

The Sharia-Conscious Consumer Driving Demand

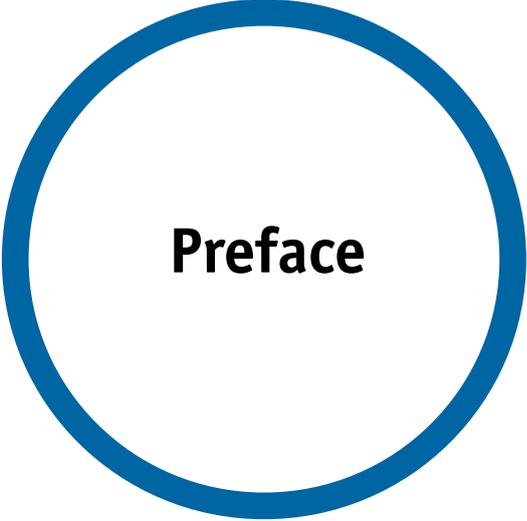
A report from the Economist Intelligence Unit commissioned by Kuwait Finance House

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Preface

The Sharia-Conscious Consumer: Driving Demand, an Economist Intelligence Unit report commissioned by Kuwait Finance House, seeks to determine the factors that have an impact on the appetite for a broad range of Sharia-compliant products and services. It assesses the growing Muslim consumer market, consumption patterns across regions and the implications for business. The Economist Intelligence Unit bears sole responsibility for the content of this report. The findings and views expressed in this report do not necessarily reflect the views of Kuwait Finance House. The report was written by Nigel Gibson and edited by Trevor McFarlane.

March 2012



Executive summary

Ignore the Sharia-conscious consumer at your peril. With the world's Muslim population now at around 1.8 billion and rising, few in business can turn their back on such a demographic. Since more than 50% of Muslims worldwide are under the age of 25 and, together, account for more than 10% of the world's population, the prospects for the future look remarkably bright. From food and Islamic finance, the industry is spreading its wings into pharmaceuticals, fashion and tourism, among many other areas. But given the global nature of the business, the industry will grow at varying speeds in different regions, while certain segments will garner more attention than others.

The principal findings of the survey and a series of interviews with senior experts are as follows:

The Sharia-conscious consumer is an increasingly important segment across the world. More than one-half (54%) of survey respondents say that the market for Sharia-compliant products and services is already significant for their business. Asked the same question but for their business in three years' time, the number of respondents giving the same answer jumped to 68%. Businesses are seeing this translate into sales: over one-half (51%) of respondents are currently enjoying annual growth in revenue of at least 5%, while 34% are registering higher than 15% growth. The same participants are sanguine about the future: over 60% of respondents foresee at least 5% growth in three years, while 43% envisage growth in revenue higher than 15%.

There are a collection of issues helping to promote growth in the Sharia marketplace. When asked to select up to three factors, the majority (56%) of survey respondents chose the growing acceptance of Islamic precepts and Muslim population growth in both Muslim (46%) and non-Muslim (39%) countries as important drivers of demand.

Three categories of regions are propelling demand: the "Muslim heartland" or Muslim majority countries; "mixed culture" countries such as those in South-east Asia; and non-Muslim countries such as those in North America and Western Europe. However, it is Muslim-majority countries that are seeing the fastest-growing demand. When asked to select the top three regions where Sharia-oriented demand is currently growing strongest, 70% of respondents chose the Arabian Gulf countries,

followed by North Africa (36%) and South Asia (34%). In three years' time, respondents see largely the same trend: around 62% selected the Arabian Gulf countries, while 41% picked North Africa and 38% see growth in demand coming from South Asia.

Although areas such as halal-friendly tourism and Islamic fashion are growing in demand, halal food and Islamic finance are still the mainstays of the broader sector. Respondents see food and finance as having the fastest growth, both now and in three years' time. Improving standards related to issues such as labelling and marketing communications could help to grow the businesses. No fewer than 81% of respondents to our survey agree that labelling products as halal, which is an integral part of the food industry, is important. This is a higher percentage than those (77%) who judge corporate branding, a key thought for banks, to be important.

Barriers to growth in the industry do exist. No fewer than 44% of those surveyed say that a lack of professional management and awareness on the part of the seller is holding business back. Almost as many respondents (42%) worry about a lack of convincing branding for products and services that comply with Sharia. Standardisation and certification, a troublesome issue within the global market for halal food, is seen by industry experts as a chief concern within the segment's development.

There is no question that Islamic finance is seen as a vitally important enabler of the broader industry. More than one-half (55%) of survey respondents cite access to Sharia-compliant finance as important. An even higher percentage (58%) believe that easy access to such finance is crucial for their customers as well.

Demand for Islamic bonds (or sukuk) is expected to grow. Nearly 30% of survey respondents say they expect demand for sukuk to grow strongly, a view shared especially by those who work in finance. With international banks, particularly European ones, lending less in order to meet stricter requirements for capital, there is little doubt that banks and other such institutions in the Middle East and North Africa (MENA) will be encouraged to take up the slack, particularly in raising money for infrastructure and the like. As a result, Islamic bonds are likely to grow in popularity as a means of financing projects, particularly around the Gulf.

In the future, firms will have to show that they share the values of integrity and community to which Muslims aspire if they are to build a brand which endures. When considering what best promotes demand for goods and services that comply with Sharia, just over one-half (52%) of survey respondents point to a reputation for honesty and integrity on the part of the company offering the goods or services.

About the research

In January and February 2012, the Economist Intelligence Unit conducted a global online survey of 398 C-level (44%) and senior executives (56%) on behalf of Kuwait Finance House. The respondents reflect a variety of job functions and industries, although the survey is slightly weighted towards financial services and professional services. Survey participants represent firms with varying company revenue. Slightly over one-half have under US\$500m or less in annual revenue, while the remaining have over US\$500m. The global company headquarters of respondents are as follows: Middle East and Africa (36%), Western Europe (32%), North America (12%), Asia-Pacific (19%) and other (2%). All respondents are either already active in the market for Sharia-compliant products and services or have an interest in participating in the industry in three years' time. To complement the survey results, the Economist Intelligence Unit also conducted a programme of in-depth interviews with a range of experts and senior executives. The insights from these interviews appear throughout the report. The Economist Intelligence Unit would like to thank the following interviewees (listed alphabetically by surname) for their participation:

- Chakib Abouzaid, chief executive officer, Takaful Re
- Naif Al-Mutawa, chief executive officer, Teshkeel Media Group
- Fazal Bahardeen, chief executive officer, Crescentrating
- Hala Matar Choufany, managing director, HVS Global Hospitality Services
- Nawel Dehiri, market researcher, Solis
- Ghias El-Yafi, managing director, Tahira Foods
- Abdalhamid Evans, senior analyst, Imarat Consultants
- Idoia Iturbe, deputy chief executive officer, Farvital S.L-Carasa Laboratorios
- Shelina Janmohamed, senior strategist, Ogilvy Noor
- Melih Kesmen, founder, Styleislam
- Saleh Abdullah Lootah, managing director, Al Islami Foods
- Ashar Nazim, Islamic finance leader, Ernst & Young, Bahrain
- Rushdi Siddiqui, global head, Islamic finance and OIC countries, Thomson Reuters

1 Burgeoning demographics

When the faithful gathered for Milan Fashion Week 2012, it proved to be more than the usual jamboree of international designers, models and retailers. This year, for the first time, the event included Malaysia’s Islamic Fashion Festival, a show that began in Kuala Lumpur six years ago and has since visited cities in Asia and the Arab world as well as other international capitals.

For many fashionistas, the Islamic Fashion Festival is intriguing and different. But another reason for the interest is that the organisers of Milan Fashion Week know a trend when they see one. This invitation for Islamic trendsetters testifies to the growing acceptance of the increasing importance of the Sharia-conscious consumer. With the world’s population of Muslims now at around 1.8 billion and rising, those who sell clothing, cosmetics, pharmaceuticals, finance and even food know that the time has come to treat such consumers seriously, particularly since more than one-half of them are 24 years or younger.

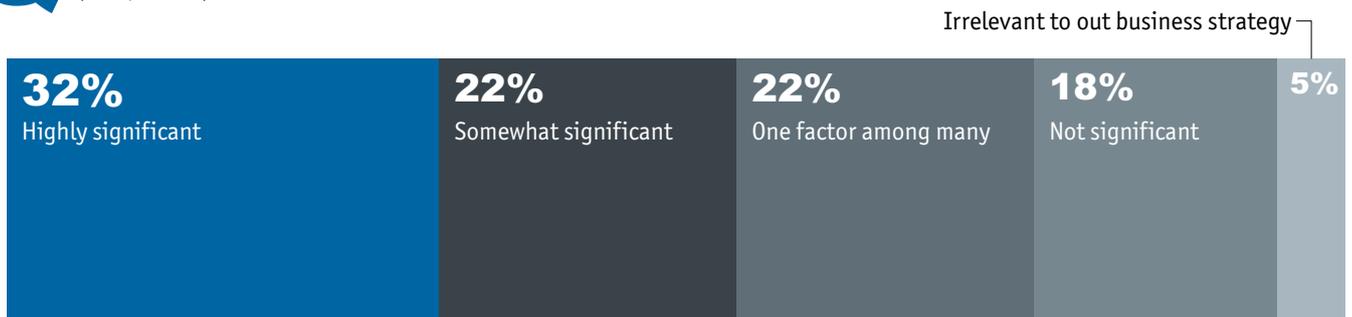
Muslim youth together accounts for as much as 11% of the world’s population. Many are concentrated in countries such as Indonesia, where the Muslim population of all ages exceeds 188 million; or in India, where there are more than 131 million; or in Turkey, with a total of 67 million. Yet such big numbers in many ways hide the purchasing power that has grown (and is still growing) in parts of the Middle East, Europe and North America.

In Europe alone, there are now more than 53 million Muslims, many of them young, educated and with money to spend. In North America, there are as many as 7 million Muslims, again many of them young and well-educated. What is the “demographic dividend” from such a population? Vali Nasr, author of *Forces of Fortune*, a book examining the rising Muslim middle class, noted recently: “In 2008, the gross domestic product of the five large countries in and around the Middle East—Egypt, Iran, Pakistan, Saudi Arabia and Turkey—was US\$3.3trn, the same size

Chart 1



Please indicate how significant Sharia-compliant products and services are for your organisation’s business today?
(% respondents)



as India but at a third of the population.” Against this background, the potential for economic growth and for business in general among Muslim populations is worth chasing.

Estimates of the value of the worldwide market for products and services that comply with Sharia (or Islamic law) vary enormously. Before the financial crisis of 2008, Reuters put the value at US\$2trn. Others believe that it could now be twice that figure. Whatever the exact size, it is already an important market, and demand is increasing.

Over one-half (54%) of survey respondents say that Sharia-compliant products and services are already “significant” for their business today.

