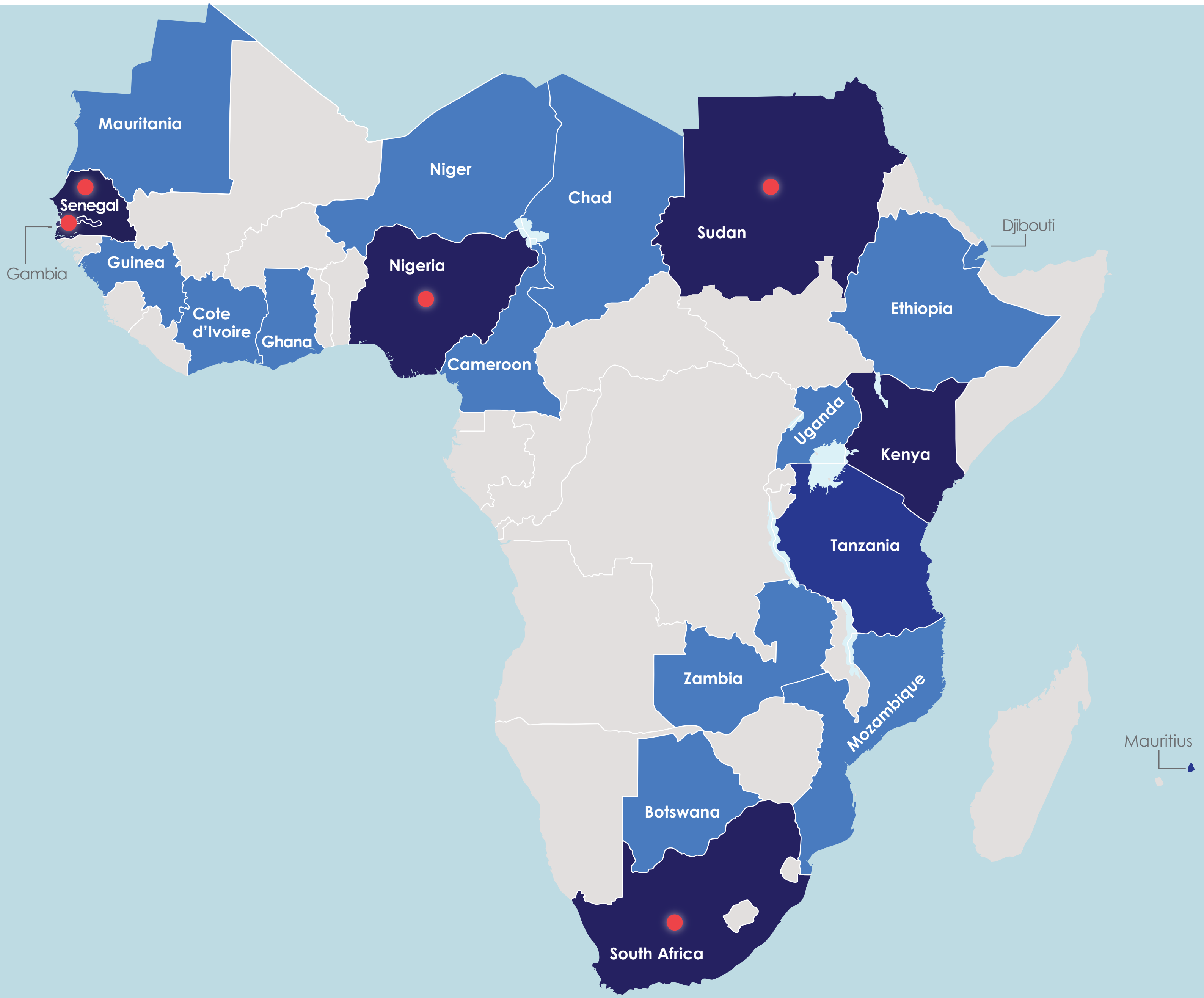
The Economist Intelligence Unit

Mapping Africa's Islamic Economy

A report by The Economist Intelligence Unit



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About this research

"Mapping Africa's Islamic economy" is a report by The Economist Intelligence Unit. The findings are based on desk research and interviews with experts, conducted by The Economist Intelligence Unit. The research was commissioned by Dubai Chamber.

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- **Saidu Babayo**, head of non-interest banking, Stanbic IBTC Bank
- **Basheer Oshodi**, group head of non-interest banking, Sterling Bank
- **Ndako Mijindadi**, portfolio manager, Lotus Capital
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- **Ebi Lockhat**, public relations officer, South African National Halaal Authority
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Executive summary

The "Islamic economy" refers to a wide range of commercial activities and geographies, from the financial centres of Kuala Lumpur to the markets of Niger, and spanning everything from sharia-compliant bonds to halal food, travel and fashion. The global market was worth over US$3.6trn in 2013.

As the world's fastest-growing population, with a large Muslim contingent, Africa's place in the global Islamic economy is a subject worthy of investigation. Islam and Christianity are the two dominant religions in Africa, the population of which will more than double, to 1.9bn, by 2050. Almost every country will see a significant increase in their Muslim population, driving demand for sharia-compliant products and services. This report maps Africa's Islamic economy, assesses growth trends and challenges faced and proposes measures to nurture the segment.

Key findings

- ***Sukuk* are an attractive tool for financing African infrastructure.** Africa faces a severe infrastructure deficit but government budgets have come under pressure due to low commodity prices. Sharia-compliant bonds, or *sukuk*, have been used in five countries to raise capital. However, there are long time lags to sukuk issuance because of technical and legal hurdles. There is limited knowledge of Islamic finance instruments among end-users and policymakers. Greater support from multilateral development agencies could help.

- **Islamic finance has a presence in 21 African countries, from established systems like Sudan through to new entrants like Uganda.** Sudan has the most experience in formalised Islamic finance, dating back to the 1970s. South Africa has taken significant measures to advance its Islamic finance system since 2011, as have Nigeria, Senegal and Kenya. Other countries are in the exploratory phase, including Ethiopia, Uganda, Zambia and Mozambique.

- **"Islamic economy" activity does not depend on Muslim-majority populations.** While countries such as the populous Nigeria stand out as potential markets due to population size and religious makeup, interest in Islamic economy goods and services is not reliant on majority or even large Muslim populations. Non-Muslims are among the consumers, and governments of non-Muslim countries identify economic potential in halal sectors and sukuk.

- **Political tensions mean that some populations are concerned about Islamic economy discourse.** While sharia simply refers to Islamic law, the word can be associated with certain practices of extremist groups in hotspots around Africa, which may cause concern and confusion among populations. Current religious tensions may be a hindrance to Islamic economy reforms and educational campaigns could help promote public understanding.

