

The reality of financial innovation in Islamic Finance

واقع الابتكار المالي في المالية الإسلامية

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Abstract

This research aims to shed light on the reality of innovative products, services, applications and offerings in Islamic finance. As Islamic finance is one of the most important growth areas for economic activities, we touched on Sukuk as a leading model in Islamic finance, focusing on Sukuk issuance internationally and globally. Our study concluded that Sukuk is one of the most successful Islamic financial products and the fastest growing financial sector in the world.

Keywords: Financial Innovation, Islamic Financial Innovation, Islamic Finance, Sukuk.

ملخص

يهدف هذا البحث إلى تسليط الضوء على واقع المنتجات والخدمات والتطبيقات والعروض الابتكارية في التمويل الإسلامي، باعتبار التمويل الإسلامي أحد أهم مجالات النمو للأنشطة الاقتصادية، تطرقنا إلى الصكوك باعتبارها نموذجا رائدا في التمويل الإسلامي، بالتركيز على إصدارات الصكوك دوليا وعالميا. توصلت دراستنا، تعد الصكوك إحدى أنجح المنتجات المالية الإسلامية، وأسرع القطاعات المالية نموا عالميا.

الكلمات المفتاحية: الابتكار المالي، الابتكار المالي الإسلامي، الصكوك.

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1. Introduction

The religion of Islam has existed for 1400 years, but Islamic economic theory and its financial institutions as an industry emerged only in the 1970's. (Karen, 2013). Islamic finance is an particularly interesting phenomenon because its presents itself as an alternative to conventional finance not only in Muslim countries but in the rest of the world as well, at times broadening its appeal to non-Muslims .(Hans ,2009).

The development and innovation of Islamic financial instruments has become imperative given the increasing demand for these products in light of the growing global trend towards ethical investment, which is compatible with Islamic financial transactions that exclude usury and most important Islamic financial instruments and the most widespread Islamic financial instruments (Sukuk), because they have a global spread and Islamic in non-Islamic countries and their governments prefer to cover their financial needs through them.

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

Research problem:

**What is the reality of Financial innovation in Islamic finance, and
What are the most innovative Islamic financial products?**

Which will be answered through:

- An overview of Islamic finance
- what is financial innovation
- Sukuk

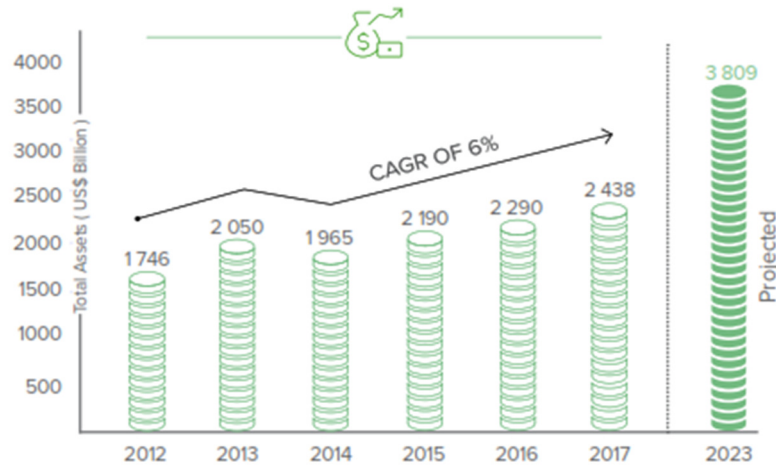
2. An overview of Islamic finance

The Islamic finance development 2018 shows that the global Islamic finance Islamic industry grew year-on-year through of 11% to USD 2.4 trillion in assets in 2017 or by CAGR growth of 6% from 2012 primarily based on figures reported for 56 countries, basically in the Middle East and South and South east Asia, Iran, Saudi Arabia and Malaysia remain the largest Islamic finance markets in terms of assets, while Cyprus, Nigeria and Australia noticed the most fast growth.

Malaysia, Bahrain and the UAE once more leading the 131 countries assessed in terms of the Islamic finance development indicator score, which aggregates indicator ranking for quantitative, corporate social responsibility and awareness. The crowned emerging Islamic finance markets which had most upgrades in their financial and supporting ecosystems encompass Iraq, Suriname, Nigeria and Ethiopia.

According to report Thomson Reuters 2018. Prospective for the industry to boost to USD 3.8 trillion in assets by 2023, an average expected raise of 10% per year. (Thomson Reuters IFDI, 2018).