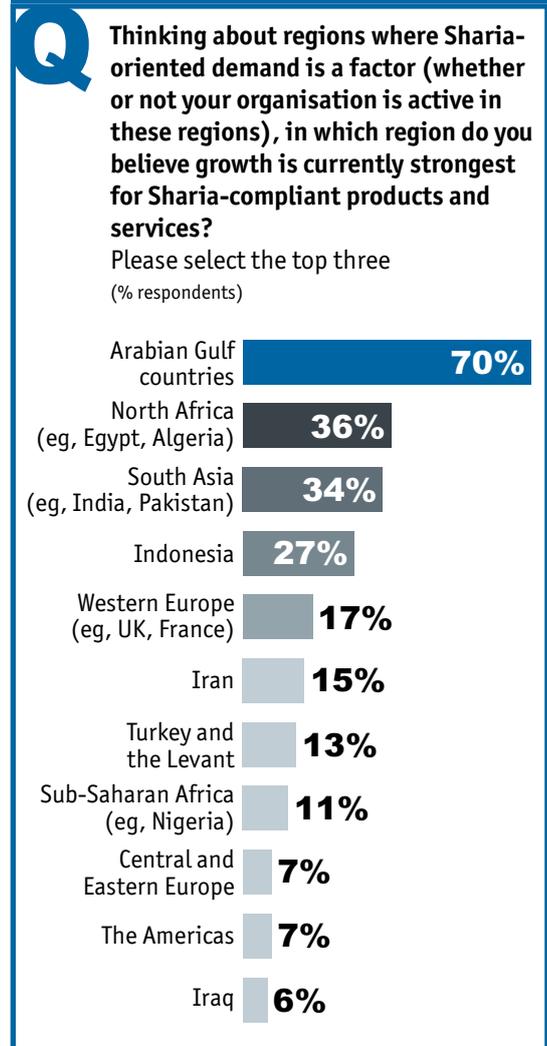
More respondents (68%) reckon that they will be of even greater importance in three years. Moreover, it is not just the importance of the sector that is expected to rise. Businesses are seeing this translate into sales: over one-half (51%) of the respondents are currently enjoying annual growth in revenue of at least 5%, while 34% are registering growth higher than 15%. The same participants are sanguine about the future: over 60% of respondents foresee at least 5% growth in three years, while 43% envisage growth in revenue higher than 15%.

Thus both demand and revenue are rising. But beyond these issues, different regions have different dynamics and will therefore develop in their own individual ways. The Middle East and Africa (MENA), however, was identified within this research as the key market, especially the Arabian countries. This is unsurprising, given that the region is considered to be the Muslim heartland and home to well-heeled consumers of Gulf Co-operation Council (GCC) countries. When asked to select the top three regions where Sharia-oriented demand is currently growing strongest, 70% of respondents chose the Arabian Gulf countries, followed by North Africa (36%)

and South Asia (34%). Expectations for three years from now follow the same trend: nearly 62% selected the Arabian Gulf countries, while almost 41% picked North Africa and 38% see growth in demand coming from South Asia. Western Europe (18%) and the Americas (9%), meanwhile, scored relatively low in comparison.

The corollary to this is that mass market demand is coming from places with large Muslim populations. And while that is true, according to Abdulhamid Evans, senior analyst at Imarat Consultants, two other important categories of markets for providers of Islamic products and services have also emerged. Muslim minority

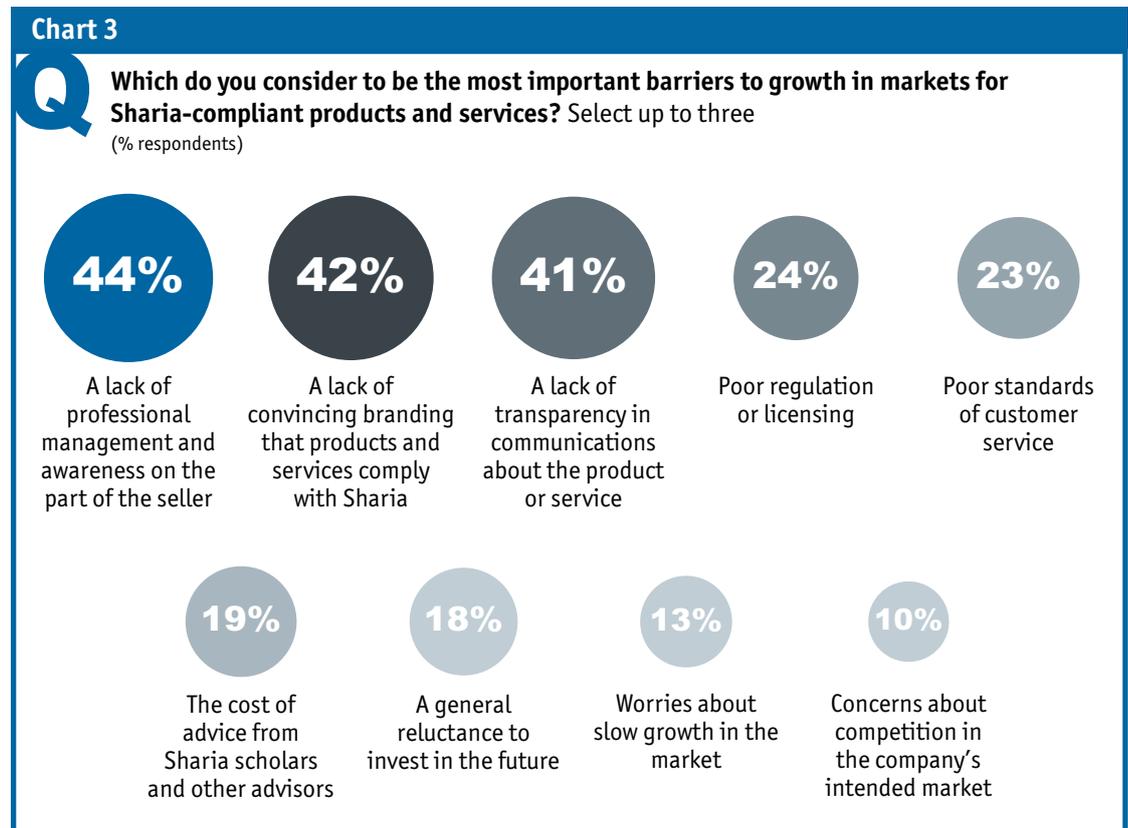
Chart 2



countries such as the US, UK and France and “mixed culture” countries like Malaysia are proving to be an important dynamic within the global Sharia-marketplace. A high proportion (39%) of survey respondents selected growing Muslim minorities in non-Muslim countries when

asked to choose the most important growth-promoting factors for Sharia-compliant demand.

This gets to the heart of how each market’s evolution is shaped by its own characteristics. Consumption patterns of young Muslims living



Sharia is the Way

Muslims are guided by Sharia, the Way, a collection of teachings which derives from the Quran and other sources such as the Hadith, oral traditions and the Sunnah, the practices relating to the Prophet Mohammed and his earliest followers during the 7th century CE. The essential beliefs may be universal yet there is no simplified code of Islamic law. The interpretation of practices may vary from one believer to the next.

What Sharia says about finance is straightforward. The first is to prevent individual Muslims from exploiting others. The second is to protect them from themselves. Riba, an important prohibition in Islam, is taken to mean not just the sin of usury but the charging of interest in any form. Also forbidden is maysir, or games of chance—gambling, in other words. Another is gharar, or uncertainty, a term that covers betting as well as deliberate deception. Also forbidden, or haram, are such things as alcohol, pork and munitions, none of which can be the subject of a transaction.

in the West are very different from those of their often pious forbearers who first landed in, say, the UK. For instance, the only travel concern for the first wave of immigrants was jetting back to South Asia to see their families. Today, things have changed. According to Fazal Barhardeen, chief executive officer of Crescentrating, younger Muslims are still interested in living their lives in accordance with Islam, but they want to visit the latest hotspot travel destinations. The tourism industry is waking up to this market, currying favour with Muslims by tailoring their offering. But it is not just travel. These same Muslim holidaymakers want to consume many of the products and services enjoyed by their non-Muslim compatriots, except with the halal stamp of approval. They want, for example, to wear the latest Islamic fashion when going to meet friends for halal pizza.

In South-east Asia, meanwhile, countries like Malaysia are shaping the newest innovations in the industry, with new products in Islamic finance and the best standards in halal food. Such innovation, as it spreads, will help to drive demand.

Despite all this, the segment often goes unnoticed. Mr Evans of Imarat Consultants relates how car dealers in parts of America were surprised to find that sales of new cars accelerated when the interest rate on loans for new vehicles was reduced to zero. It was only after the dealers discovered that a large proportion of the buyers were Muslim that the fact dawned on them. One of the main tenets of Islamic finance is that transactions should involve no *riba*, or interest. Sharia forbids the charging of interest or any form of return or advantage obtained by a lender as a condition of making a loan. As a result, when the rate on new cars drops to zero, Muslim buyers in the US feel able to avail themselves of the offer.

This example illustrates the need for companies to find out exactly what it is that Sharia-conscious consumers want and how they want

it. Yet 26% of survey respondents say that they did not research the significance of Sharia-compliance for their customers.

Shelina Janmohamed is a senior strategist with Ogilvy Noor, part of Ogilvy & Mather, an international advertising agency. She believes that the new generation of Muslim consumer—those she calls “the futurists”—are more confident about their preferences and ready to express this confidence.

“Consumers are more concerned about the values that a brand embodies, particularly Sharia-friendly values, rather than whether it is manufactured or supplied by a local company or a multinational one,” Mrs Janmohamed explains. Some consumers like global brands because they appear friendly and offer reassurances about quality. “Yet the same people are also prepared to try local brands if they deliver what they promise,” she adds.

By such a measure, marketing communications take on a vitally important role for providers of Sharia-compliant products and services. Yet, according to Mr Evans of Imarat Consultants, the halal sectors are still in the “dark ages when it comes to how they market their products”.

41% of survey respondents identify a lack of transparency in communications about the product or service as a barrier to growth.

There are other challenges to overcome too. No fewer than 44% of those surveyed agree that a lack of professional management and awareness on the part of the seller is holding business back. This is particularly so in markets such as entertainment and media where technology is at a premium. Almost as many (42%) respondents worry about a lack of convincing branding for Sharia-compliant products and services.

2

Food glorious food

"It's about creating role models," says Naif Al-Mutawa, founder of THE 99, a series featuring "Muslim archetypes who possess values shared by the world". He was talking about his cartoon characters who leap from the page and who one day could be in cinemas too. Yet he might also have been describing the dynamism of an ever broadening array of Sharia products and services such as halal-friendly tourism or healthcare. That said, it is the halal food and Islamic finance segments—seen by many as the two pillars within the wider Sharia-compliant industry—that are the mainstay of the sector. Survey respondents cite manufactured foods (53%) and banking services (48%) as the two industries oriented towards Sharia in which they see the fastest rate of expansion.

The manufactured foods industry topped the list of sectors likely to perform well not just today but in three years' time. This is underlined by the high number of respondents in both manufacturing (69%) and retailing (54%) who point to the strength of manufactured foods.

Hard numbers about the size of the market for halal foods worldwide are difficult to obtain. Estimates vary even in regulated markets such as those of continental Europe. Solis, a research outfit in Paris, reckons that the 5 million or so Muslims in France will soon consume around €4.5 billion worth of halal foods each year. Around one-quarter of this is fast food and other such food eaten outside of the home.

Tahira Foods is based near London but distributes its products in continental Europe too. Ghias El-Yafi, the company's managing director, says that chicken is still the halal meat of choice in much of Europe, accounting for around 60% of sales, partly because it is the cheapest. Lamb and beef, which account for 30% and 10% respectively, make up the balance.

The market for halal food in Europe may be easier to quantify. Yet, as living standards rise, the biggest potential lies in countries with predominantly Muslim populations across the MENA region. This is borne out in the survey results. Asked where their company is most active today, nearly one-half (46%) of respondents point to countries in the Arabian Gulf. Three years from now, 48% are even more confident that the region would offer the best prospects worldwide.

Saleh Abdullah Lootah is managing director of Al Islami Foods, a company based in Dubai. "The market for halal food is huge. The problem is that everyone in the industry gives different numbers, so it is hard to say how fast it is growing," he says.