1 Introduction

Africa is the world's largest untapped growth market for "Islamic" commerce, spanning Islamic finance (banking, insurance, bonds and capital markets) and halal (sharia-compliant goods and services). This is the result of both "positive" trends—a rapidly growing population, increased consumer spending and robust GDP growth—and economic need. Africa has a huge infrastructure deficit and governments need tools for raising capital.

Islam is a dominant religion on the continent, along with Christianity, which it pre-dates by centuries. Islam arrived in Africa in the 11th century. From the ancient cities of the Sahel to the modern mosques of coastal capitals, Sub-Saharan Africa is now home to over 250m Muslims, projected to grow to over 385m by 2030.[1] Most live in West Africa, which hosts 160m Muslims. That will rise to 257m Muslims by 2030. By then, the region will account for 67% of Muslims in Sub-Saharan Africa.

The impact on demand for Islamic economy activity will be sizeable. "The region's Muslim population represents a potential customer base that no one can afford to ignore," argues Baba Yunus Muhammad, president of the Ghana-based Africa Islamic Economic Foundation (AFRIEF). "Unlike most Western countries, 40% of West Africa's Muslim population is under 25 years old. The youthful population is starting to achieve a certain level of affluence and has the potential to be a vibrant customer base for decades to come."

Nigeria stands out. The Washington-based *Pew Research Centre* projects that by 2030 there will be 116.8m Nigerians practicing Islam, up from 75.7m in 2010; by far the largest increase in Sub-Saharan Africa. By then it will be a Muslim-majority country. "Already we have at least 35m adult Nigerians who are interested in Islamic finance," says Basheer Oshodi, group head of non-interest banking at Sterling Bank, a Nigerian lender. "It could be more than that if we count non-Muslims who are interested in Islamic finance. The market is absolutely huge."

While sharia-compliant goods and services appeal to the values of the Muslim population, large Muslim populations are not essential for a vibrant Islamic economy sector. Even in countries with a low proportion of Muslims, the values and principles of Islamic financing—such as investment products that avoid alcohol or gambling, and no-interest lending—appeal to investors seeking ethical schemes or banking customers seeking alternative products.

In the aftermath of the global financial crisis, some investors are seeking less risky investment and Islamic financial institutions have a strong financial performance record in recent years worldwide, partly due to high capitalisation rates, and their avoidance of speculative activity. Moreover, countries with small Muslim populations are looking to Islamic economy activities as part of a commercial strategy, notably South Africa, whose industries have now positioned the country as a halal goods export hub for the continent.

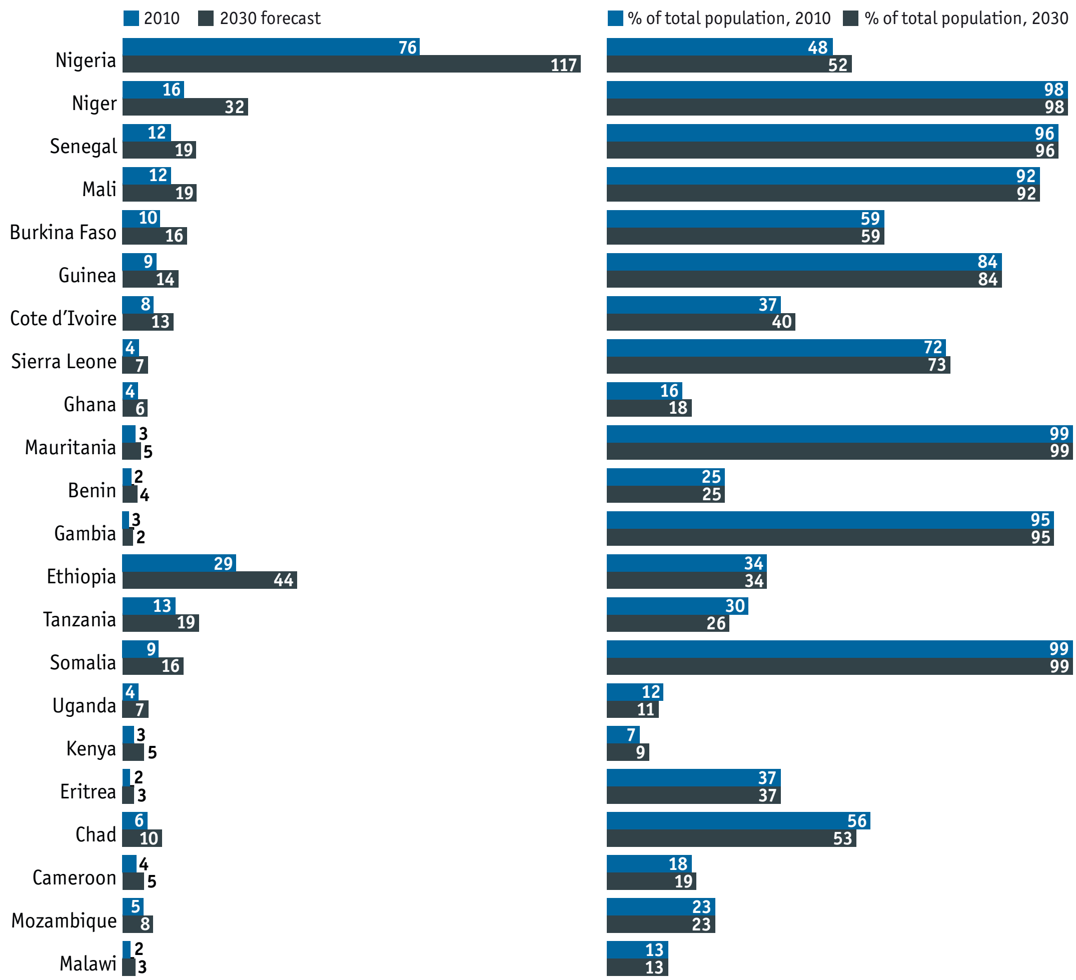
The second driver of Africa's Islamic economy is the infrastructure need. Inadequate supplies of roads, railways and ports, insufficient energy supplies and housing shortages are among the

[1] Pew Research Centre

challenges facing the continent. An urbanising population—forecast to grow from 38% of the total population in 2015 to 45% in 2030 and to 55% by 2050[2]—will drive demand for social infrastructures, encompassing housing, healthcare, and utilities. Sukuk are of growing interest to governments trying to raise capital for such shortfalls.

