Outlook and strategy for Islamic Finance's development in North Africa

Islamic finance is one of the most developing industries today, with a compound annual growth rate estimated at 15-20% per annum between 2006 and 2010 and several countries competing for the *"gold medal"* to become the ultimate Islamic Finance hub. This situation does not seem to apply for North African countries, where Islamic finance is still lagging behind other Muslim countries in the GCC or South East Asia, or even behind non Muslim countries such as the United Kingdom.

We aim in this essay to analyse why Islamic finance did not develop at a faster pace in North Africa. We consider the following countries in our definition of North Africa: Morocco, Algeria, Tunisia, Libya and Egypt. We will first present some interesting socio-economic facts in the region, then we will derive what we consider the main drivers for the development of Islamic finance and finally we will provide a strategic outlook on the development of the industry for the next 5 years in North Africa.

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North Africa, a crossroad of similarities and disparities

North African countries certainly share common features such as religion, language and a similar social structure characterized by the presence of a large middle-class population. A quick glance at some socio-economic indicators to analyse the region's situation shows that three of the five countries have large populations (figure 1) with over 30 million people (Morocco, Algeria and Egypt with the largest population in the region), this situation is more interesting if we look at the population's structure, we notice that the 15-65 years population – considered as the most active and productive is dominating representing over 63% in all 5 countries (figure 2). We can notice as well that the unemployment rate is high ranging from 9 to 30% with a median of 12% (figure 3). This has been a key factor in the popular uprising (Arab spring) that the region witnessed during 2011. These factors prove that there is a certain level of homogeneity to be taken into consideration when analyzing the market drivers for Islamic finance.

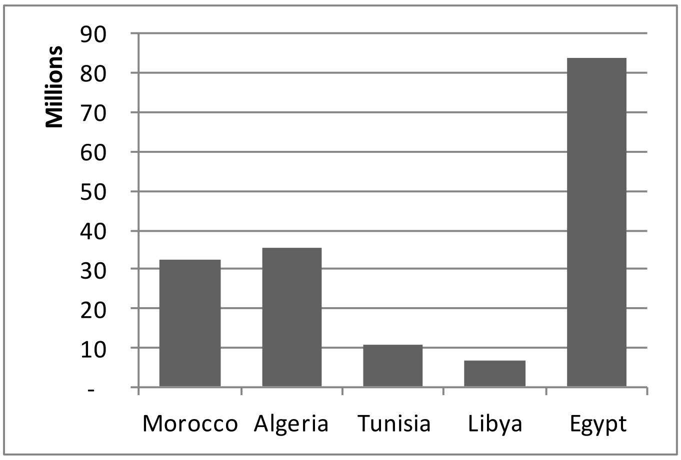

Figure 1: population in North Africa 2011 estimates
Source: CIA Factbook

However, when analyzing the development of Islamic finance in the region, we find disparities in terms of market maturity and Islamic finance products offering. Egypt is the most developed market for Islamic finance with a product span ranging from insurance and retail to mutual funds. Its economic activity is sustained by the largest purchase power parity GDP in North Africa reaching USD 515 Billion in 2011 according to the CIA factbook figures. Whereas in Morocco, Algeria, Tunisia and Libya, the Islamic finance activity is still lagging. As of today, there are few small banks such as Al Baraka Group in Tunisia and Algeria, Noor bank and Zitouna bank in Tunisia and Al Salam bank in Algeria. In 2010 a so-called "alternative finance" activity in Morocco has appeared with the creation of Dar Assafa financing institution which uses Islamic finance Murabaha contracts without mentioning the word "Islamic". Libya is still attempting to offer Islamic financial products but

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as of today it is still at its inception.

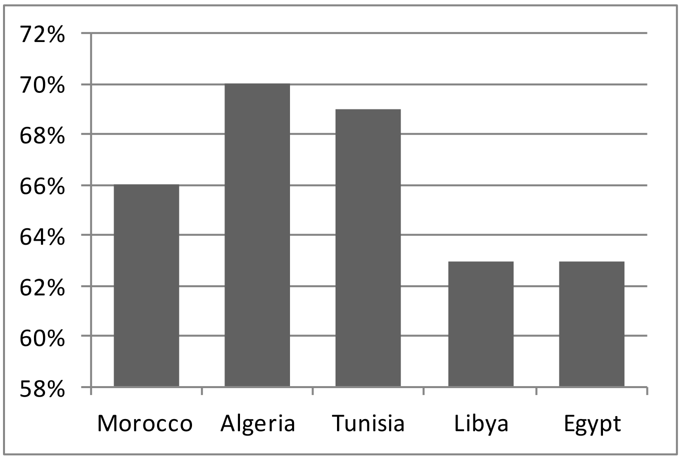

Figure 2: 15-65 years population in North Africa 2011 estimates
Source: CIA Factbook

This particular mix of similarities and disparities between the five North African countries can be considered as a starting point to determine the drivers of the development of Islamic finance in the region.