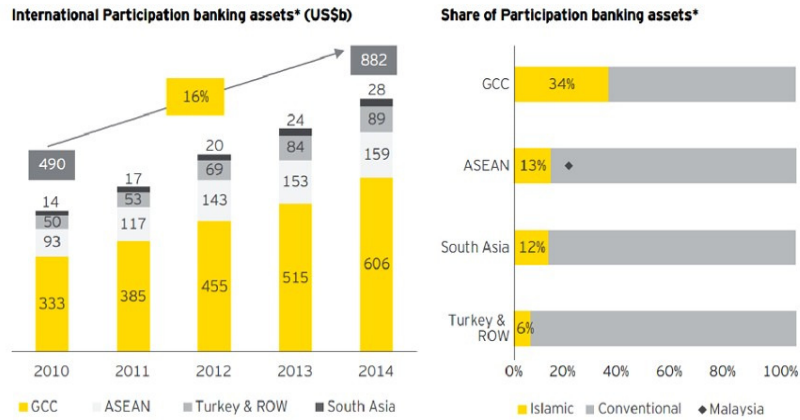
Fig.1. Global Islamic finance assets growth



Source: Thomson Reuters, 2018.

Figure2 shows that the participation banking assets grew powerfully in 2014, with GCC gaining above average growth rate, participation bank keeps going to show strong growth of approximately 16%, in spite of political and economic volatility in the major regions.

Fig. 2. International participation banking assets

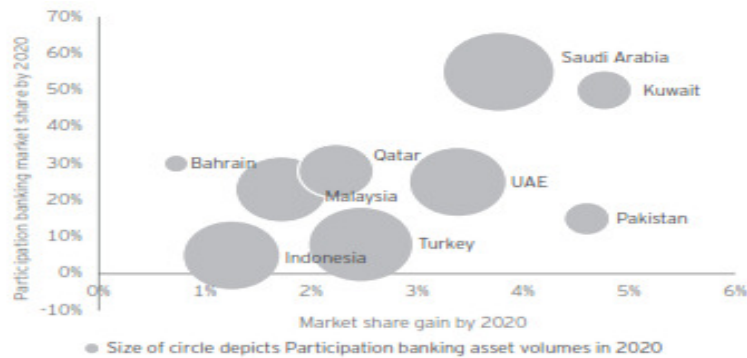


Source: Ernst and Young (EY16), 2016, World Islamic banking competitiveness, p9.

In future outlook: Key players recognized on account of “average annual growth rate” and “banking sector assets” are Saudi Arabia, Qatar, Pakistan, UAE and Turkey, Based on banking sector asset estimates.

On the other hand, for Participation banking, the key players in terms of banking market share by 2020 are Saudi Arabia, Kuwait, Bahrain and Qatar. (Ernst and Young, 2016).

Fig.3.Participation banking sector projections



Source: Ernst and Young (EY16), 2016, World Islamic banking competitiveness.

3. What is financial innovation?

An analytical review of the modern history of financial innovation and its phases indicates us that, the invention of financial theory has taken place over centuries and in parallel with many inventions in mathematics and economic theory. The first beginnings of the mathematical theory of probability in the seventeenth century led to the first insurance companies in that same century, which based their operations on sound statistical risk analysis. The mathematical thinking that led to the Laplace transform in the mathematics of the eighteenth century also led to the concept of present value of a flow of income, and as a consequence to modern investment theory. In addition, advances in the theory of stochastic processes in the nineteenth century led to the concepts of statistical innovations and of the random walk, and thus, to the twentieth-century concept of efficient markets. Furthermore, advances in theoretical physics in the twentieth century led to the mathematics of the Black-Scholes option pricing theory. (Almad, 2017, p 97).

Financial innovations can thus define as financial services, which offer certain customers a new product. They also refer to actions, which aim at introducing or improving financial instruments, making changes in the organizational structure of the system and implementing modern technology and computerization. (Karolina, 2018).

According to Davila and Shelton, financial innovation is the unexpected improvement in the collection of mechanisms and products that are encouraged by unanticipated transformation in tax policy, regulatory impulses, technology, preferences and needs of the customers. (Vivien, Caroline & Jared, 2016, p99).

Although innovation is most closely associated with the tech sector, finance institutions have been just as energetic in coming up with creative solutions to client problems and finding new ways to deliver financial services. (See table 1 top financial innovation2018).

Table 1. Top financial innovation 2018

BANK	INNOVATION
ANZ	Real time payments
Aseco Poland	Asseco advisory banking platform smart queue
Bancolumbia Asset Management	High conviction mutual fund (Fonf Renta Alta conviccion)
Bank Millennium	Travel assistance widget
Bank of America Merrill lynch	Intelligent receivables
Blackwell global	Bleus challenge
Caixa bank	Digital engagement
Commercial International Bank (CIB)	Branch customer journey simulator
Citibanamex	Big data strategy
Danske Bank	Distict
Dbz Bank	Customer science
Emirates NBD	Paperless personal loan
Finastra	Fusion Lendercomm
Mashreq Bnak and MEED	Mashreq/MEED construction partnership
Meezan Bank	Master pass QR payments through Fonepay App
Santandee	Strategy helping UK Businesses Expand Internationally
Saxo payments	Banking circle virtual IBAN
Sberbank	The navigator
Siam commercial Bank	Digital Business Account opening

Source: Gilly, june 2018.

