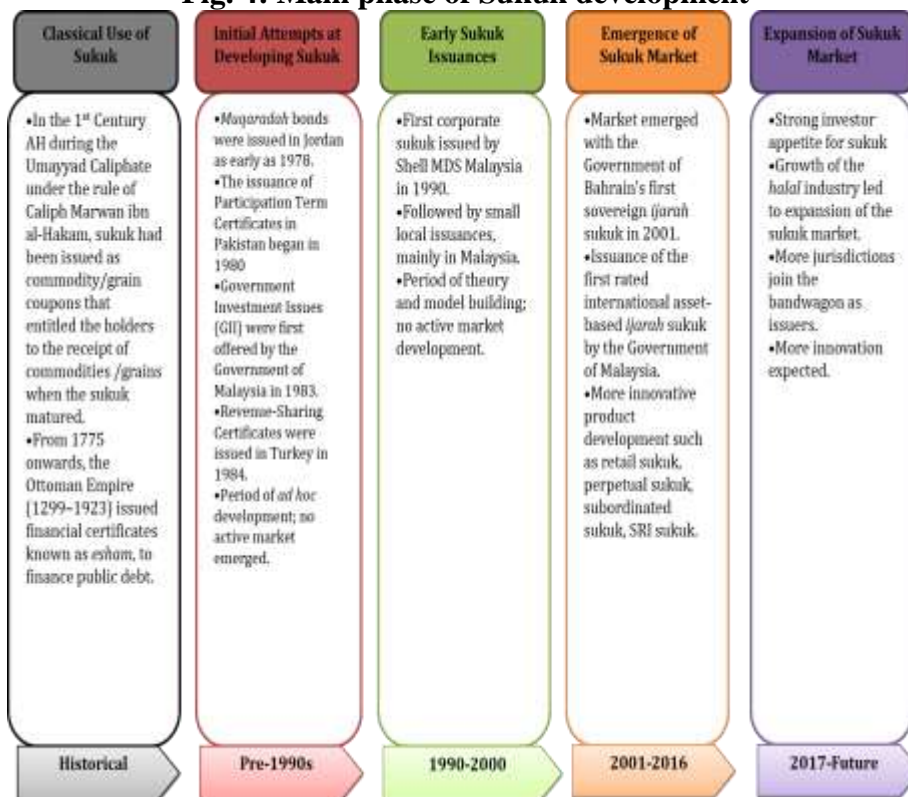
Sukuk is an Arabic word that has its origin from the word Sakk that means financial instrument or check. (Shafiu, 2015, p214). Sukuk is an Islamic bond issued in compliance with Sharia. Though the receipt and payment of interest is prohibited by Sharia, profits that arise from management of assets and business activities are allowed to distribute. (Yasuharu, 2018, p2).

3.2. Development of Sukuk market:

The evolution of Sukuk can be traced back from its classical use to its development in modern. Initial use of the term “Sukuk” in classical literature can be traced back to the 1st Century AH.

The Sukuk market marks its real development from 2001; there has been an augmented number of Sukuk issues amid significant market development. (COMCEC, 2018, p 9).

Fig. 4: Main phase of Sukuk development



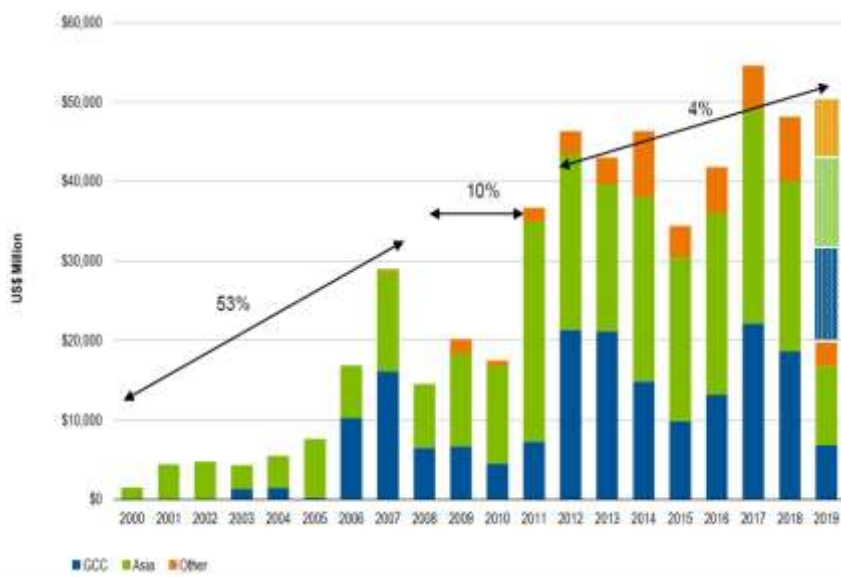
Source: COMCEC, February 2018, p11

3.3. The reality of the Islamic Sukuk industry:

We present the experience of Islamic Sukuk by tracking the developments of the global Sukuk issuances during the period from 2000 to 2019, and reality of listing Sukuk in the international markets.