Figure 1

Muslim population by country
(m)

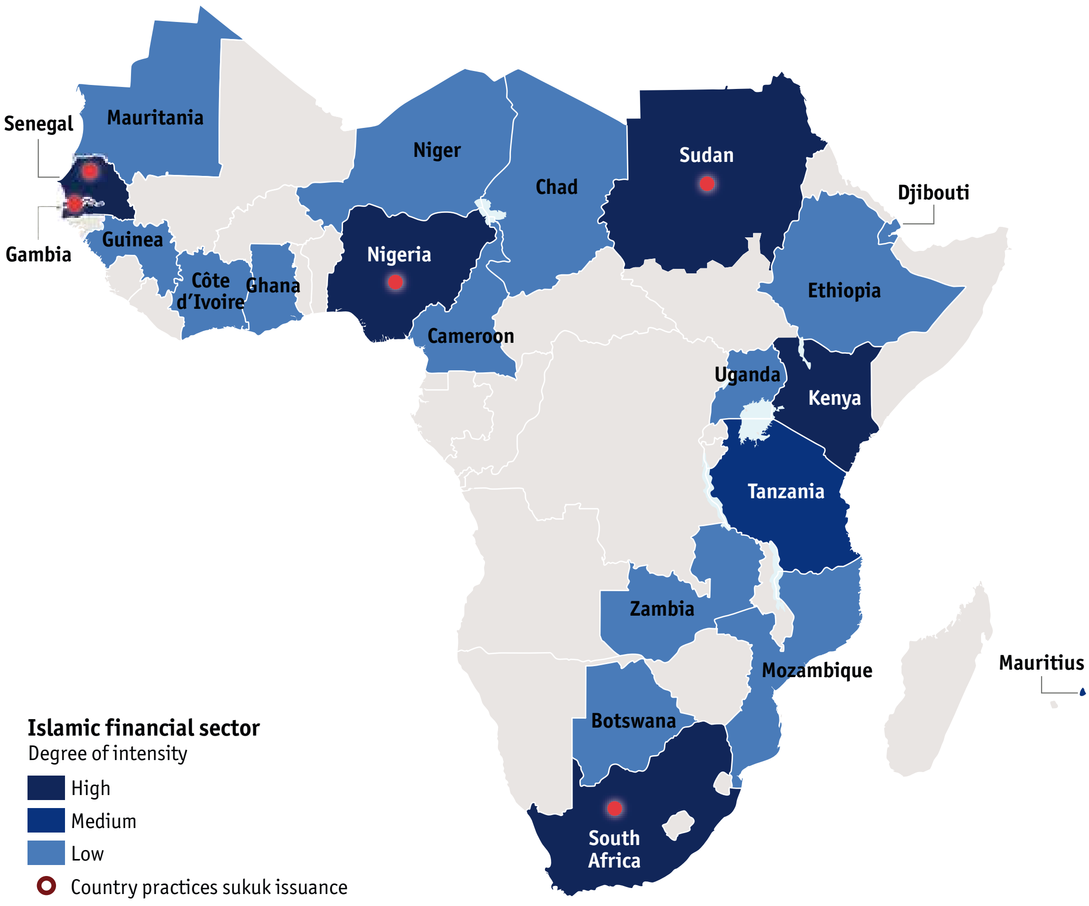


Source: Pew Research Centre. Only countries with a Muslim population above 1m represented in graph

[2] UN Department of Economic and Social Affairs, *World Urbanisation Prospects*, 2014.

Figure 2

Map of Islamic finance activity in Sub-Saharan Africa



Country name	Issued sukuk	Planning sukuk	Islamic banks	Banks with Islamic windows	Foreign Islamic banks	Islamic Microfinance	Other Sharia-compliant financial products	Sharia-compliant funds	Islamic regulation
Nigeria	✓	✓	✓	✓			✓	✓	✓
South Africa	✓		✓	✓	✓			✓	✓
Sudan	✓		✓		✓	✓	✓		✓
Senegal	✓		✓				✓		
Gambia	✓		✓				✓		✓
Kenya		✓	✓	✓	✓		✓		✓
Tanzania			✓	✓					
Mauritius			✓	✓					✓
Zambia				✓	✓				✓
Uganda			✓						✓
Niger		✓	✓						
Ethiopia				✓		✓			
Botswana				✓					
Ghana				✓		✓			
Guinea			✓						
Cameroon				✓					
Chad				✓					
Djibouti			✓						✓
Mozambique					✓				
Mauritania			✓				✓		
Cote d'Ivoire		✓							

Data based on publicly available information

2 Financing Africa

Infrastructure is an ideal form of project for *sukuk* due to long timelines to completion, large values, and a clear connection to the real economy in the form of the asset. Africa's infrastructure financing needs come at a time when global interest in Islamic finance for such purposes is growing.

Between 2001 and 2014, global *sukuk* issuances were nearly US$670bn, and appeal to countries regardless of whether they are majority Muslim. The UK and Hong Kong have both issued *sukuk*. Moreover, as part of Basel III—reforms developed by the Basel Committee on Banking Supervision—banks need more high-quality capital. Since Sharia-compliant banks do not have many securities that satisfy Basel III's definition of 'Tier 1', they too have a large appetite for sukuk issuances.

Currently, Sub-Saharan African issuances account for just 2.5% of global *sukuk*, but since 2014 activity has been significant in a handful of countries. In June 2014, Senegal's local-currency sukuk raised the equivalent of US$200m from local and international investors. The oversubscribed note bolstered the nation's ambitions to become a centre for Islamic finance.

Senegal, a 95% Muslim nation on the northern fringes of the Sahel, had beaten both Nigeria and South Africa to the market. "Senegal can become an El Dorado for Islamic finance investors," argued Mouhamadou Lamine Mbacke, CEO of the African Institute of Islamic Finance in Dakar. "There are a lot of infrastructure projects to be developed and the return on investment is higher here than in developed countries."

Following legislative reforms in 2011, South Africa issued a US$500m *sukuk* in September 2014, demonstrating the role that sharia-compliant financing tools could play in a non-Muslim country. The *sukuk*, jointly arranged by BNP Paribas, Kuwait Finance House Investment and Standard Bank of South Africa, was four times oversubscribed and investors from the Gulf Corporation Council (GCC) acquired one-half of the subscription allocation.