Some may regard that as a nice problem to have, yet it is worrying for several reasons. First, notes Mr Lootah, people add different categories such as cosmetics and medicines into the total for halal, which blurs the boundaries. Second, and more important, is the question of how to define

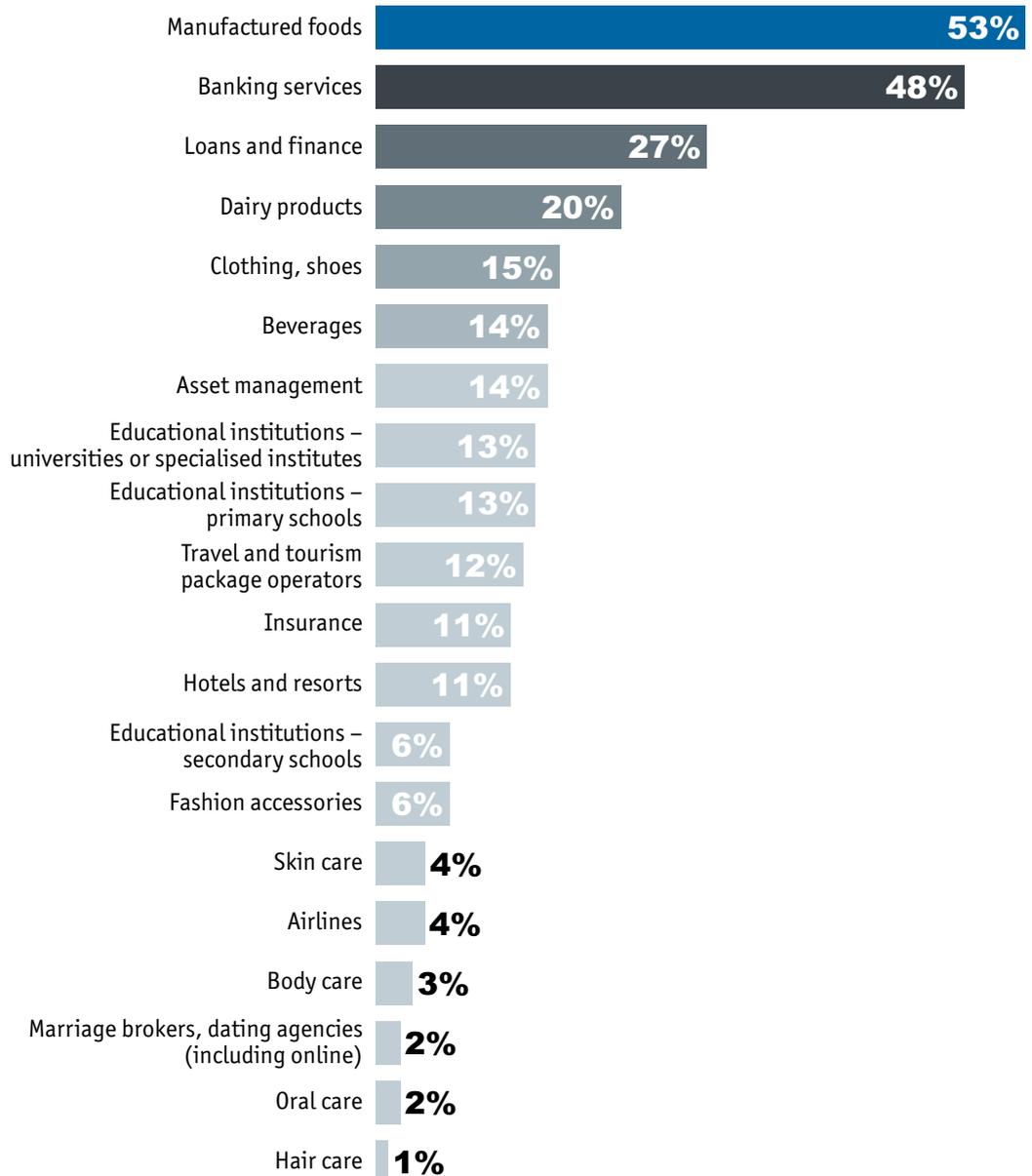
Chart 4



Thinking about Sharia-oriented industries (whether or not your organisation is in these sectors), in which industries do you consider current growth to be strongest?

Please select the top three.

(% respondents)



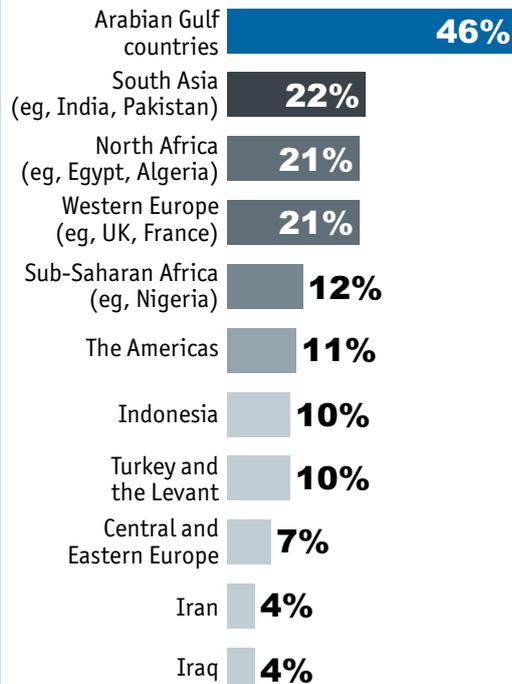
halal and how to regulate the market. Currently the global market lacks proper oversight, leaving many unscrupulous companies to cut corners. According to Mr Lootah, customers may not know if the food they are getting is truly halal.

No fewer than 81% of respondents to our survey agree that labelling products and services as halal is important. Respondents also want to be informed through labelling how such products complied with Sharia. This is even more than the

Chart 5

Q With demand for Sharia-compliant goods and services rising worldwide, where is your company currently most active? Please select up to three.

(% respondents)



total (77%) who say that corporate branding is important to them.

It is not just customers who say they need to be reassured. The industry itself has difficulty plotting the patterns of demand. Some 40% of those surveyed who work in consumer goods cite the most important barrier to the growth of sales of products and services complying with Sharia as poor licensing and regulation. This compared with 24% of the overall sample. Controversies over certification even in regulated markets such as France, which has five bodies overseeing the produce on offer, have done little to calm these fears (see box "Your Certificate, Please").

To exacerbate matters, each country tackles the issues in different ways. John Pointing is a barrister and lecturer in law at Kingston

University in the UK. Writing in the *Journal of Criminal Law*, he noted recently that UK legislation provides for the religious slaughter of animals for food by exempting Muslim and Jewish communities from a provision in the Welfare of Animals (Slaughter and Killing) Regulations 1995 (as amended) which requires all animals to be stunned before they are slaughtered. Yet there is no food legislation in the UK that is specific to halal.

"One reason for this," writes Mr Pointing, "is that there is no consensus within the Muslim community about what precisely constitute halal requirements with respect to the slaughter of animals for human consumption. In particular, whether the use of stunning prior to slaughter is allowed remains a highly controversial issue."

He recommends setting up a Sharia court of appeal which could rule on whether a particular interpretation was correct. A hierarchy of courts, he says, could be established up to an international Sharia court. "An international court able to make binding rulings would make sense as the issues are made more complex by the international nature of trade in halal products," he says.

As it stands now, the market is a long way off achieving universal agreement. But some countries lead the pack in terms of how to regulate their own markets. Mr Evans of Imarat Consultants urges regulators to learn from the Malaysian standard. Named the MS 1500 "General Guidelines on the Production, Preparation, Handling and Storage of Halal Food", it prescribes the practical guidelines for the food industry on the preparation and handling of halal food.

The reason that Malaysia and other mixed culture countries have developed better standards was born out of necessity. Historically, where consumers in the Middle East presumed that what

was on offer was halal, those in mixed culture countries had to verify that what they consumed was indeed halal, as it was often produced by non-Muslims.

It is not just Muslim consumers that have noticed the value in enhancing standards. Regulators in Brazil, Australia and New Zealand, all important players in the global livestock market, have some form of oversight regulating their markets in accordance with halal. These countries have recognised the importance of the sector to their national trade figures.

Retailers also see the development of the halal food market as a new growth area. Mr Evans of Imarat Consultants sees parallels between the way whole foods and organic offerings began as niche markets in developed countries in the West but have since become part of the mainstream. Could halal foods follow suit? The fact that Wal-Mart now stocks halal foods in its US stores is a big step. With as many as 7 million Muslims in North America alone, many of them wealthy and well-educated, it is a market that retailers are monitoring carefully.

Your certificate, please

In early 2011, France's Muslim community was taken aback after a popular brand of halal-certified sausages made of poultry was found to contain pork DNA, and was therefore haram (or forbidden). Few could have imagined how it would shake up the market. Further allegations of impropriety during the run-up to Ramadan stoked the debate. "The past few months have been among the most significant in the market for halal foods for years because of the controversy," confirms Nawel Dehiri, a senior analyst with Solis, a research outfit in Paris.

Understandably, says Mr Dehiri, consumers have become more demanding about what they buy and where they buy it. Some have concentrated on shops where the owner is a Muslim; others have turned to certified organisations with established reputations. And despite a difficult economy, the market for all halal foods in France is still growing, particularly in supermarkets

where sales of processed foods have expanded at the rate of 15% a year.

"Purchases of meat remain by far the largest part of the market," confirms Mr Dehiri. "But sales of other halal products like delicatessen foods, ready-meals, soups and even baby foods are rising strongly too."

Among the supermarkets doing best are Casino and Carrefour, both of which have launched ranges of halal foods. Yet, notes Mr Dehiri, such chains still have work to do. Research by Solis shows that, depending on the region and the size of the local Muslim community, only between 34% and 72% of customers buying halal foods are satisfied with the products on offer.

3

Hospitable as well as halal-friendly

What began some 20 years ago with food and finance is now catching on in hospitality and travel too. “The same halal consciousness that drove [Islamic] finance is now affecting the lifestyle industry, and travel is one of the key lifestyle industries,” observes Mr Bahardeen of Crescentrating, an agency that rates hotels and other facilities on their compliance with Sharia.

Mr Bahardeen believes that the market for halal hospitality and travel already constitutes about 10% of the total market for such things. By 2020, he reckons, halal travel and hospitality will account for 13-14% of the total, making it worth as much as US\$200bn a year.

To some extent, says Hala Matar Choufany, managing director of HVS, a consultancy, what drives demand for Sharia-friendly tourism is the same as that for conventional hospitality: rising affluence among growing populations that are able to take advantage of business between regions as well as globalisation. Yet that is by no means all. In the Middle East in particular, she says, there is an expanding market among “conservative travellers looking for a conservative set-up, or something similar to home”.

One example is the Saudis, who make up a large proportion of travellers from the countries in the

GCC. “Many of them, particularly when they travel with their families, want an environment that is conservative,” says Mrs Choufany.

The difficulty, as with other businesses appealing to Muslim audiences, is in deciding what complies with Sharia and what does not. Hence the title of “Sharia-friendly hospitality” preferred by many in the business. Where the formula works well, according to Mrs Choufany, is with serviced apartments: by definition, they are (or can be) free of alcohol and guests may live in them as they please.

The tricky thing, however, is gauging if this Islamic demand is new or if it always existed. Mr Bahardeen of Crescentrating notes that, with their Muslim traditions, hotels in parts of South-east Asia are used to catering for clients who require dry accommodation and Sharia-friendly facilities.

Not so those in North America and parts of Europe, where hoteliers face a challenge in terms of Western society’s interpretation of “Sharia”. For instance, a bevy of commentators and some political movements in the United States have, says Mr Evans of Imarat Consultants, led to “a backlash against Sharia”. For this reason, Mr Bahardeen believes that his approach to rating

hospitality helps to solve a problem: some hotel owners in the West are weary of the term “Sharia”. Crescentrating.com, however, allows hotels to enter this market without fear of isolating existing non-Muslim clients. “Hoteliers can shout through us because we are focused on these guys [Sharia-conscious guests]. This way hotels can explain what halal-friendly facilities they have, but don’t have to shout to the rest of the world.”