Islamic financial innovation, the way it has been practiced, can be defined as the process of utilizing Islamic legal contracts in new ways to develop financial product that comply with Sharia and have the ability to

replicate the economic effects of conventional financial products. (Mumayon, 2003).

Islamic finance continues to boost faster than conventional banking, with the numbers of Islamic institutions growing and non-Islamic institutions opening Islamic windows. (See tables 2 and 3, top innovators in Islamic finance 2016, innovators in Islamic finance 2019).

Table 2. Top innovators in Islamic finance 2016

Organization	Type of innovation	Innovation
Abu Dhabi Islamic Bank	Process innovation	A new Digital studio with IBM
Al Rajhi Bank	Organizational innovation	Self-service channel with Diebold Technology
Al Rayan Bank/ Masraf Alrayan	Marketing innovation	Brand Reinforcement and product Expansion
Bidaya Home finance	Process innovation	Website
Dubai Islamic Bank	Product innovation	ELtrade
Malaysian Bank consortium	Marketing innovation	Investment Account platform
Meezan Bank	Process innovation	Meezan Upaisa
Path solutions	Process innovation	iMal Islamic Banking platform

Source: Darren, June 2016.

According to table 2 top innovators in Islamic finance 2016:

- The digital studio initiative, will transform how Abu Dhabi Islamic Bank cooperates with clients. The studio improved the several digital innovation projects through the bank, with mobile-banking iOS apps.

- Al Rajhi Bank has selected Diebold's technology to migrate transactions from the traditional teller line to the self-service channel and transform the in-branch banking experience for its clients.

- Masraf Al Rayan has positively rebranded and transformed it, increasing its retail and commercial product proposing to a wider audience. Brand identity is reinforced at all touch points, from bank branches to the website to printed literature.

- Bidaya advanced a website that allows operators to look through its calculator and find the sum they are entitled for, then apply online and upload all requisite documents essential to procedure their home finance application with more-complex transactional banking services and meeting compliance demands.

- Emirates Islamic Bank launched EI Trade, online trade finance and supply chain platform. EI Trade offers the bank's customers an electronic platform to start trade finance transactions on a safe system, available 24/7.

- Six Malaysian Islamic banks launched a shariah-compliant investment platform. , the platform will help as a central marketplace to finance small and midsize businesses.

- With MeezanUPaisa, clients are today be capable to send and receive money, pay utility bills and do mobile top-ups through Islamic banking.

- Banking PlatformKuwait's Path Solutions stays, after two decades, to lead the advance of essential Islamic banking solutions, with more than 100 clients worldwide. Islamic banks through the globe are adapting Path Solutions' innovative banking platform—iMAL R14, providing real-time, 24/7, nonstop banking. (Darren, June2016).

Table 3. 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 Sharia-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 book runner, lead manager and dealer for a wakala Sukuk for the Republic of Indonesia. The Republic of Indonesia launched the first Green Sukuk. The transaction represents the world's first Sovereign Green Sukuk issuance and the first ever-sovereign

green offering in USD in either Sukuk or conventional formats. (Gilly, June 2019).

4. Sukuk

4.1 Definition of Sukuk

The “AlMonajed” encyclopedia has defined “Suk” as book, manifest or receipt of money. One more encyclopedia has defined it as: “Suk” means documents (promissory note) and is a Persian term for “cheque”. Arabs developed the term and applied it to all types of money orders and commitments. (Rezaei, 2013, p261).

From a technical point of view, Islamic bond (or Sukuk) is defined as certificates of equal value representing ownership over an underlying asset. Thus, they represent common shares and rights over the underlying assets or over usufruct (benefits derived from an underlying asset) and services. Sukuk have been structured and placed in the market according to different contracts such as Ijarah, Mudarabah or Musharakah. (Achene, Kabir & Rubi, 2018, p1).