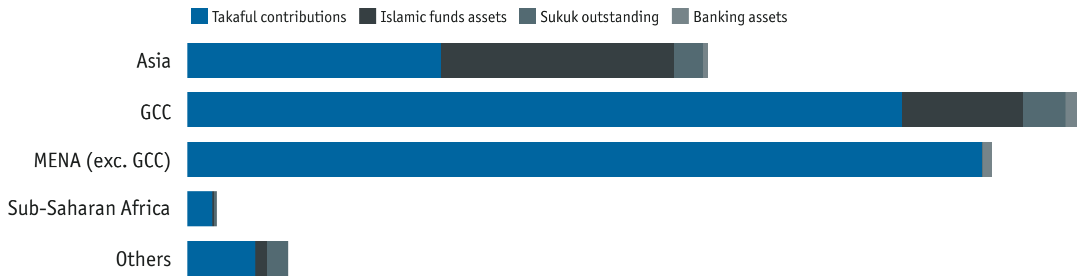
The bond, which matures in June 2020, was part of efforts by the National Treasury (NT) to diversify its funding and investor base. The NT is now working on issuing South Africa's first domestic rand-dominated *sukuk* with the aim of expanding Islamic finance beyond the banking sector.

State-owned enterprises are also pondering *sukuk*. In August 2015, cash-strapped Eskom said it was exploring the possibility of issuing *sukuk* tranches to raise funds from international markets. State-owned rail company, SANRAL, is also exploring the possibility of extending its toll roads network with *sukuk* financing. Meanwhile, a draft law proposes the expansion of existing *murabaha* and *sukuk* legislation to cover South African listed companies from January 2016.

"From a South African perspective, as we continue to require investment around infrastructure, we need to look to alternative forms of financing. Sharia-compliant

Figure 3

Islamic finance segments by region, 2014
(US$bn)



Source: Islamic Finance Services Board, *Islamic Financial Services Industry Stability Report 2015*.

instruments would support that flow of funds from the Gulf ," says Merisha Kassie, director of financial services at EY's Centre in Islamic Finance for Africa.

Nigeria passed laws governing Islamic banks in 2009[4] and the central bank now has an advisory council of experts that oversees the sector. The Security and Exchanges Commission has issued guidelines for Islamic fund management and *sukuk*, and PENCOM, the national pension commission, is finalising its investment outlines for the sector.

"The guidelines are there in Nigeria. You do not have that in most African countries," Sterling Bank's Mr Oshodi explains. Ms Kassie at EY spoke positively about the potential of the Nigerian market: "In terms of where the greatest need is, it would be an economy like Nigeria because it is growing at a rapid rate, the demand for finance is high and the infrastructure is so dire considering the rate at which the country is growing", says Ms Kassie at EY.

Côte d'Ivoire announced that it would issue sukuk earlier this year, and followed up with a government-led Islamic finance conference in September, hoping to attract investors interested in the Francophone nation's 8.3% growth rate and relatively developed capital markets. Kenya has published a vision for developing Islamic capital markets through to 2030, and the country has an on-going partnership with the Qatari government to develop the legal and regulatory framework to issue a sukuk and sharia-compliant products.

Sharia-compliant financing can also be used for asset purchases. In December 2014, a joint venture between Bahrain-based Ibdar Bank and Dubai-based lessor Palma Holding closed a US$100m deal with Ethiopian Airlines for the lease of four Bombardier planes, the first sharia-compliant transaction in Africa's aviation sector. It followed with a smaller deal for Kigali-based RwandAir in March.

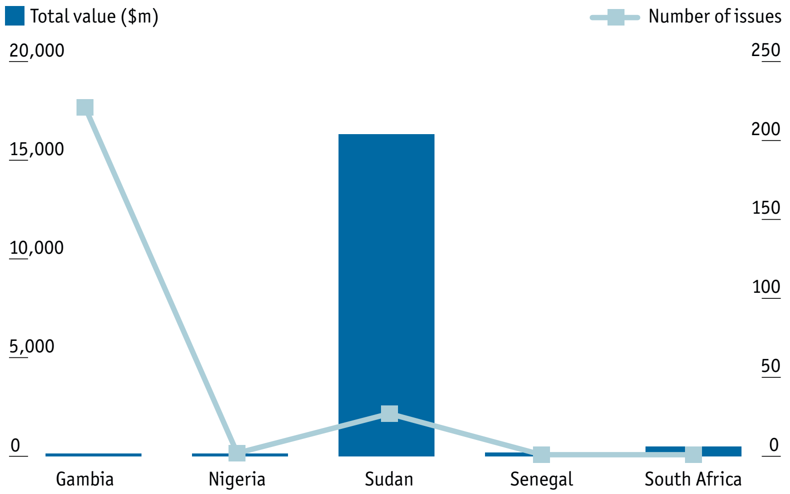
[4] "Islamic Finance in Sub-Saharan Africa: Status and Prospects", IMF 2014 Working Paper , WP/14/149, and data from Nigerian Securities and Exchange Commission

Why *sukuk*?

Because it must fund tangible and productive assets, sukuk is appropriate for some infrastructure financing. Assets such as toll roads and real estate facilitate the use of sale-lease structures because ownership is transferable and generates predictable cash flows. To mitigate exchange rate risks between project cash flows and financing, sukuks can also be issued in local currency; local-currency sukuk are issued weekly in the Gambia, and Nigeria's Osun state tapped the Islamic debt market for US$63m in 2013 for the construction of schools.

Figure 4

Total value and number of sukuk issuances in Sub-Saharan Africa



Sources: International Islamic Financial Market, *Sukuk Report*, November 2014, and Economist Intelligence Unit research.

Banking on Africa

While sukuk are on the agenda for governments, corporations and large-scale investors, Islamic finance is much broader, and includes investment products for affluent citizens and financial services for the wider population.

At the wealthy end of the market, sharia-compliant asset management services have grown in South Africa, with ten asset management companies offering sharia-compliant investment, including Sanlam, Element, Kagiso and Stanlib. Oasis Asset Management handles the largest number of sharia-compliant investment funds. It is also pioneering Islamic pension funds. However, total Islamic banking assets only currently account for 3.5% of total banking assets in the country, according to Mushtak Parker, editor of Islamic Banker, a magazine.

South Africa's commercial banks have improved product development and marketing, rebranding Islamic-compliant products to attract a broader audience rather than appealing only to Muslims. "There is better awareness about these products and we are seeing some more interest in the non-Muslim segment. Islamic funds appeal to the socially responsible," says Bilal Jakhura, director of the Centre of Islamic Economics and Finance in South Africa (CIEFSA).

Nigeria is another player in Islamic investment funds and financial services. Its first full-fledged Islamic bank, Jaiz International Bank, has been operational since 2012 and is waiting for approval to operate throughout the country. Other mainstream banks, including First National Bank (FNB), Absa Bank and HBZ Bank, offer Islamic finance "windows" alongside conventional services. Four institutions—Lotus Capital, Sterling Bank, Stanbic IBTC and Cornerstone Insurance—manage sharia-compliant assets. Lotus Capital has diversified the nation's Islamic offerings with a halal share index and exchange-traded fund.