Halal cosmetics: looking good

On the face of things, Saudi Arabia is not the ideal market for cosmetics, halal or otherwise. With its strict observance of Islam and insistence on modesty among women, the kingdom would not top most peoples’ lists of markets to watch. Yet, at the last count, sales of cosmetics (including men’s grooming products as well as perfumes and make-up for women) were worth around US\$2.7bn a year.

Idoia Iturbe, deputy chief executive officer of Farvital–Carasa Laboratories, says it is hard to gauge the size of the market. “We are sceptical of estimates which put the Saudi market for cosmetics and other products alone at US\$2.1bn a year. But there is no doubt that it is a large market and one that is growing fast, with an estimated annual increase of 15% in general. The demand for halal products is expected to increase by around 30% annually in the coming years.”

This is partly because of rising levels of income in Saudi Arabia, thanks, among other things, to

a high oil price. Also playing a part, however, are the country’s demographics: with a burgeoning population and, as elsewhere in the Middle East, an average age of 25 years or younger, the country has much to offer manufacturers like Farvital that have experience of making halal products for Muslim markets.

“In some societies, of course, cosmetics such as make-up are considered inappropriate. But even in these markets there is a demand for moisturisers, face creams, hair colour and other products,” says Mr Iturbe. To reassure their customers, some of which sell Farvital’s products under their own brands, the company’s laboratories in Spain are tested independently. Shipments to countries like Saudi Arabia are also examined on arrival. In addition, the company displays its wares at Beauty Show Middle East, an annual extravaganza in Dubai.

4

The business of Islamic finance

It is no coincidence that a recognition of Islamic precepts worldwide is behind not just the demand for halal goods and services but also for the finance which pays for them. Nor is it a surprise that among those in our survey who believe most strongly in the prospects for business in markets with sizeable Muslim populations are the bankers themselves. More than one-half (55%) of the respondents to our survey see access to Sharia-compliant finance as important. Even more (58%) say that easy access to Islamic finance is important for their customers as well.

So, while conventional banks (and bankers) remain pariahs in many Western capitals, is

finance which complies with Sharia enjoying a renaissance? Yes and no. It is true that the industry of Islamic finance continues to grow at an annual rate of up to 20%, which, at a time when the balance sheets of many conventional banks are shrinking, can be no bad thing.

It is true, too, that commentators such as Rushdi Siddiqui, global head of Islamic finance for Thomson Reuters, believe that, having taken 40 years or so to top US\$1trn, the industry of Islamic finance in all its guises worldwide could be worth double that figure by 2020. Yet, after a bumpy ride since the financial crisis of 2008, Islamic banks are far from out of the woods. Many, notably

Chart 6



How important is easy access to Sharia-compliant finance for your business?

(% respondents)



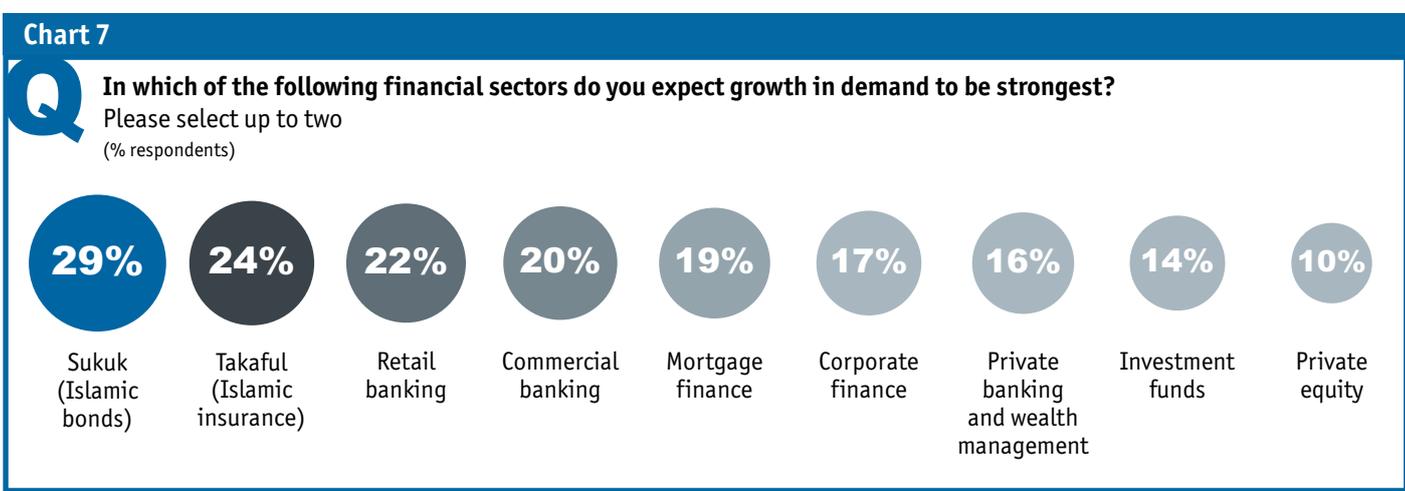
investment banks in the Gulf, remain pegged to property values that have yet to recover to their levels before the crisis.

With 500 or so institutions spread over 90 countries, the industry of Islamic finance remains fragmented too. Ironically, says Ashar Nazim, Islamic finance leader at Ernst & Young in Bahrain, it could become even more so over the next few years. "In terms of absolute numbers, the Middle East and North Africa (MENA) will be the market for Islamic finance which grows the most until 2015. In addition, more than a hundred new Islamic financial institutions are expected to be formed across MENA by 2020; and this signifies that the region will continue to be the engine of growth worldwide." Much of the growth may be in countries which are under-banked or which, as in Egypt and Libya, are undergoing political change.

Such forecasts chime with the results of our survey. No fewer than 62% of those questioned believe that the economies of the Gulf are likely to see the most demand for Islamic products and services; and many of those (62%) who say so are employed in financial services. The same can be said of the 56% who point to a recognition and acceptance of Islamic precepts as a factor in promoting growth in goods and services that comply with Sharia.

With international banks, particularly European ones, lending less in order to meet stricter requirements for capital, there is little doubt that banks and other such institutions in the Middle East and North Africa will be encouraged to take up the slack, particularly in raising money for infrastructure and the like. As a result, Islamic bonds (or sukuk) are likely to grow in popularity as a means of financing projects, particularly around the Gulf. Nearly 30% of respondents to our survey expect demand for sukuk to grow strongly, a view shared especially by those who work in finance. Also leading the way, according to respondents, will be takaful or Islamic insurance (24%), other forms of retail banking (22%) and commercial banking (20%).

The picture is not all rosy, however. Islamic banks will have to become more competitive as well as better at translating inquiries into profitable business. Compared with their conventional counterparts, the return on equity of many Islamic banks has dropped significantly following the crisis of 2008. Competition, meanwhile, may be even fiercer, particularly in markets such as Malaysia and the United Arab Emirates where there are plenty of Islamic banks. Customer service will be one area where banks will be keen to improve.



Risky business

Even with 200 or so takaful companies worldwide and a combined growth rate of nearly 18% a year, Islamic insurance is still a fledgling industry. Granted, it is well established in countries like Malaysia and parts of it (such as health cover) are growing like topsy in markets like Saudi Arabia. True, too, what is known as family takaful (saving and investment policies tied to insurance) are becoming ever more popular.

Yet, says Chakib Abouzaid, chief executive officer of Takaful Re, a reinsurer in the Gulf, insurers that follow Islamic precepts would benefit from having a clearer path ahead. "The industry would like to see clearer regulation in certain markets. The industry failed to reach a common understanding on regulation when it started out some years ago. We also need to develop the skills which are required to run a successful takaful company."

"There is a big difference, for example, between the entitlements of policyholders and those who own the operating company. Like a mutual insurer, a takaful company must be transparent in its business. One has a duty to explain the business to one's policyholders."

"Many takaful operators are able to reinsure their so-called treaty business through retakaful companies such as ours. But when it comes to specialist lines such as aviation or energy, there is insufficient capacity among retakaful companies, so some operators must turn to conventional reinsurers for cover. It is not through choice. Some may see this as a weakness. Yet, for policyholders, cover through a conventional reinsurer may be better than none," Mr Abouzaid says.

However, Mr Ashar of Ernst & Young disputes the perception that Islamic banks have poorer track records than conventional ones at taking care of customers. "In fact, the top banks for customer service in the United Arab Emirates and Saudi Arabia, for example, are Islamic. Customers often have the perception that the services offered by Islamic banks are sub-par compared with conventional ones. "This is wrong." The truth, according to Ernst & Young's most recent study, is that service standards among banks as a whole in the Middle East and Africa region are poor.

Meanwhile, Mr Siddiqui of Thomson Reuters argues: "The customer is attracted to Islamic finance because of its Islamicity. However, he or she is just as demanding as the customer of a conventional bank. Customers of Islamic banks do not want to be penalised for being Muslim and for banking in an Islamic manner. If the consumer financing (for a mortgage or a car, say) costs more, or if the Islamic (investment) funds deliver inferior returns to an Islamic equity benchmark

or a peer fund, they will vote with their wallets."

What of the future for Islamic finance?

Consolidation, says Mr Siddiqui, is the need of the hour since, in finance as in many things, size matters. Islamic banks need to be bigger, he says, not just to get a seat at the table when borrowers raise money for big ticket schemes such as infrastructure and the like. Banks that comply with Sharia also need to consolidate if they are to fend off competition from their conventional rivals with so-called Islamic windows. A priority as well will be for Islamic banks to beef up the way they manage risk and to make better use of technology. It is one thing to be linked to the real economy, as the tenets of Sharia require; it is another to be hooked up to young Muslims who are tech-savvy and demanding.

These banks, as well as other providers of Islamic products and services, will also have to show that they share the values of integrity and community to which Muslims aspire if they are to build a

brand that endures. When considering what best promotes demand for goods and services that comply with Sharia, more than one-half (52%) of survey respondents point to a reputation for honesty and integrity on the part of the company offering the goods or services. This point will not be lost on Islamic banks, especially as conventional lenders struggle to heal their bruised reputations following the financial crisis. ■

Chart 8



Considering what best promotes demand for Sharia-compliant products and services, which of the following do you consider most important to consumers and clients? Please select the top three.

(% respondents)

52%

The reputation for honesty and sincerity of the company offering the product or service

35%

The purity and authenticity of the products and services

34%

The credibility of the company's products and marketing claims

32%

Belief in the Sharia compliance of that company's suppliers

31%

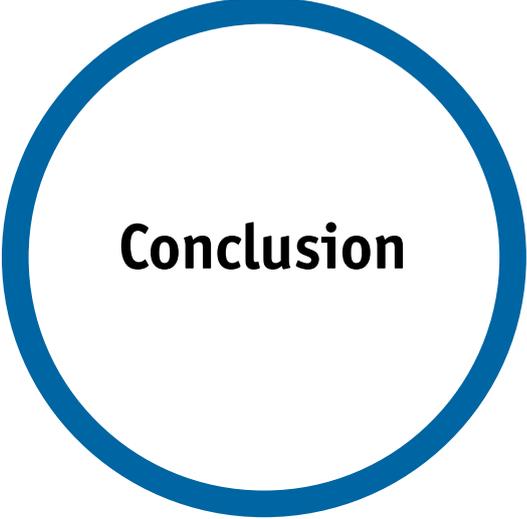
The company's adherence to traditional Islamic values such as modesty, dignity and trustworthiness

30%

The company's perceived sense of community in the Islamic world

23%

The transparency of the company's communications



Conclusion

It is clear that the burgeoning Muslim population worldwide is acting as a fillip to the Sharia-compliant marketplace. As this report has argued, there are other factors, such as rising purchasing power among Muslims and a broader offering of products and services, helping to grow the industry.