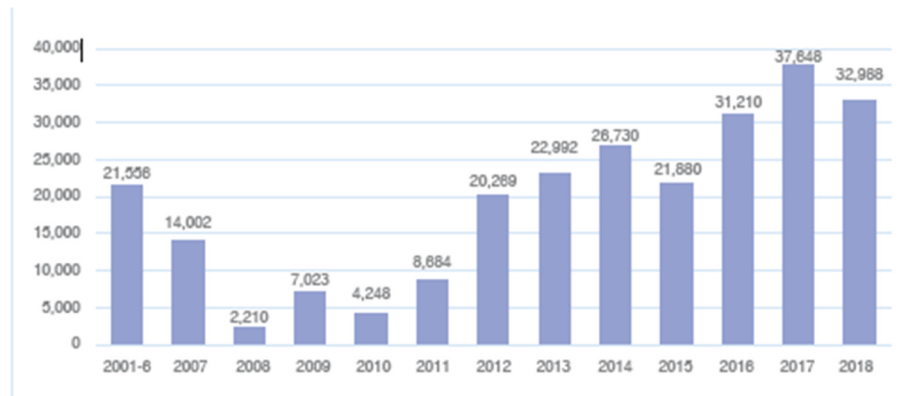
4.2 growth and evolution of Sukuk

Opinions vary in the literature concerning the origins of modern sukuk and their initial issuances. However, one can identify four main stages of sukuk development, with considerably varying levels of number of issuances, capitalization, geographical spread, and structural innovation. Arranged based on activities and sophistication that took place in the market, these phases are as follows:

1. Introductory period (1977–1999)
2. Growth of the Sukuk market (2000–2007)
3. Decline in the Sukuk market (2008–2009)
4. Sukuk: back on track (2010–2018). (Salim, 2019, p40).

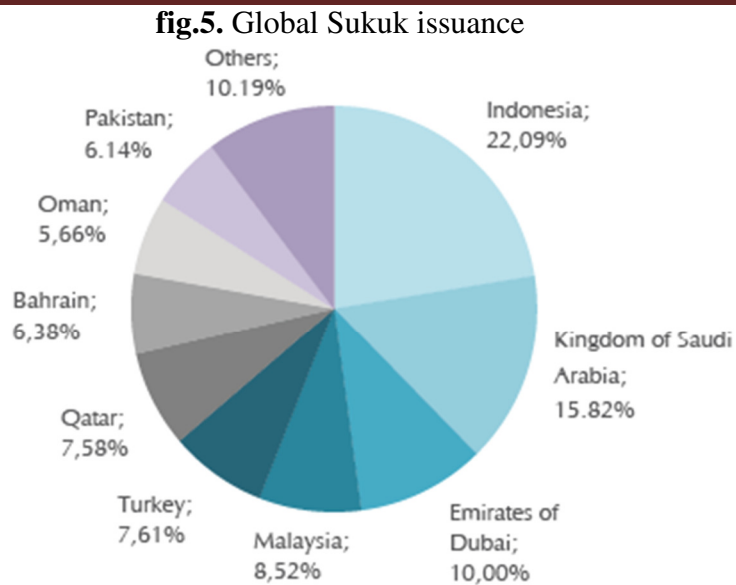
figure 4 shows Total international Sukuk issuances stood at USD 32.98 billion in 2018 which translate into a decrease of USD 4.66 billion or negative 14% from 2017 level of USD 37.64 billion, which means that the year 2017 was the best year where highest value of Int'l Sukuk issuance recorded since the inception of the Sukuk market.

Fig.4. Total, International Sukuk Issuances (Jan2001-Dec 2018)
All Tenors, All Currencies, In USD Millions



Source: International Islamic Financial Market (IIFM), Sukuk report (8th Edition), 2019, p24.

According to International Islamic Financial Market, Sukuk report, Indonesia is strongly committed to be one of the world players in the global Sukuk market. Indonesia was also contributing to the innovation of the Global Sukuk Structuring by issuing the first Global Green Sukuk projects in the late of 2018, to finance projects in line with the government green framework policies.



Source: International Islamic Financial Market (IIFM), Sukuk report (8th Edition), 2019, p 147.

5. Conclusion

Financial innovation is one of the most important areas of interest for banks and financial institutions, because financial innovation makes banks and financial institutions effectively present in the banking and financial market, for the renewal of its financial products to meet contemporary financing needs.

After clarifying the reality of financial innovations in Islamic finance, we can present the following results:

- Financial innovations have contributed to the emergence of a number of financial products to meet the changing needs of customers and to find solutions to financing problems.
- Innovation in Islamic financial instruments is necessary, especially with the increasing global demand for Islamic banking products.
- The most important characteristic of innovative Islamic financial products is that they combine compliance with Sharia and economic efficiency.

- Islamic finance is one of the fastest growing areas of international finance.
- Islamic Sukuk is one of the most prominent Islamic financial innovations that are growing rapidly in the financial markets for their economic efficiency and legitimacy.
- Islamic Sukuk are innovative innovations that have the ability to respond to global financial and economic changes.

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