Head of non-interest banking at Stanbic, Babayo Saidu, describes a rapid increase in banking

Islamic banking: An explainer

Islamic finance must support real economic activity, without charging riba - which is an increment earned on the sale of money itself. Islamic finance covers project finance, trade finance, and buying and selling goods at a profit. It rules out hedging, derivatives, and lending at interest. Risk-sharing means both the bank and the lender are exposed to risk.

Islamic banking separates current and savings accounts from investment accounts and requires the bank to hold 100% of reserves on deposit. Islamic banking can take two forms. The first is a full-fledged Islamic bank, entirely sharia-compliant across all products and services. The second option is a dedicated "Islamic finance window" in a conventional bank.

While a full-fledged bank demonstrates stronger commitment to Islamic values, Islamic windows can help conventional banks venture into Islamic finance. Islamic banking exists in both forms in Sub-Saharan Africa.

Foreign Islamic banking players in Sub-Saharan Africa

- Al Baraka Bank of Bahrain established South Africa's first Islamic bank in 1989.
- Dubai Islamic Bank has recently received, in principal, approval from regulators in Kenya to establish a branch, expected to open by the end of 2015.
- Standard Chartered has expressed its intention to develop Nairobi as its Islamic finance hub in Africa.

activity. "We have 181 bank branches and other alternative channels that offer non-interest banking across the country. This is in addition to Jaiz and Sterling Bank branches. I wonder which Sub-Saharan African country has that? I cannot see any Sub-Saharan African country competing with Nigeria in the next five years."

As with South Africa, there is interest from non-Muslims in such services as well. Mr Oshodi, group head of non-interest banking at Sterling Bank, said: "90% of those who come [to the bank] are non-Muslims." Lotus Capital had a similar experience. "People are interested because the pricing is competitive," portfolio manager Ndako Mijindadi said. "We've been able to take up credit from the conventional space because some people find the product more attractive."

Throughout the rest of West Africa, however, including in larger economies such as Ghana and Côte d'Ivoire, Islamic lenders are less visible. Senegal has just one Islamic bank, *Banque Islamique du Sénégal*, even though Muslims make up 95% of the country's population. In Niger, where about 94% of the population is Muslim, Islamic banking accounts for less than 3% of total assets[5]. There is little presence of formal Islamic finance in Mali, despite over 90% of the population being Muslim.

Large African lenders including South Africa's Absa and Morocco's Attijariwafa Bank have expressed interest in launching Islamic finance windows in West Africa, but they are yet to act. "I do not yet feel any serious intention to develop Islamic products among the big banks," added Mr Mbacke.

In southern Africa, beyond South Africa there is limited Islamic banking presence. Zambia is laying the groundwork to accommodate Islamic windows within conventional banks following the release, in December 2014, of guidelines by the Bank of Zambia.

In East Africa, Kenya - which has a significant Muslim population - appears intent on growing Islamic banking, which currently represents 2% of total banking assets. Two Islamic banks, Gulf African Bank and First Community Bank, received licences from the Central Bank of Kenya in 2007. They had US$170m in loans and advances at the end of February 2013, and US$215m in total deposits. Kenya Commercial Bank has spoken publicly of its desire to integrate Islamic windows into its business across the East Africa region.

In Ethiopia, despite a Muslim population exceeding 30m people, the sector is in its infancy. In 2011, the National Bank of Ethiopia issued formal directives on Islamic-compliant finance, but the rollout of products has been slow. Oromia International Bank is the first private bank to implement interest-free banking and the Commercial Bank of Ethiopia and United Bank have licences for interest-free banking. Lastly, in June this year the government of Uganda issued a bill paving the way for Islamic banking.

Financial deepening

Limited access to finance is a developmental challenge for Africa. Prohibitive interest rates offered by conventional banks means many individuals, entrepreneurs and SMEs eschew the mainstream banking system. Many remain unregistered to avoid bureaucratic interference and taxes. Because Islamic finance is interest-free, it could be an appealing source of capital for small companies and individuals.

[5] "Islamic Finance in Sub-Saharan Africa: Status and Prospects", IMF 2014 Working Paper , WP/14/149

Takaful: An explainer

Takaful is sharia-compliant insurance, primarily issued through banks. In Kenya, First Community Bank has a takaful licence and has a joint venture with a local insurance company. In 2011 Absa Group, a local South African bank, acquired Takafol SA, merging its operations into Absa's own developing Islamic financial services, which now operates under the Absa Takafol brand. While the number of African *takaful* companies is still limited, gross *takaful* contributions across the continent have shown an 18% compound annual growth rate (CAGR) between 2005 and 2008, and increased by 26% in 2009 reaching an estimated US$377m. The EY Centre in Islamic Finance for Africa forecasts that gross *takaful* contributions will increase from US$432m in 2010 to US$464m in 2016. Established *takaful* markets, like Sudan, offer prospects for replication across other African markets embracing Islamic finance.

For Islamic finance advocates, non-interest banking could play a role in deepening financial services. "We want to bring [SMEs] into the formal economy through non-interest banking," says Mr Saidu of Stanbic. "We see opportunities there."

However, the challenges of lending to African SMEs - lack of collateral, absence of property titles, thin business plans and inadequate financial documentation – will all be as problematic for Islamic lenders as conventional ones.

Lastly, could "Islamic microfinance" be of interest to low income customers? The government of Sudan has developed Islamic microfinance over the last decade. In 2007, the Central Bank of Sudan created a Microfinance Unit and required that banks allocate 12% of their portfolio to microfinance. Ten dedicated microfinance institutions have been set up; 12 banks have introduced Islamic microfinance windows; and five insurance companies have developed "micro" products[6].

In 2013 Sudan had a microfinance client base of 430,000 and Bank of Khartoum recently won the Ethical Finance Initiative Award by the Abu Dhabi Islamic Bank (ADIB) for providing micro-insurance to farmers[7].

While *musharaka* and *mudaraba* models have been pursued, there are opportunities for *salam* financing given the presence of a large agricultural sector.[8] Islamic microfinance has also been deployed in Ethiopia. Through the Somali Microfinance Institution, 16 branches have been established, with a client base of over 16,000[9]. Expanding this will require refining the regulatory framework and educating end-users.

However, the growth of Islamic microfinance is hindered by risks associated with providing loans to the extremely poor. Under structures where the financier purchases the asset, which in some cases can include livestock, monitoring and maintaining the asset brings challenges. Islamic microfinance is also constrained by the 'first-mover' advantage of existing conventional microfinance firms, which have existing networks of borrowers, allowing them to operate at scale. Another challenge concerns compliance—some Islamic microfinance institutions still have rates and fees that are ambiguous, and may simply be interest dressed up as "management fees". Ensuring sharia-compliance among a vast number of often un-regulated providers is a far from easy task.