a. Global Sukuk issuances:

Illustrated in the figure below, the global of Sukuk issuance has grown significantly by 53% during the period 2000-2007, the Sukuk issuance in 2006 grew by 145% compared to 2005 to reach 87 USD billion. In 2007, the Sukuk market peaked at 47 USD billion, but declined in 2008 to reach 21 USD billion. (Mohamad Mokhtar & Abdullah, 2010), due to the repercussions of the global financial crisis, Sukuk issuance has regained its growth since the beginning of 2009, during the period 2012-2019 the global of Sukuk issuances continues to grow with an increase by 4%, this improvement in the Sukuk market is mainly due to the Sukuk issuance by the Kingdom of Saudi Arabia and the Sukuk issuances in East Asia, And some Middle Eastern countries.

Fig.5: Global Sukuk issuance

Source: Michael , ZAWYA, May 2019

For March 2019, a total of 12.8 USD billion of Sukuk was issued globally. Malaysia remained leader by commanding 35.1% (or 13.9 USD billion) of the issued amount. Indonesia and Saudi Arabia came next, with respective shares of 17.0% (or 6.7 USD billion) and 15.3% (or 6.1 USD billion).

Malaysia recorded a 54.4% jump in Sukuk issuance as at end- March 2019, compared to only 9 USD billion a year earlier. (RAM Rating Services Berhad, May 2019).

b. The listing of Sukuk in the international markets:

Listing Sukuk is another main step to develop Islamic finance industry in the international financial market radar.

A listing defined as the process of registering a security with a regulatory organization and a financial market to be negotiable among investors in that country.

The table below shows the number and percentage of Sukuk listed in the financial markets.

Table 4: The number and percentage of listed Sukuk in the financial markets

	Number	Percentage
Listed Sukuk	195	94.2
Unlisted Sukuk	12	5.8
Total	207	100

Source: collected database Thomson Reuters on 23/03/2019

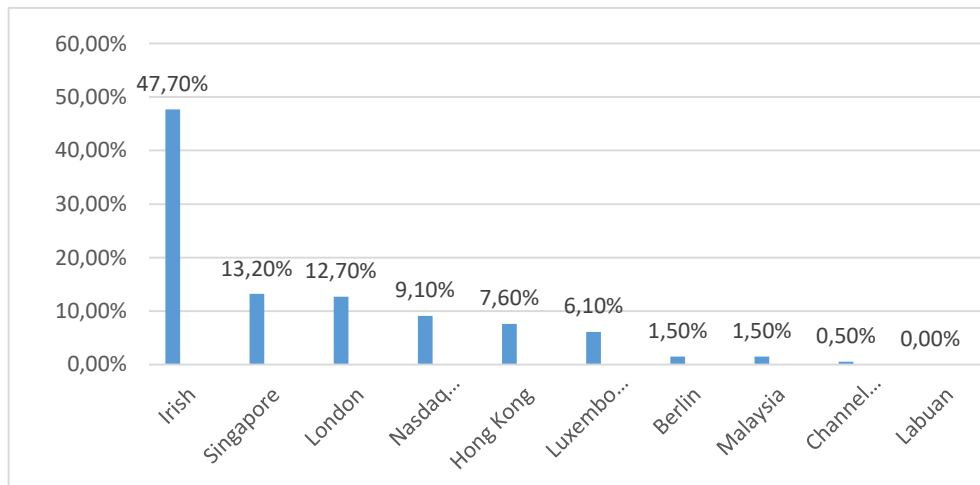
According to table 4, we can see the increasing number of listed Sukuk compared unlisted Sukuk.

Sukuk are listed in a number of stock exchanges in the world, the major markets for Sukuk listing include Irish stock exchange, Singapore exchange, London stock exchange, Nasdaq Dubai, Hong Kong stock exchange, Luxembourg stock exchange, Boerse Berlin, Bursa Malaysia, and the Channel Islands stock exchange.

Table 5: The distribution of Sukuk listed according to the listing market

Market listing	Listed Sukuk percentage in mono market
Irish stock exchange	47.07%
Singapore stock exchange	13.02%
London stock exchange	12.7%
Nasdaq Dubai	9.1%
Hong Kong stock exchange	7.6%
Luxembourg stock exchange	6.1%
Boerse Berlin	1.5%
Bursa Malaysia	1.5%
Channel islands stock exchange	0.5%
Labuan International financial exchange	0.0%

Source: Collected data Thomson Reuters on 23/03/2019

Fig.6: Percentage of Sukuk listed in mono market

Source: Prepared by researchers based on the table 5 data

Illustrated by figure 6, the Irish Stock Exchange has developed into a leading center for listing Sukuk, recorded the highest percentage and estimated at 47.70%, it is the leading global exchange for the listing of structured bonds, so it is a natural venue for the listing of Sukuk product, with a small percentage of Sukuk listed in channel islands stock exchange estimated at 0.5%

Conclusion:

In this research, we discussed the Islamic finance status quo in the light of financial innovation, Where financial innovations have contributed to the emergence of a number of financial products to meet customer needs specifically Islamic Sukuk, as the most prominent Islamic financial innovations with rapid growth and the ability to respond to global financial and economic variables and the role in the development of Islamic banking. We attempted to address this research by answering the main problem that focused on the Islamic finance status quo in the light of financial innovation by addressing the conceptual framework of Islamic finance and innovation Islamic finance. We found the following results:

- There has been large-scale growth in Islamic finance and banking in Muslim countries and around the world.
- We can see that Islamic financial innovation has dramatically increased as the industry has continued to grow.
- Sukuk is a tool developed to replace conventional bonds and conventional financial instruments in general and is in accordance with the Sharia.
- Islamic financial innovation is a destination for investors to invest their money, and even non-Muslim countries have become a new destination for the Islamic economy.
- The rapid growth in Sukuk market internationally indicates huge potential of this innovative financial instrument.
- Malaysia is a great example of Islamic finance in general and Sukuk as a financial market that relies on Islamic financial instruments in equal measure with conventional instruments. This has greatly contributed to its economy. It is one of the models that built its economy on Islamic finance.
- The phenomenon of listing is not strange but the term Sukuk new to foreign investors.
- sukuk are listed in a number of stock exchange worldwide.

References:

- Ahcene, L., Mkabir, H., & Ribi, A. (2018). Forward lease Sukuk in Islamic capital markets structure and governing rules, Palgrave Macmillan.
- Alsadek, H.G., & Andrew, C. (2007). Worthington, A primer on Islamic Finance: definitions, sources, principles and methods, School of accounting and Finance working paper series N°7/5.
- Amr, M.A., & Wafik, G. (2015). Islamic Finance and economic development risk management regulation and corporate governance, Wiley.
- Faten, B., Chantal, A., & Aldo, L. (2016). Banking governance performance and Risk-taking conventional banks vs Islamic banks, Wiley.
- Gilly, W., (June 2019).The Innovators 2019: Islamic Finance, Retrieved from: <https://www.gfmag.com/june-2019/innovators-2019-islamic-finance>, (consulted on 27/6/2019).
- Hans, V. (2009). Islamic finance principles and practice, Edward Elgar publishing.
- Hazik, M., & Hassnian, A. (2019). Block chain, Fintech and Islamic Finance, De Gruyter.

- Imam, W., & Fenny, R. (2015). Risk Management for Islamic Banks recent developments from Asia and Middle East, Wiley.
- Joanna, B., (2011). Financial innovation and their role in the modern financial system identification and systematization of the problem, EFinance Financial Internet Quarterly, vol 7, Iss 3.
- Karolina, A. (2018). The impact of innovation on the improvement of the competitiveness of banks and analysis of case studies, *Ekonomika Miedzynarodowa*, N°22.
- Mohamad Mokhtar, S., & Abdullah, N.I. (2010). A synthesis of shariah issues and market challenges in the application wa'ad in equiy based Sukuk, Kuala Lumpur: ISRA.
- Mondher, B. (2014). On Islamic banking performance and financial innovation, Cambridge scholars publishing.
- Muhamad, Z., Abdul, M., & Turkhan, A. (2019). Islamic Finance Risk-sharing and macroeconomic stability, Palgrave Macmillan.
- Muhammad, H. (2018). Emerging in Islamic banking and finance: challenges and solutions, *Academy of accounting and Financial studies journal*, vol 22.
- Muhammad al-Bashir, M. (2012). Global Sukuk and Islamic securitization market: financial engineering and product innovation, Brill, Boston.
- Mumayon, A.D. (2003). Islamic financial innovation, tools, and trends, *Journal of Emerging Economies and Islamic Research*, vol 1, N3.
- RAM Rating Services Berhad, (13/05/2019). Malaysia's sukuk issuance in 1Q 2019 shored up global performance, Retrieved from: <https://www.ram.com.my/pressrelease/?prviewid=4961>, consulted on 03/06/2019.
- Samir, A. (2017). Financial innovation and engineering in Islamic finance, Springer.
- Samir, A. (2019). Financial and accounting principles in Islamic finance, Springer.
- Shafiu, I.A., (May 2013). Sukuk as an alternative source of finds for Nigerian government, essentials of Islamic banking and Finance in Nigeria, Benchmark publishers limited.
- Simona, F., & Asma, A. (2018). Principles of Islamic finance and principles of corporate social responsibility: what convergence? Department of Economics and management.
- Standing Committee for Economic and Commercial Cooperation of the Organization of Islamic Cooperation (COMCEC). (February 2018), the role of Sukuk in Islamic in capital markets.
- W.Scott, F., Larry, W., & Lawrence, J.W. (October 2018). Technological change and financial innovation in banking some implications for fintech, Federal Reserve Bank of Atlanta.
- Yasuharu, O. (2018). Development of Sukuk (Islamic bonds) market and challenges of Japanese market, Institute for International Monetary Affairs (IIMA), N°2.