But perhaps more interesting is the emergence of three categories of markets: the broader Middle East or Muslim heartland; the mixed culture countries of South-east Asia; and the non-Muslim majority countries of Western Europe or North America. The Muslim heartland is driving mass demand, defined by the high purchasing power of the Gulf countries. South-east Asia, meanwhile, is shaping the newest innovations in the industry, whether they are Islamic finance products or certificates and standards in halal food. Non-Muslim majority countries such as France or the UK are giving rise to a new Islamic consumer with tastes akin to the Western world.

All this augurs well for the future expansion. But like any growing sector, there are steps that need to be taken in order to keep attracting customers. Things like standardisation of international regulations within the halal food sector. Professional management, transparency in marketing communications and improvements in the level of customer service are also required.

Such challenges reflect the current landscape, but they also mask the potential opportunities moving forward. Manufacturing foods and Islamic finance are expected to lead the way in terms of this growth.

To some extent, the acceptance of these sectors among Muslims is relatively well known. The big question is how receptive consumers will be to the increasing range of non-food and finance products and services. If they are keen, then the industry will be limited only by its imagination. ■

Appendix

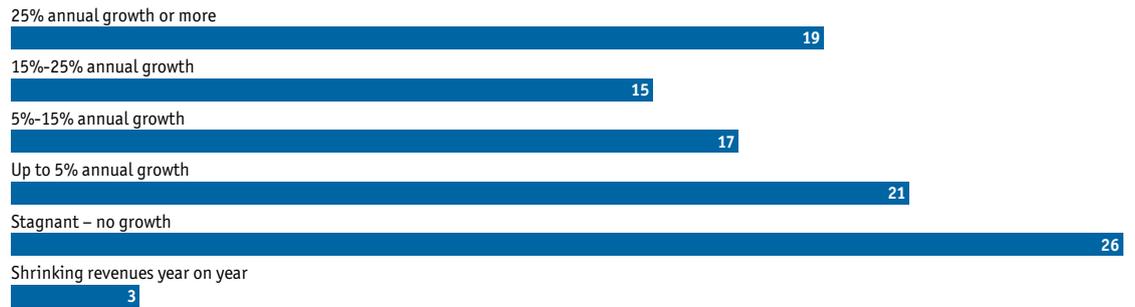
Please indicate how significant Sharia-compliant products and services are for your organisation’s business today?
(% respondents)



Please indicate how significant you expect Sharia-compliant products and services to be for your organisation’s business in three years’ time?
(% respondents)



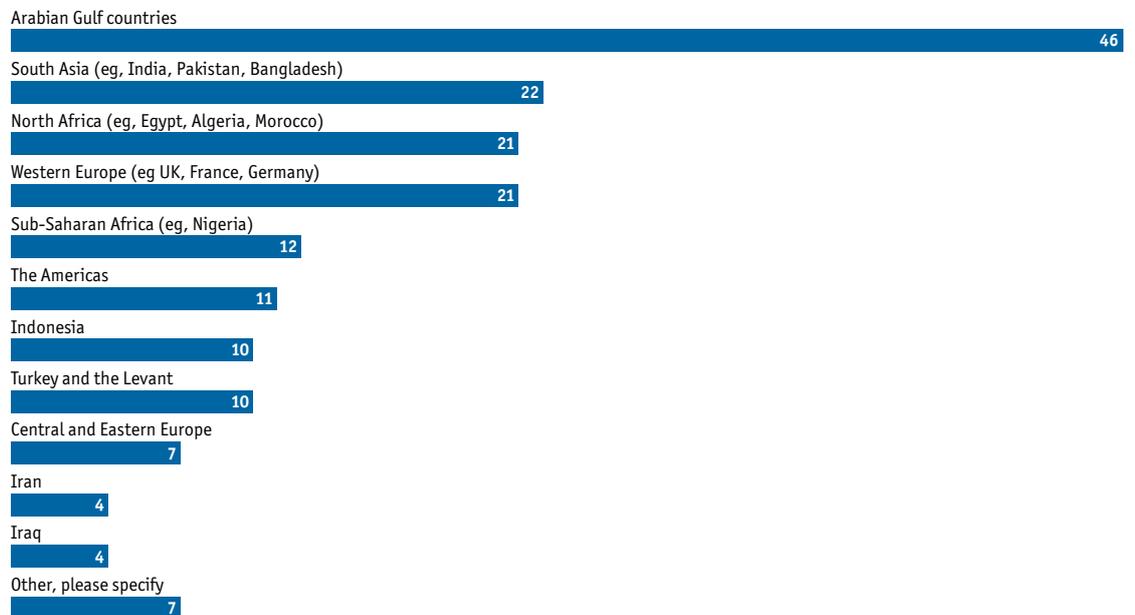
What is the current rate of annual growth (in revenue terms) of your Sharia-compliant business unit(s)?
(% respondents)



What do you expect the average rate of annual growth (in revenue terms) of your Sharia-compliant business unit(s) will be over the next three years?
(% respondents)

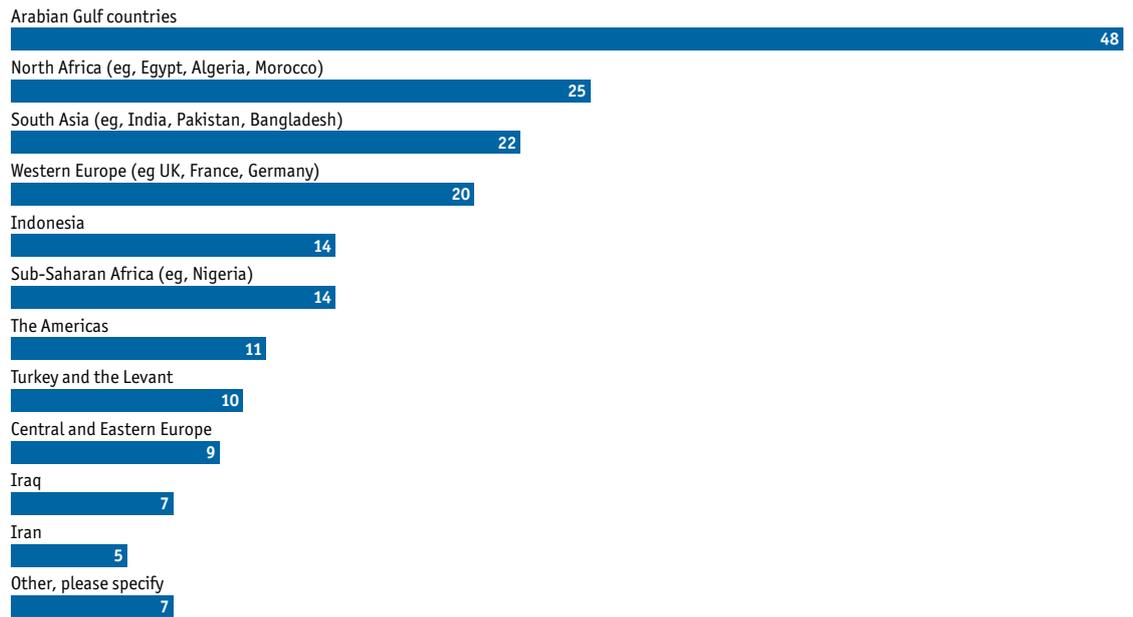


With demand for Sharia-compliant goods and services rising worldwide, where is your company currently most active?
Please select up to three.
(% respondents)



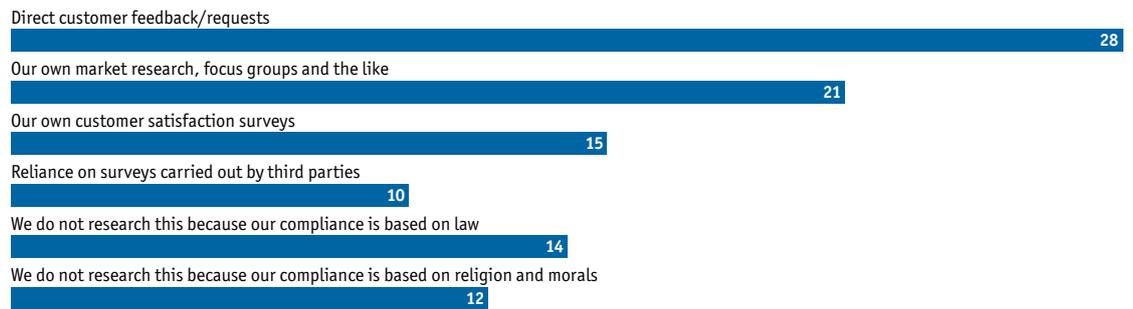
With demand for Sharia-compliant goods and services rising worldwide, where is your company likely to be most active in three years' time? Please select up to three.

(% respondents)

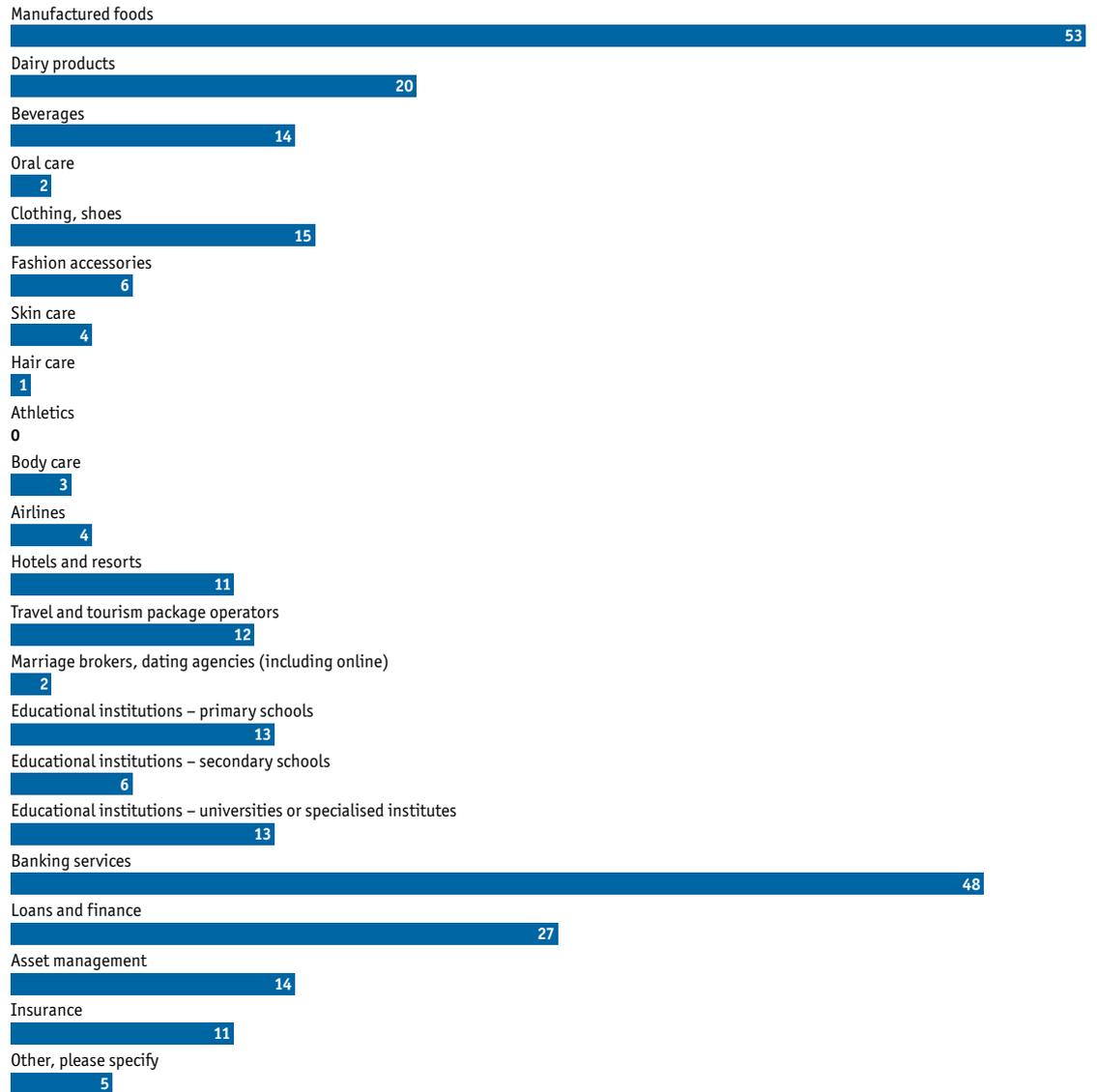


How do you determine the significance for your customers/clients of Sharia compliance?