[6] *"A national experiment: sharia-compliant finance in Sudan"*, Consultative Group to Assist the Poor (CGAP)

[7] *"Trends in Sharia-Compliant Financial Inclusion"*, Consultative Group to Assist the Poor (CGAP), No. 84 March 2013.

[8] Under *musharaka*, two or more parties contribute capital in cash or kind (equity financing), whereas *mudaraba* is a partnership where capital is provided by one party and labour or managerial expertise by the other. Salam financing involves an advance payment against future delivery of products

[9] *"Religion and money: is Islamic banking the way forward for Ethiopians?"*, The Guardian, 19th March 2015

3 The halal economy: A lucrative, but invisible market

Sub-Saharan Africa's halal economy remains largely informal, even in countries with an almost entirely Muslim population. Halal goods are everywhere—from meats in the butcher's stalls to clothes vendors sewing niqab in street-side warehouses, and travel companies offering packages for the Hajj to pilgrims. However, very few businesses identify themselves as halal, even in majority Muslim countries where halal is the norm and not an exception in need of a descriptor. The combination of a large informal sector, and the absence of businesses identifying themselves as halal, leaves the notion of a halal economy looking, in Mr Oshodi's words, "rather abstract". Mapping the market is therefore a difficult task.

Overall spending estimates suggest a significant market, even though it may lack detail. In 2013 Sub-Saharan African consumers spent an estimated US$114bn on halal food[10]. Most spending is on halal meats, but the trend has been shifting to halal franchises, prepared meals, and canned, frozen, and instant foods.

South Africa is one of the five largest producers of halal products worldwide, largely thanks to its access to the rest of Africa and its advanced halal certification programmes - 60% of all products that retail in the country are certified halal, worth approximately ZAR1bn (US$71.7m), according to the Malaysia External Trade Development Corporation (MATRADE). Upmarket supermarket Woolworths is dedicating more shelves to halal products in its Western Cape stores, where there is a high concentration of Muslims.[11]

South Africa's supermarkets have a footprint on the continent, making South Africa a gateway for halal exports into Africa. The country hopes to increase the value of halal exports by US$31bn by 2020. A US$72m halal agro-processing food park has been proposed for the Western Cape. Generating over 5,000 jobs, the park will allow the Western Cape to double its share of the halal food market targeting the Middle East and North Africa. Burger King's meat pattie factory, also in the Western Cape, is the second in the world to produce halal patties, opening up opportunities for export to the rest of Africa and the Middle East.

A second halal market is tourism and leisure. Muslim tourists globally represent a major market; a young demographic, increasingly asserting its needs on the travel, tourism and hospitality industry, according to Nabeel Shariff from UK-based Serendipity Travel, a tour operator company specialising in Halal travel. Global expenditure by Muslims on travel reached US$140bn in 2013 (excluding Hajj and Umrah)[12] and is expected to reach US$238bn by 2019. The priorities of Muslim tourists concern the availability of halal food, a family-friendly environment, and accommodating religious practices, such as private pools.

Africa has a small share of the global halal travel market—5% compared with Europe's 51%, according to DinarStandard research. "Since establishing ourselves in 2010, we have seen a 40% increase in tours to Africa year on year. But compared with our other destinations - the Far

[10] According to estimates by DinarStandard.

[11] According to Woolworths online supermarket.

[12] Expenditure data base-lined from 2013 UN World Trade Organisation data; IMF Outlook Oct 2014 database for projections; Muslim market estimates based on DinarStandard analysis.

East, Indian Ocean and Australasia - it has not been as strong," says Mr Shariff.

Tanzania, Zanzibar and South Africa are the most popular destinations, and best equipped for the halal market. Other destinations are of interest only to intrepid travellers, says Mr Shariff, but this may be down to poor marketing strategies. "It is a lack of awareness. Many hotels cater to halal but they do not market themselves well. Many of our clients here in Europe are not aware of it."

If marketed well, halal travel in Africa could compete with more established destinations. South Africa was listed as one of the top ten global halal tourism destinations, according to research by Singapore-based Crescent Rating, but "much remains to be done to exploit the opportunities," says Ebi Lockhat, public relations officer for the South African National Halaal Authority (SANHA). Halal travel could also attract non-Muslim tourists, says Mr Shariff. "We do have a few non-Muslim clients who are looking for the privacy associated with halal travel, the food element less so […] they might want somewhere where there is no nightclub or alcohol available."

"Because of our Muslim populations, we have unconsciously put a halal economy in place, but only by default," AFRIEF's Mr Muhammad explained. "These businesses are there, but they are informal. We now have to formalise them." Noting that such businesses lack the collateral or the cash flow to invest or borrow, Sterling Bank is piloting a crowd-funding platform in Nigeria. "98% of businesses here belong to the micro and small category," Mr Oshodi said. "This product is for people who want 1m or 2m Naira or less. We can give such funding at very low pricing so that they can get started with their business."

[13] "Regulations And Fiscal Incentives Could Speed Islamic Finance Development In Africa", Standard and Poor's, August 6, 2015

4 Supporting Africa's Islamic economy

Population growth, increased consumer spending power, and the dominant place of Islam in Africa's demographic makeup, mean that 'Islamic economy' is playing an important role in the economic trajectory of the continent. Africa's challenges, notably infrastructure financing and the need for wider access to financial services, also provide an opportunity for the Islamic finance industry to grow.

This report has outlined a clear uptick in activity over the last five years in the likes of Senegal, South Africa and Kenya, with growing interest - as evidenced through the issuance of guidelines, laws, regulatory reforms and national strategies - in the likes of Zambia and Uganda. Moreover, the appeal of Islamic economy sectors appears to be spreading beyond Muslim communities or Muslim-majority countries. At the same time, current evidence suggests the full extent of Islamic economy activity is lagging behind potential beyond a handful of markets and a few major milestones. It is fair to say the Islamic economy industry remains in its early phases in Africa as a whole.

To thrive, the Islamic economy needs to overcome several hurdles. The first is skills and technical capacities to build the foundations for Islamic finance and certification systems for halal. The region has too few Islamic finance and Shariah experts in government, financial institutions, central banks and regulatory bodies, and hiring in such expertise is prohibitively expensive. "The fees charged to develop a regulatory framework are too big for countries like Burkina, Niger, even Ghana," AFRIEF's Mr Muhammad argued. "At the current rates they may never do it." The capacity gap is evidenced by the time lags between initial discussions about Islamic finance to the deployment of instruments, as countries address legal hurdles, costs and legislative processes - all testified by experiences from Senegal, Uganda, Nigeria and South Africa.