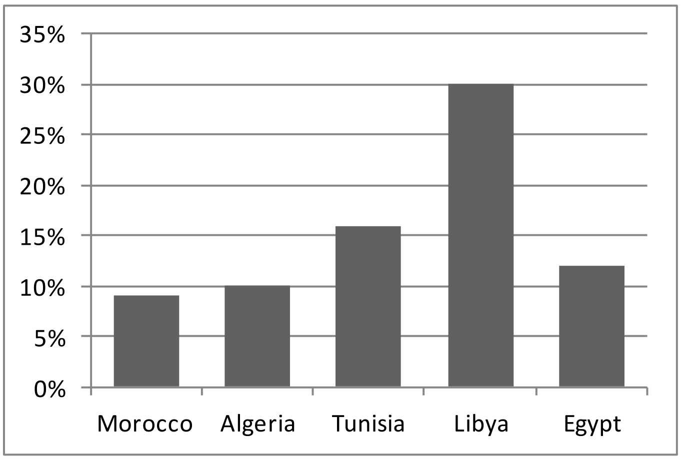

Figure 3: Unemployment rate in North Africa 2011 estimates
Source: CIA Factbook

Consumer centric approach as a key driver for the development of Islamic finance

Following the Arab spring, and given the new political environment under which three of the five North African countries are operating, one can make an educated guess that Islamic finance will definitely receive the support it has always been missing from governments and regulators. However we consider that this alone will not be enough to set the Islamic finance activity to thrive.

Religious aspects are to be considered as a driver, but this would be certainly a weak driver if the development of Islamic finance relies only on religious beliefs. An interesting example is the one of Malaysia ranked third in the world in terms of Sharia compliant assets[i] where only 60% of the population are Muslim. Moreover, the emergence of a *post-revolutionary social model* following the Arab spring could be considered as a real challenge for the development of Islamic finance, since the newly established social models are still unstable and will need time to refine. Thus there is a strategic risk when importing specific Islamic finance models to North African countries, as those which might have worked well elsewhere in the world, could prove to be unsuitable for the specific North African environment.

The main driver for the development of Islamic finance in North Africa today should be the consumer itself. A **CONSUMER CENTRIC APPROACH** should be considered in order to understand the social environment and the market thoroughly and then provide an adequate regulatory and offer "tailor made" products for each of the North African countries.

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Islamic financial institutions will have to prove their role as promoters of economic growth and social justice. In this sense, there is an urgent need in the region for project finance to improve the infrastructure, for Islamic venture capital to invest in risky innovative projects, for Profit & Loss Sharing schemes to promote and sustain the industrial activity and more importantly for the establishment of a regional system for sustainable development. In other words, there is a great potential offered for Islamic finance to flourish today.

Allocative efficiency[ii] and cost efficiency will be both considered as drivers and challenges at the same time for Islamic financial institutions in North Africa since they will have to compete with a well established conventional financial system. Islamic financial institutions will have to allocate their resources to profitable projects putting in the equation the balance between financial and *social* profitability as this will help them build a stronger image and a higher public profile. Consumers will be interested in Islamic financial products which are in line in terms of cost or even more competitive than the conventional ones. Unfortunately, this is not the case today, as Islamic financial institutions tend to offer products which are considered more expensive than the conventional products they tend to replicate through various mechanisms. This has to change if Islamic finance is about to adopt a consumer centric approach for its development in North Africa.

A positive outlook and the strategy to achieve it

Islamic finance will surely develop at faster pace in the next five years in North Africa, as compared to its development during the last three decades. We have a positive outlook on the achievement of certain objectives which will be set by governmental instances for Islamic finance. However, we consider that the strategic axes that will follow will ensure the sustainable development of Islamic finance in North Africa:

— First and before all, there is a strong call for North African countries to collaborate more closely and to establish an integrated economy. The "Arab Maghreb Union" in 1989 was an interesting experience, and the failures from this project should be analyzed in order to establish and enhanced version that what could be called the *"North Africa Union"* which focuses on social and economic development.

— Second, there is an urgent need for a dedicated regulatory environment for Islamic finance in North Africa, by setting Islamic banking laws (such as the case of Malaysia) or adding provisions to banking laws (such as the case of Kuwait or Bahrain).

— Third, the development of the banking sector in the region will largely rely on strengthening banking penetration amongst the population. More specifically, the efforts that are to be deployed should include raising awareness on Islamic finance fundamentals and mechanisms. Consumers will then choose this system rather than the conventional one, based on a well formed opinion on its benefits (provided Islamic financial institutions become competitive in terms of products offering and pricing).

— Forth, offer an excellent service quality, be it within banks, insurance or any Islamic financial institution, as this will set the new standards in North Africa that will attract consumers. This can be achieved through well trained staff, and clear and streamlined processes designed to improve the consumer experience.

— Finally, there is a call for Islamic financial institutions to increase their share in investment schemes based on the Profit & Loss sharing model in North Africa. The current model relying on financing activities with limited Profit & Loss sharing activity will have to change and a balance should be reached in order to promote and sustain the economic growth of the region.

Islamic finance will certainly shape the economic outlook of North Africa for the next five years, but it will definitely have to follow a path that leads to sustainability in order to achieve its main goal: **PROMOTE A JUST AND FAIR ECONOMIC AND SOCIAL SYSTEM**.

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[i] *Source: The Banker, Top 500 Islamic Financial Institutions, FT Business, London, November 2010.*

[ii]

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