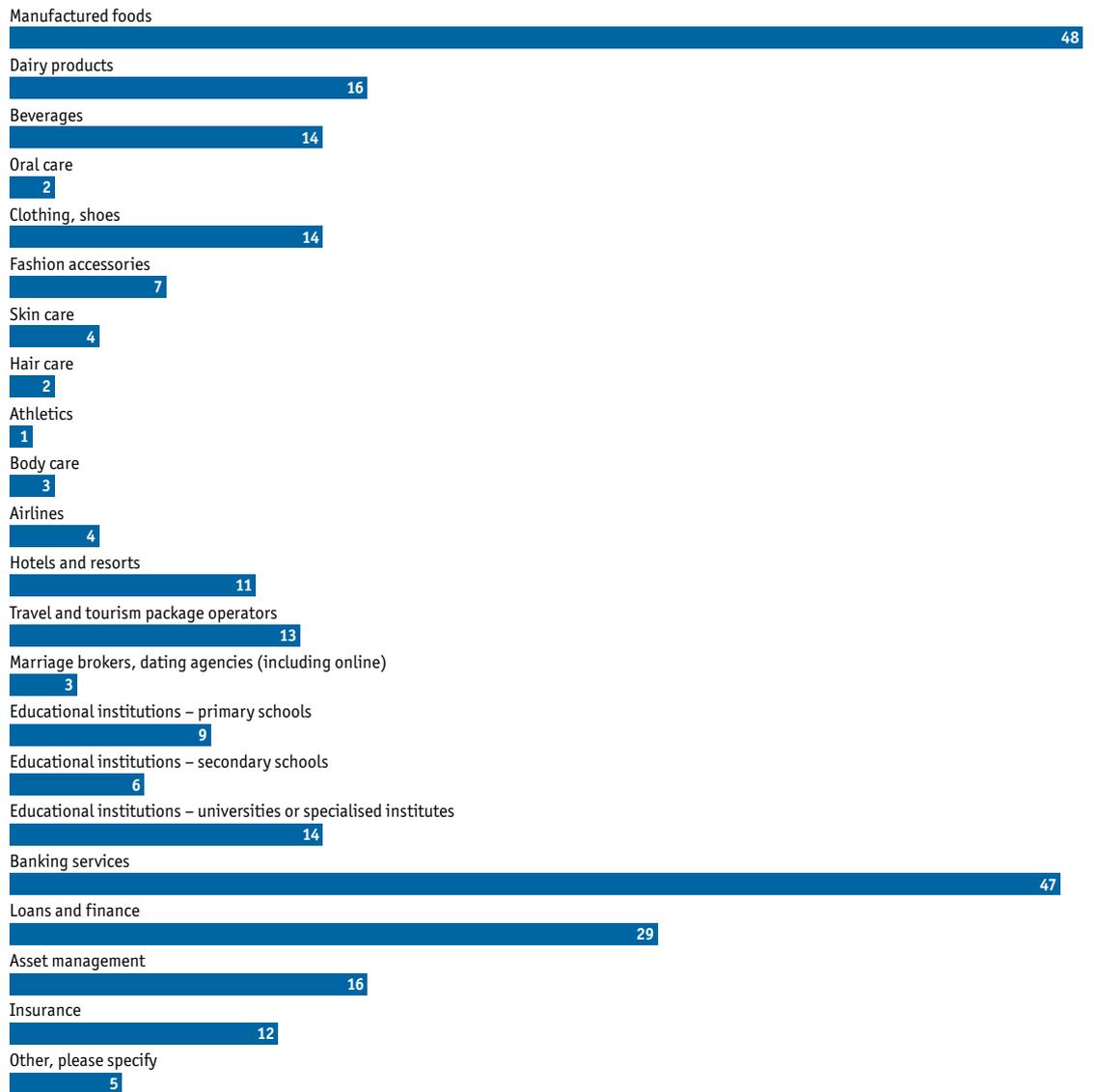
(% respondents)



Thinking about Sharia-oriented industries (whether or not your organisation is in these sectors), in which industries do you consider current growth to be strongest? Please select the top three.
(% respondents)

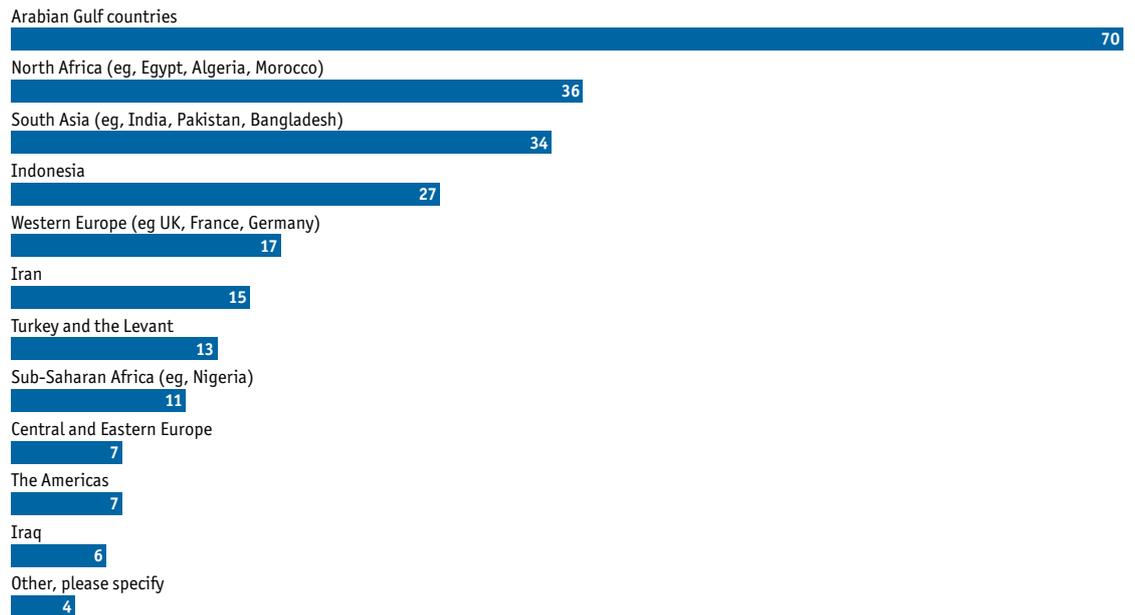


Thinking about Sharia-oriented industries (whether or not your organisation is in these sectors), in which sectors do you expect to see the strongest growth over the next three years? Please select the top three.
(% respondents)



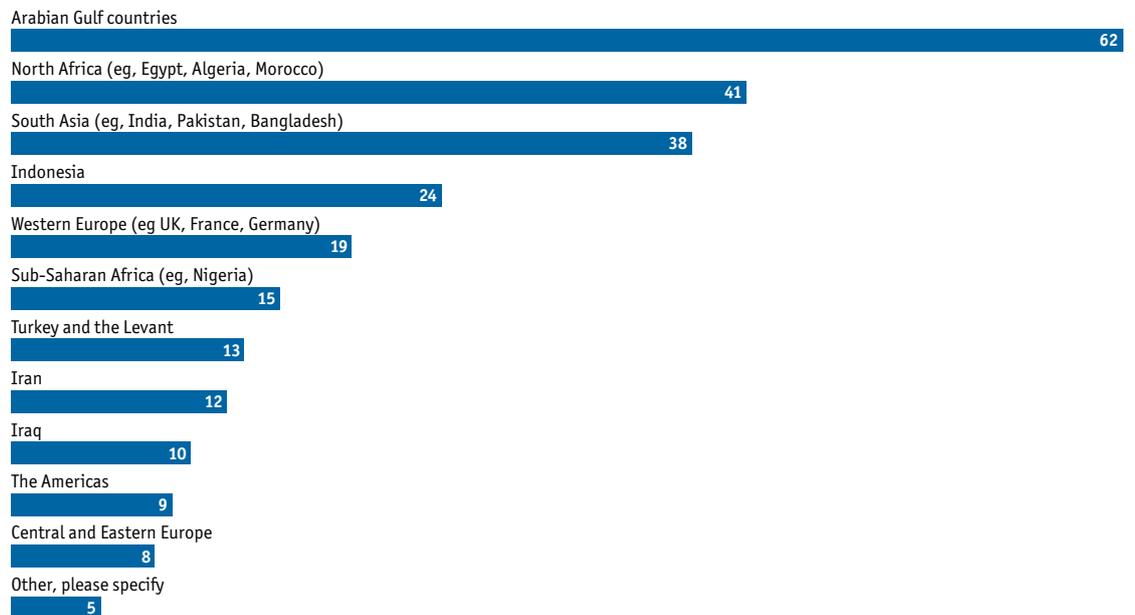
Thinking about regions where Sharia-oriented demand is a factor (whether or not your organisation is active in these regions), in which region do you believe growth is currently strongest for Sharia-compliant products and services?
Please select the top three.

(% respondents)

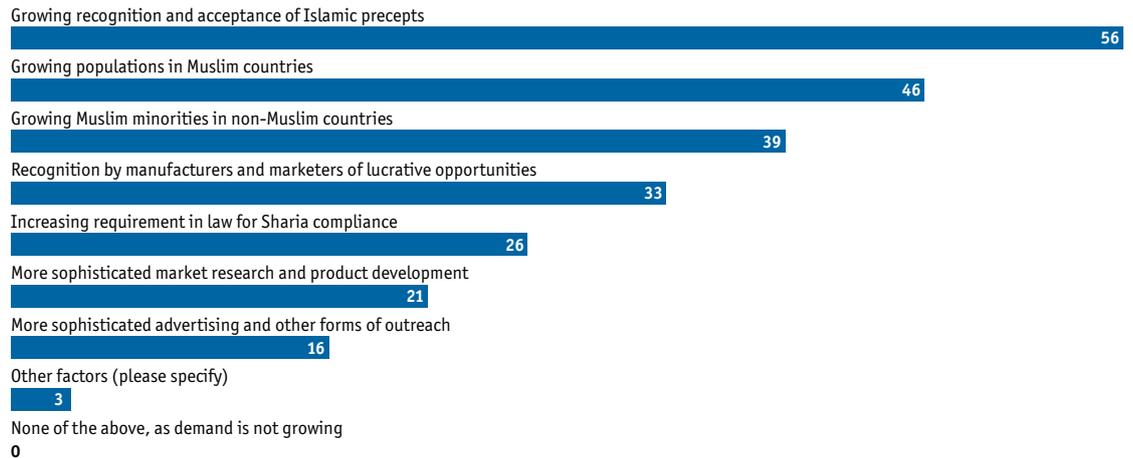


Thinking about regions where Sharia-oriented demand is a factor (whether or not your organisation is active in these regions), in which region do you believe growth in demand for Sharia-compliant products and services is likely to be strongest in three years' time? Please select the top three.