Outside of South Africa, financial markets and regulatory systems are undeveloped. Capital markets are thin and illiquid, and technical capacity in central banks and relevant authorities are constrained, albeit they are far stronger than previously. Even South Africa took several years to put in place the regulatory systems to allow the launch of Islamic finance products like sukuk. Nigeria, meanwhile, lacks a single body for capacity building, according to Sterling Bank's Mr Oshodi. A lack of expertise within the Debt Management Office may be one reason for slow progress in launching the nation's first sovereign sukuk.

Countries serious about building their Islamic economy must prioritise capacity building. "There's a lot of training and information needed for decision-makers in the region to take the full opportunity of Islamic finance," argued AIIF's Mr Mbacke. Organisations like AFRIEF and AIIF in Senegal address this problem through training, and multilateral development agencies can support the process if they see a developmental gain for beneficiary countries.

Governments wishing to develop their Islamic finance sector have several options. The first is to build stronger relationships with multilateral development banks and agencies that may have an interest in, and experience with, supporting Islamic finance regulations. Such agencies include the Islamic Development Bank (IDB), the African development bank and the Arab Fund for Economic and Social development.

Such agencies are already playing a substantial role in aid funding on the continent, and turning their attention to institutional capacity building for countries wishing to develop Islamic finance capacities would appear worthwhile enterprise. Assistance from the IDB and the Islamic Corporation for the Development of the Private Sector (ICD), an affiliate of the IDB which arranged Senegal's 2014 bond and is structuring Côte d'Ivoire's forthcoming bond, is one example. "If ICD is structuring the sukuk, then that will give comfort to foreign investors," noted Sterling Bank's Mr Oshodi. "That's what happened in Senegal, and it is something that Nigeria should consider." Both ICD and IDB have ambitions to support sukuk issuances through the region.

Islamic development agencies in Africa

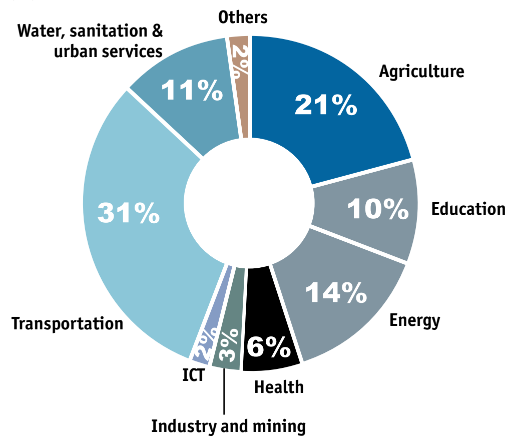
Several Islamic development agencies have a presence in Africa. The Saudi-based Islamic Development Bank (IDB) promotes economic development in its 56 member countries through sharia-compliant loans and grants. Nearly half of the bank's member countries are in Sub-Saharan Africa. In August, the Africa Finance Corporation (AFC) received a US$50m, 15-year line of financing from the IDB to finance projects across member countries, primarily in West Africa. As part of its Energy for Prosperity programme, the IDB released US$180m for renewable energy projects in six West African countries, part of a US$7bn programme across Africa.

The Islamic Corporation for the Development of the Private Sector (ICD) is studying the Ugandan market and has submitted an application to launch an Islamic bank in Kampala and demonstrated commitment in a recent agreement with West African regional authorities to develop an enabling environment for Islamic finance. Mozambique has received US$300m from the IDB since joining the bank in 1995. Currently 22 IDB-funded projects, valued at more than US$160m, are underway. Gulf-based companies have an avenue to expand into the continent under the aegis of such agencies' activities. The IDB goal is to increase intra-member trade to 20% by the end of 2015.

Figure 5

Sectoral distribution of cumulative IDB Group net approvals in Sub-Saharan Africa (Jan 1976-Oct 2014)

(%)

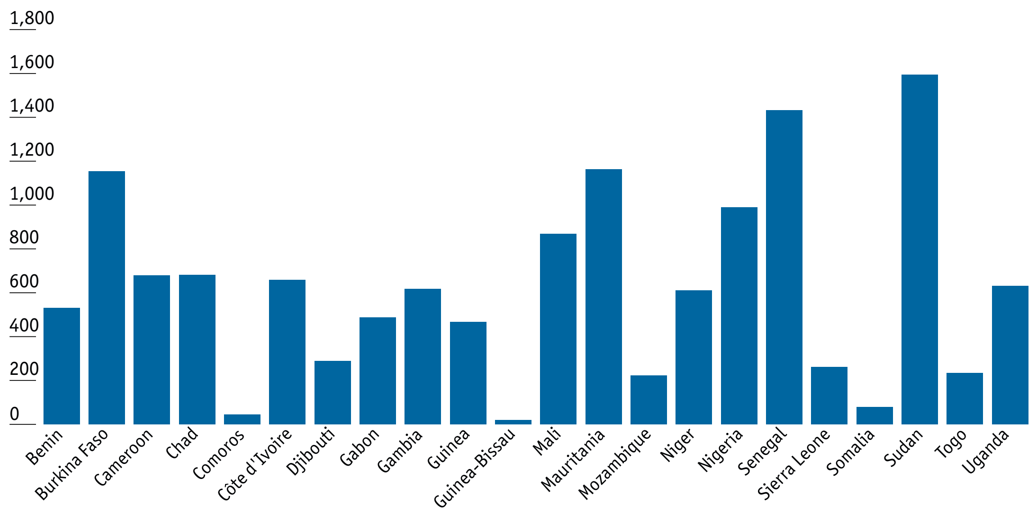


Source: Islamic Development Bank Annual Report 2014.

