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Islamic finance: preparing for take-off in Africa

With the issuance of Africa's first sovereign sukuk last year, and an expanding Muslim population, the potential of Islamic finance on this continent is vast. **Alicia Buller** looks at the first shoots of growth

As home to a quarter of the world's Muslims, Africa represents a golden, and largely untapped, opportunity for the Islamic finance sector. With its swelling middle class, rising economic growth, and a pipeline of large-scale infrastructure projects, the stage is set for the growth of Muslim money on the continent. According to *Islamic Finance in Sub-Saharan Africa: Status and Prospects,* a 2014 International Monetary Fund (IMF) working paper, "the financial sector in some sub-Saharan African countries has been growing rapidly in the past two decades. New products have been introduced and financial institutions are playing an increasing role in financial intermediation, including cross-border financial flows."

As of the end of 2012, approximately 38 Islamic finance institutions – comprising commercial banks, investment banks, and takaful (insurance) operators – were operating in Africa. Of these, 21 operated in North Africa, Mauritania and Sudan, while there were 17 in sub-Saharan Africa.

Despite its banking presence in a number of countries, Islamic finance is still at a nascent stage of development in sub-Saharan Africa. However, the IMF working paper predicts that "the demand for Islamic finance products is likely to increase in coming years. At present, about half of the region's total population remains to be banked". Moreover, the report says, the sub-Saharan African Muslim population, which currently stands at 250 million, is projected to reach 386 million in 2030, and financial activities are predicted to increase as a share of GDP. Against this backdrop, it is expected that many African countries will introduce Islamic finance activities alongside conventional banking.

The rise of sukuk

Beyond Islamic retail banking, the growth of sukuk in Africa is a prominent trend. As the continent ramps up its infrastructure projects, sukuk issuance provides a means to channel funds from the cash-flush Middle East, Malaysia and Indonesia. Notably, Nigeria, South Africa and Senegal all successfully tapped into the sukuk market in 2014, with Tunisia and Kenya also planning issuances within the 2015-16 financial year.

Maureen Mujera, Partner at Anjarwalla & Khanna, a leading law firm in Nairobi, Kenya, says: "The general consensus is that if the likes of Morocco, Tunisia, Egypt and South Africa successfully issue sukuk, it will open up the market in Africa as a whole." She notes that the region's substantial infrastructure needs and an awareness of Islamic finance as an alternative source of public funding are fuelling the growth of sukuk on the continent. "African countries are looking at Islamic finance as a way of attracting investment from the Middle East and

An employee at an Islamic bank in Kenya. Islamic finance is on the rise in Africa

South-East Asia, while retaining conventional bond investors. African countries are also keen to tap into Islamic finance because the cost of borrowing can be cheaper due to high demand, particularly from the Middle East," adds Mujera.

Georges Ferre, Project Manager at consulting firm Roland Berger in Paris, adds: "The trend of developing Sharia-compliant securities follows the development of Islamic banks. In many of those countries, the Islamic banking sector has experienced unmatched growth rates in terms of assets and revenues. New banking licences have been granted to new entrants, sometimes reserved to Islamic actors."

Legislative environment

However, the road ahead for the Islamic banking sector will not be a smooth one. In many cases, African countries must first streamline their legislative frameworks before the Sharia-compliant sector can truly prosper.

Mujera says: "There is no comprehensive regulatory or supervisory framework for Islamic finance in the banking industry in most African countries, which leaves Islamic finance at a comparative disadvantage to conventional banking and finance... The lack of a supervisory and regulatory framework has not gone completely unnoticed and certain jurisdictions have either passed or are in the process of passing new laws in an effort to make Islamic finance more attractive across the continent. For instance, South Africa amended its Income Tax Act to place financial products structured according to Islamic models on an equal footing with conventional products."

She adds: "Once countries across Africa develop their respective national legislative frameworks for Islamic finance there will be a need to harmonise Sharia financing products across the continent and internationally so that there is mutual recognition of financial standards and products across jurisdictions."

Projected growth sectors

- **Corporate or private sukuk:** more sovereign sukuk could encourage companies to issue
- **Takaful (insurance) and microfinance:** Tanzania, Namibia and Morocco are a few of the new destinations for Islamic insurance
- **Short-term trade finance, murabaha:** this is considered to be less risky by banks
- **Ijarah** (finance leasing)

SOURCE: ANJARWALLA & KHANNA

Mobilising investment

In a landmark move in December 2014, the African Union Commission (AUC) and the Islamic Corporation for the Development of the Private Sector (ICD), the private-sector arm of the Islamic Development Bank Group, signed a memorandum of understanding (MoU) to develop a platform that will enhance ties between the Islamic world and the African continent.

"The MoU will enhance and strengthen the coordination of complementary activities, interests and capacities between the ICD and AUC... including mobilising foreign direct investment in various economic sectors within the key priority sector programmes and projects identified by the ICD and AUC," says Khaled Al-Aboodi, CEO of ICD.

While the Islamic finance investment potential in Africa is already vast, the sector is only set to grow as favourable nationwide policy and legislative measures are put in place.

Ferre says: "We really believe in Sharia-compliant investment funds targeting specific sectors, such as SME or infrastructure. On the latter, Islamic finance really shows some advantages in its definition. Infrastructure financing, agriculture financing or trade can offer tremendous areas of growth. The challenge for Islamic finance will be to target Sharia-compliant sectors with growth potential where traditional finance failed."

According to Mujera, it is likely to be several years before Islamic finance truly takes off across the continent: "The growth and acceptance of Islamic finance will be determined by factors such as government support, adoption of enabling legislation, capacity building to increase the number of skilled and qualified personnel in the regulatory bodies and [effective] measures to increase public awareness of Islamic finance."