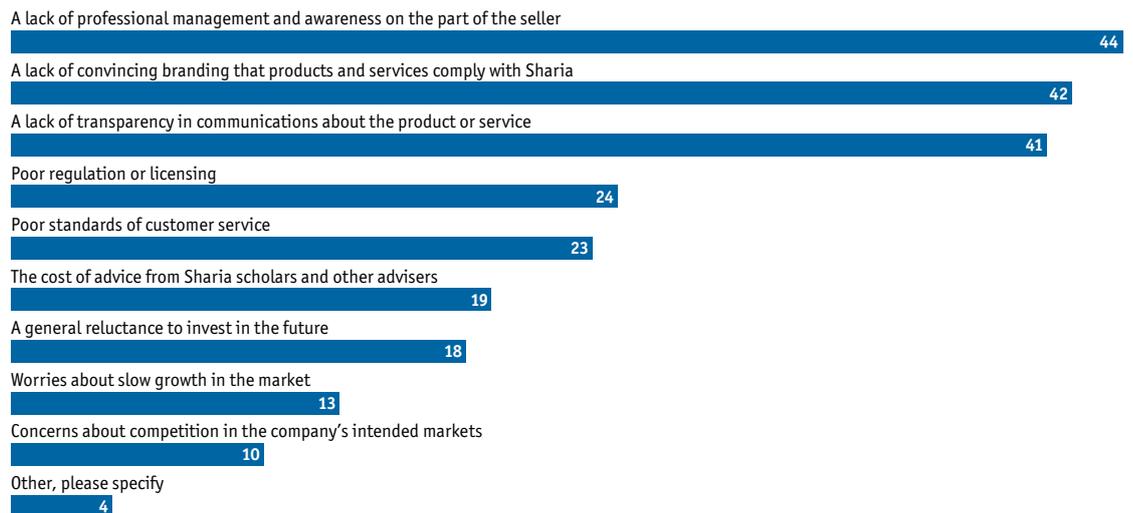
(% respondents)



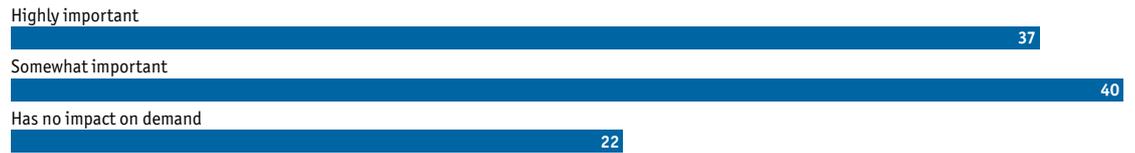
In your view, which are the most important growth-promoting factors behind Sharia-compliant demand? Select up to three.
(% respondents)



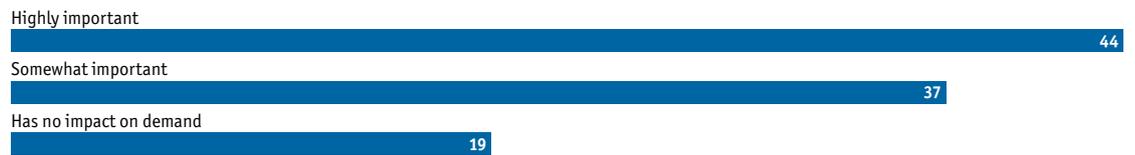
Which do you consider to be the most important barriers to growth in markets for Sharia-compliant products and services? Select up to three.
(% respondents)



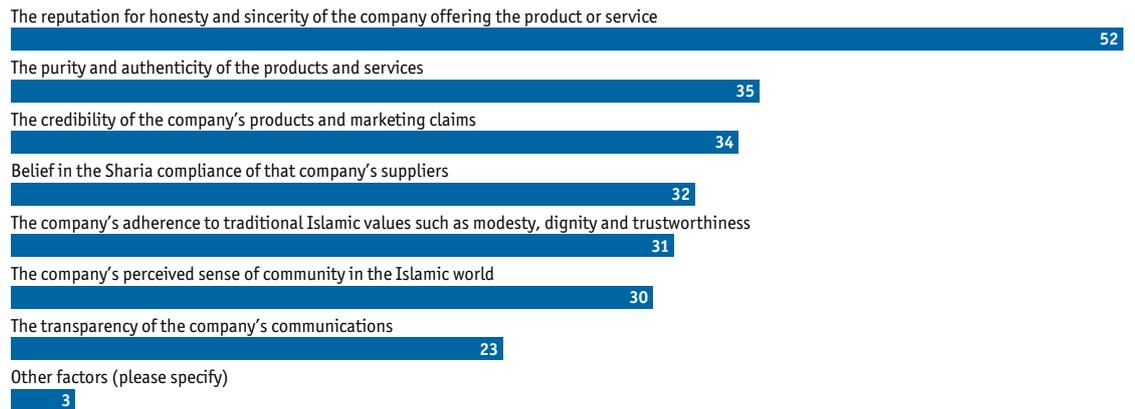
In your view, how important to your customers/clients is corporate branding of Sharia-compliant products and services?
(% respondents)



How important to your customers/clients is the labelling of Sharia-compliant products and services, including explaining the ways in which they comply?
(% respondents)

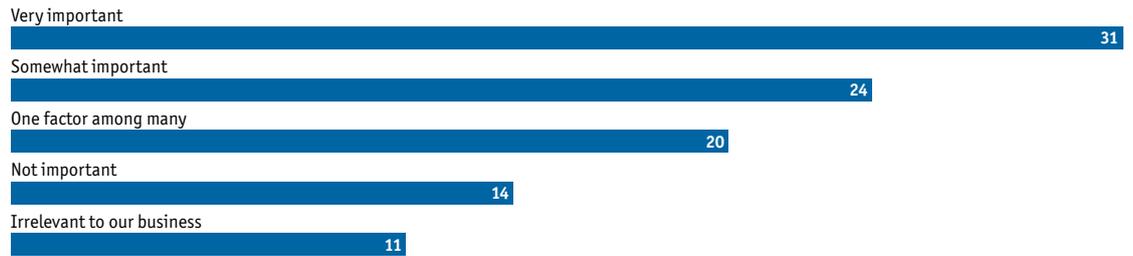


Considering what best promotes demand for Sharia-compliant products and services, which of the following do you consider most important to consumers and clients? Please select the top three.
(% respondents)



How important is easy access to Sharia-compliant finance for your business?

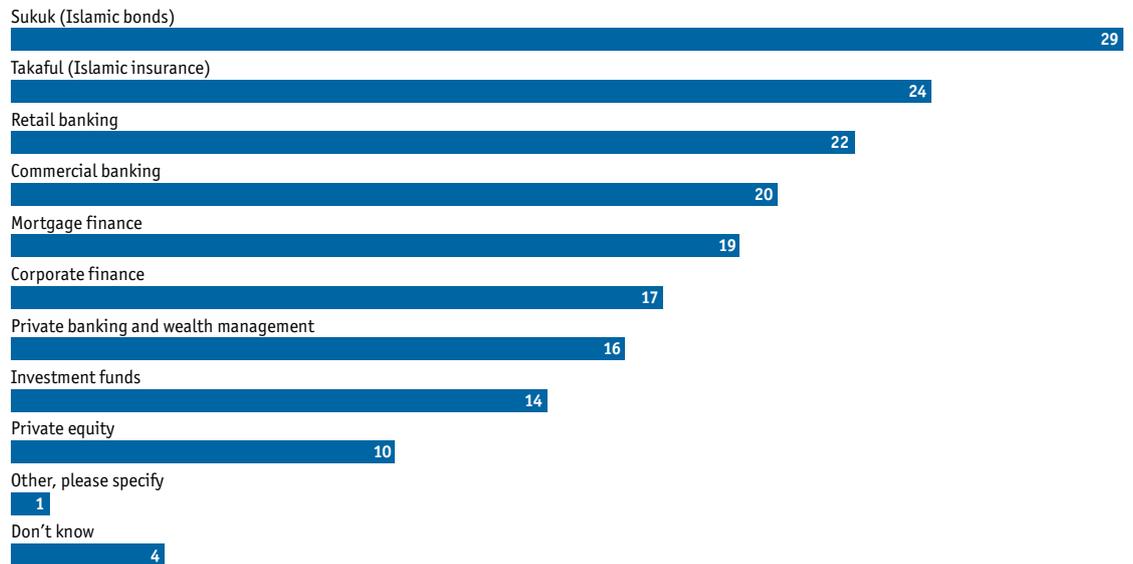
(% respondents)

**How important for your business is easy access to Sharia-compliant finance for your customers?**

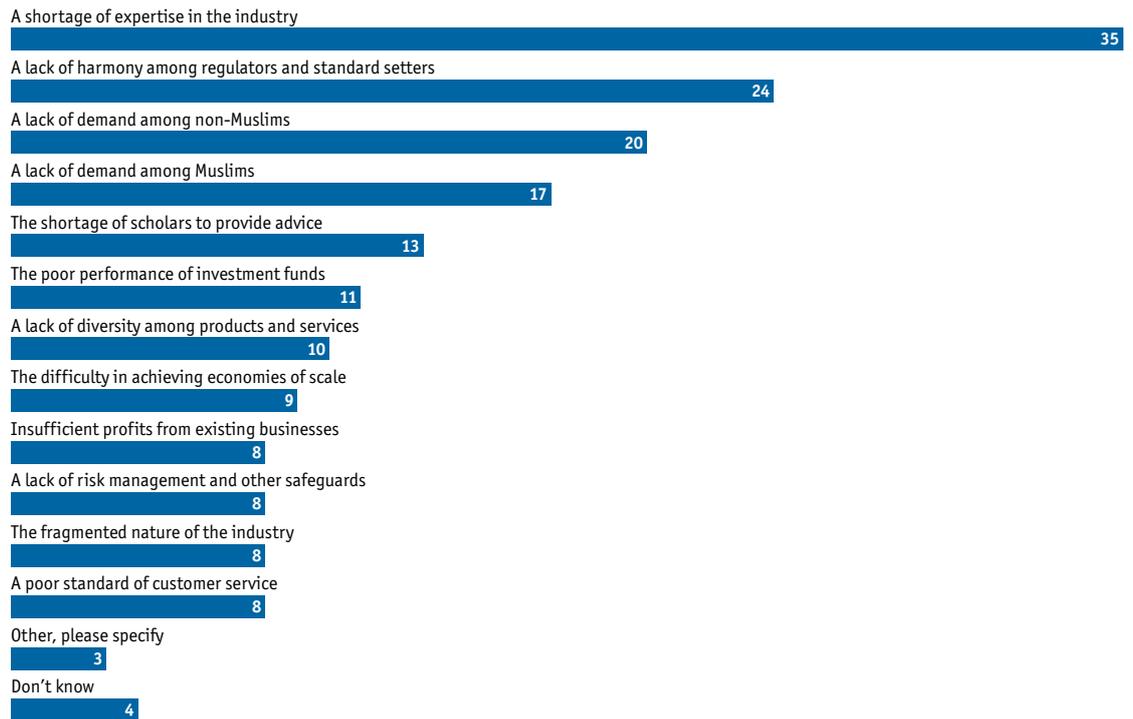
(% respondents)