Figure 6

Cumulative IDB Group operations in Sub-Saharan Africa

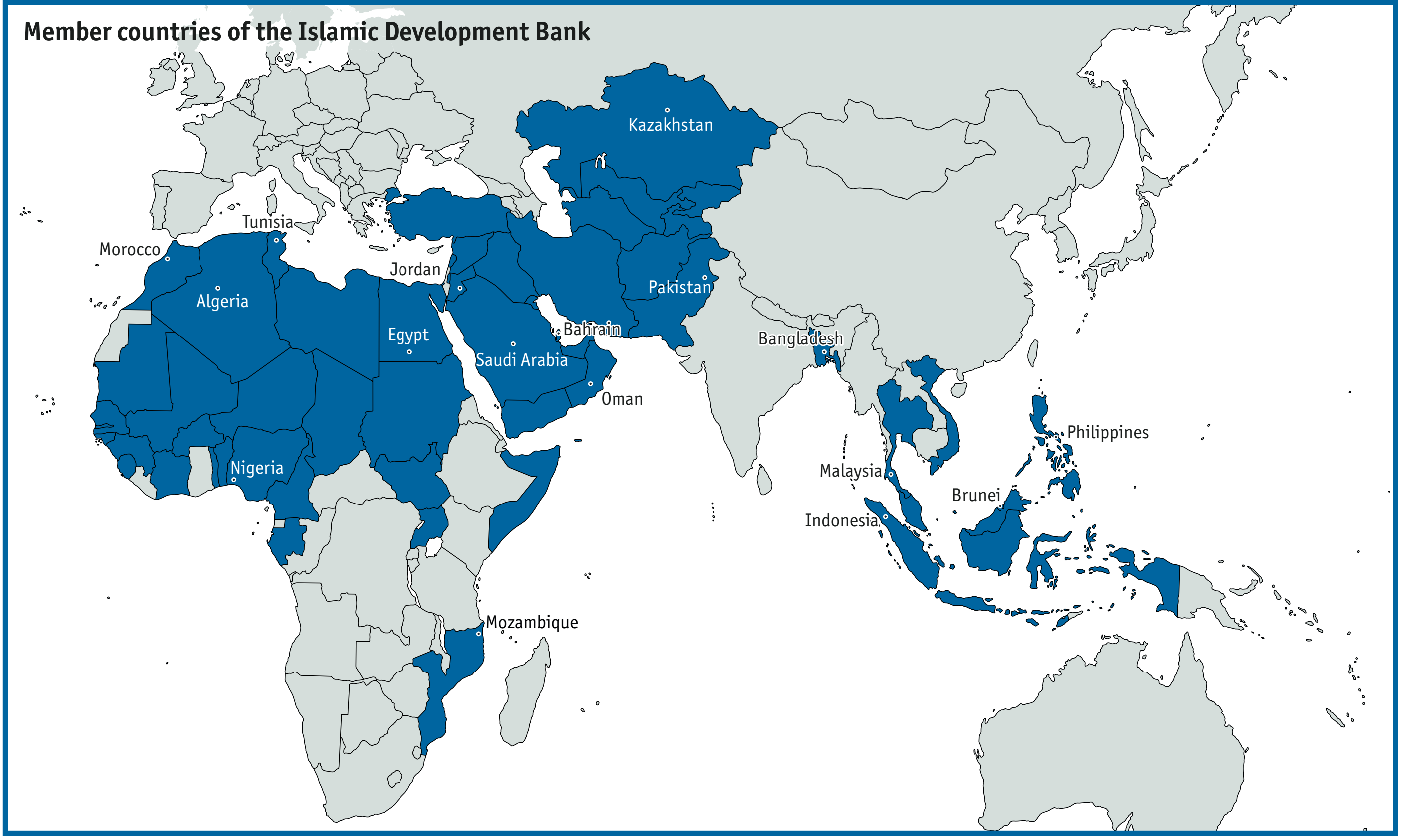
($m, Jan 1976-Oct 2014)



Source: Islamic Development Bank Annual Report 2014.

Figure 7

Member countries of the Islamic Development Bank



Regulatory strengthening also applies to niche legislation such as taxation - currently, tax codes often bias against Islamic finance when, for instance, offering tax incentives to debt over equity financing. South Africa's regulators have evened the playing field over the last five years, with tax amendment laws recognising arrangements such as *musharaka, murabaha and mudaraba* as credible alternatives to conventional financing agreements. In Senegal, by comparison, *sukuk* is exempt from tax.

However, there is debate about whether countries need to build unique legislation to issue Islamic finance instruments such as *sukuk*. Senegal's was based on existing financial legislation, not a new regulatory framework. Standard & Poor's notes that if other countries in West Africa issued *sukuk*, they might follow a similar course, although other experts favour unique legislation.

Regulation also needs to support authenticity and compliance. The Islamic finance sector will thrive only if investors and customers fully trust in adherence to sharia. The Islamic Bank of Guinea and *Banque Islamique du Sénégal* have operated as conventional banks, analysts claim. A sale of a stake in *Banque Islamique du Sénégal* to ICD could change that: "It has been Islamic in name only in the past, but since ICD and Bank Asya bought the majority shares, they are currently working on changing it into a true Islamic bank" said the AIIF's Mr Mbacke. Complications can also arise in determining if a product is genuinely sharia-compliant. Islamic microfinance organisations may charge interest but under other names such as "management fees".

Closer relations with international standard-setting institutions such as the Islamic Financial Services Board and the Accounting and Auditing Organisation for Islamic Financial Institutions can help, as these bodies are responsible for international standards and guidelines for Islamic finance. These allow for greater transparency and standardisation in the way that products are structured, increasing harmonisation across regions.

Perceptions and reality

A further challenge for the Islamic economy in some parts of Africa concerns mis-perceptions or fears surrounding discussions of 'Sharia'. Such worries among non-Muslims are particularly acute in Nigeria, which suffers long-standing tensions between the predominantly Muslim north and mostly Christian south. The introduction of sharia law in northern states at the turn of the millennium stoked concerns that northern politicians would use their position to "Islamise" the country and persecute others.

As a result, banks are cautious about their offerings. They euphemistically refer to Islamic windows as "non-interest", and choose not to advertise halal products for fear of undermining their conventional offerings. Effective marketing campaigns can start to change this. "Certainly marketing needs to be improved to create awareness within each country, to educate the public and the industry about the benefits and risks of Islamic finance and principles," explains EY's Ms Kassie.

Conclusions

Africa has the fastest growing population in the world. The predominance of Islam as one of the continent’s main religions means that such demographic trends, along with resilient economic growth, create the foundations for the Islamic economy to play a role in shaping Africa’s trajectory.

The drivers of Africa’s Islamic economy are both bottom-up—increased demand for sharia-compliant goods and services—and top-down as governments use instruments like *sukuk* to raise funding for infrastructure. The Islamic economy does not depend on Muslim-majority populations. While populous Nigeria stands out as a potential growth market due to population size and religious makeup, interest in Islamic economy goods and services is not reliant on majority or even large Muslim populations. African non-Muslims are among the consumers, and governments see potential in these areas.

While Islamic finance stretches back decades in countries including Sudan and South Africa, it is now developing in a range of newer locations including Uganda, Ethiopia, Zambia and Kenya. The technical requirements are considerable, however. Time lags between discussing and implementing Islamic economy reforms, especially in the finance sector, can be lengthy. There may be a role for multilateral development agencies to support capacity-building efforts. Certification systems for sharia-compliant finance and halal goods and services must be in place to ensure the authenticity and credibility of the sector. Lastly, there is a continuing need for public education about Islamic finance reforms, due to widespread misconceptions or misunderstandings about Sharia-related reforms.

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