**In which of the following financial sectors do you expect growth in demand to be strongest?** Please select up to two.

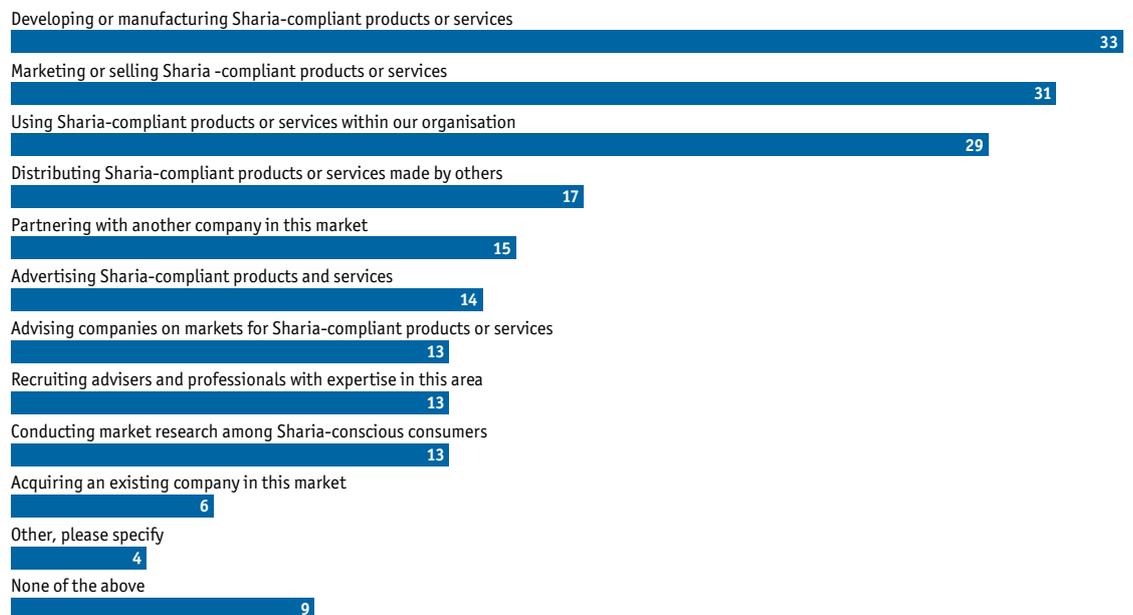
(% respondents)



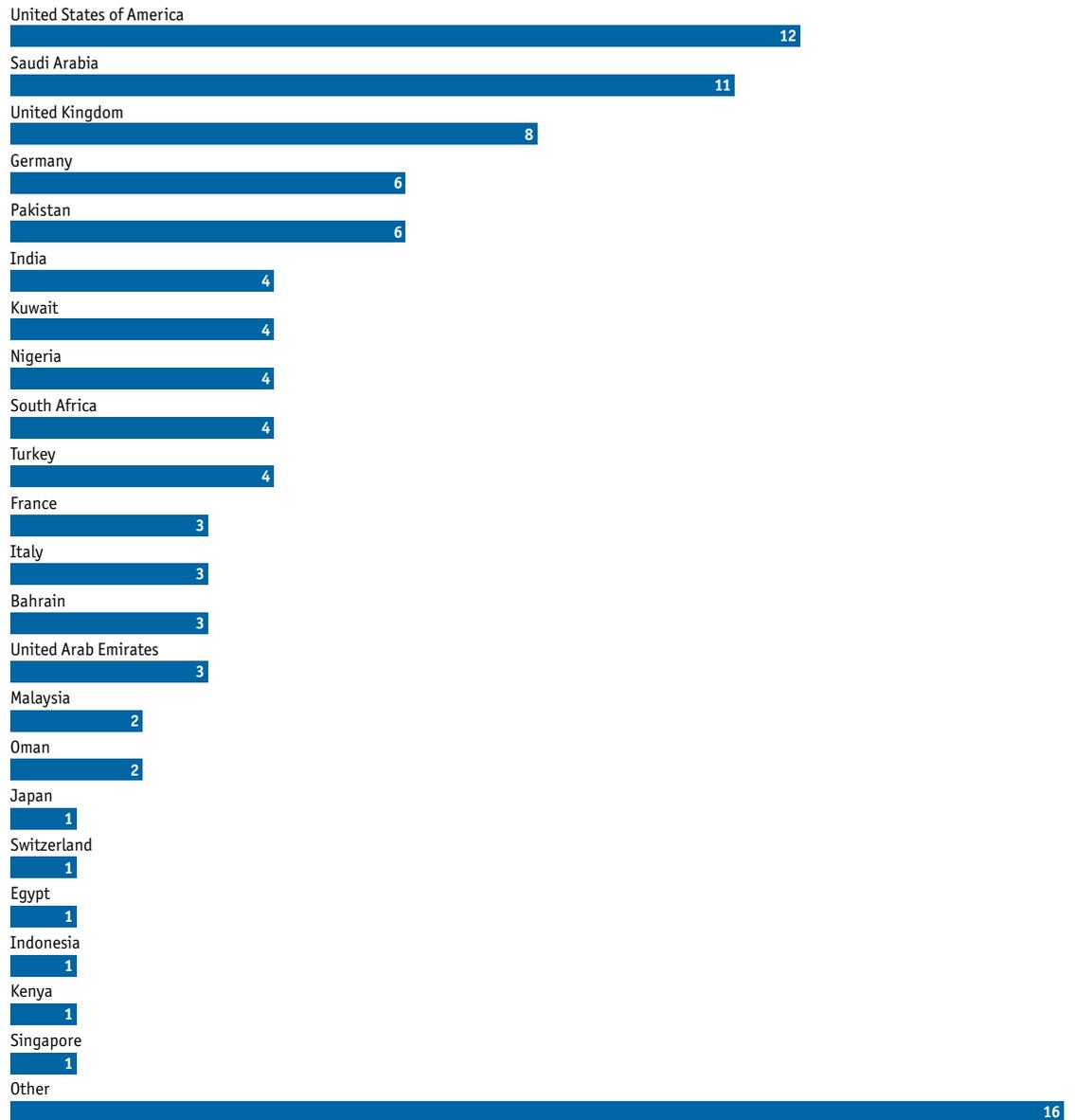
Which of the following factors are most responsible for holding back growth among banks and financial institutions which comply with Sharia? Please select up to two.
(% respondents)



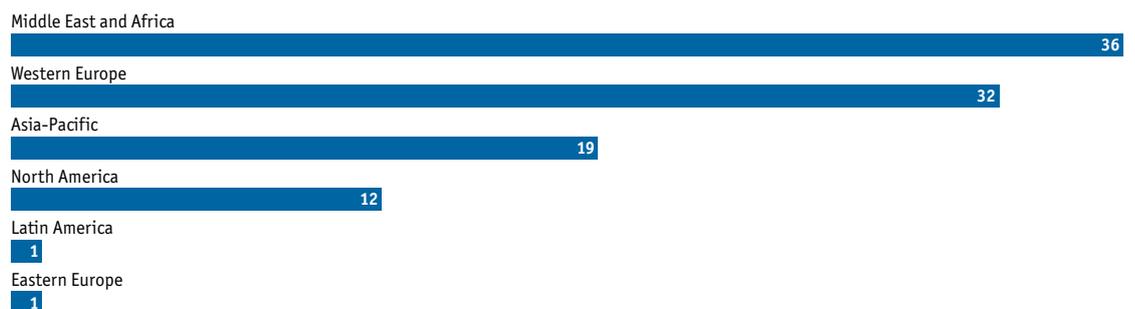
In which of the following ways is your company active in the market(s) for Sharia-compliant products and services? Please select the top three.
(% respondents)



In which country are your company's global headquarters based?
(% respondents)

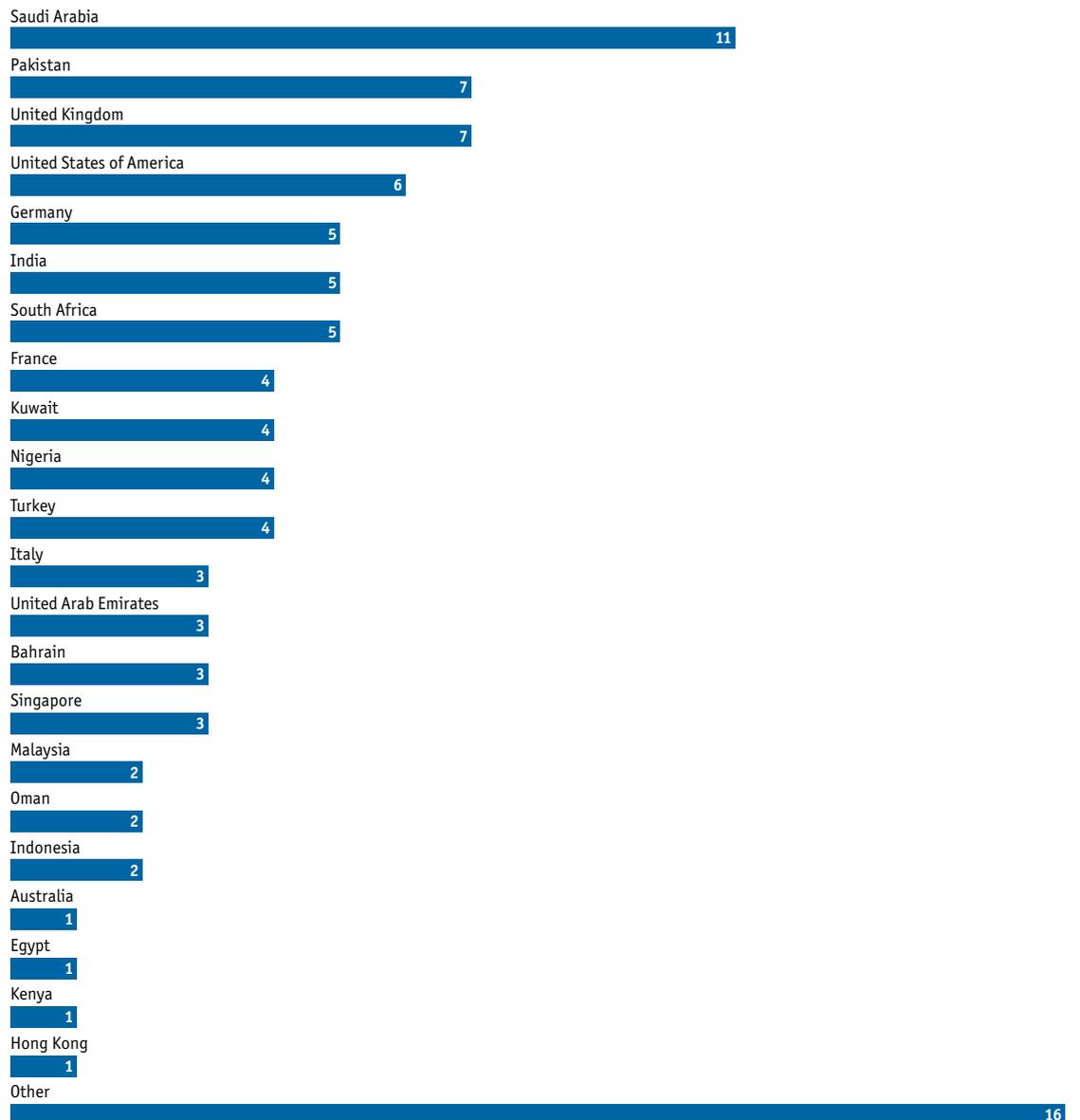


In which region are your company's global headquarters based?
(% respondents)



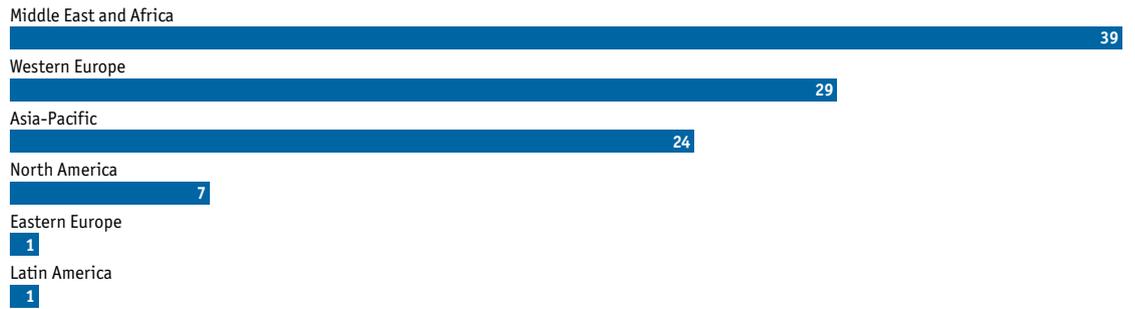
In which country are you personally located?

(% respondents)



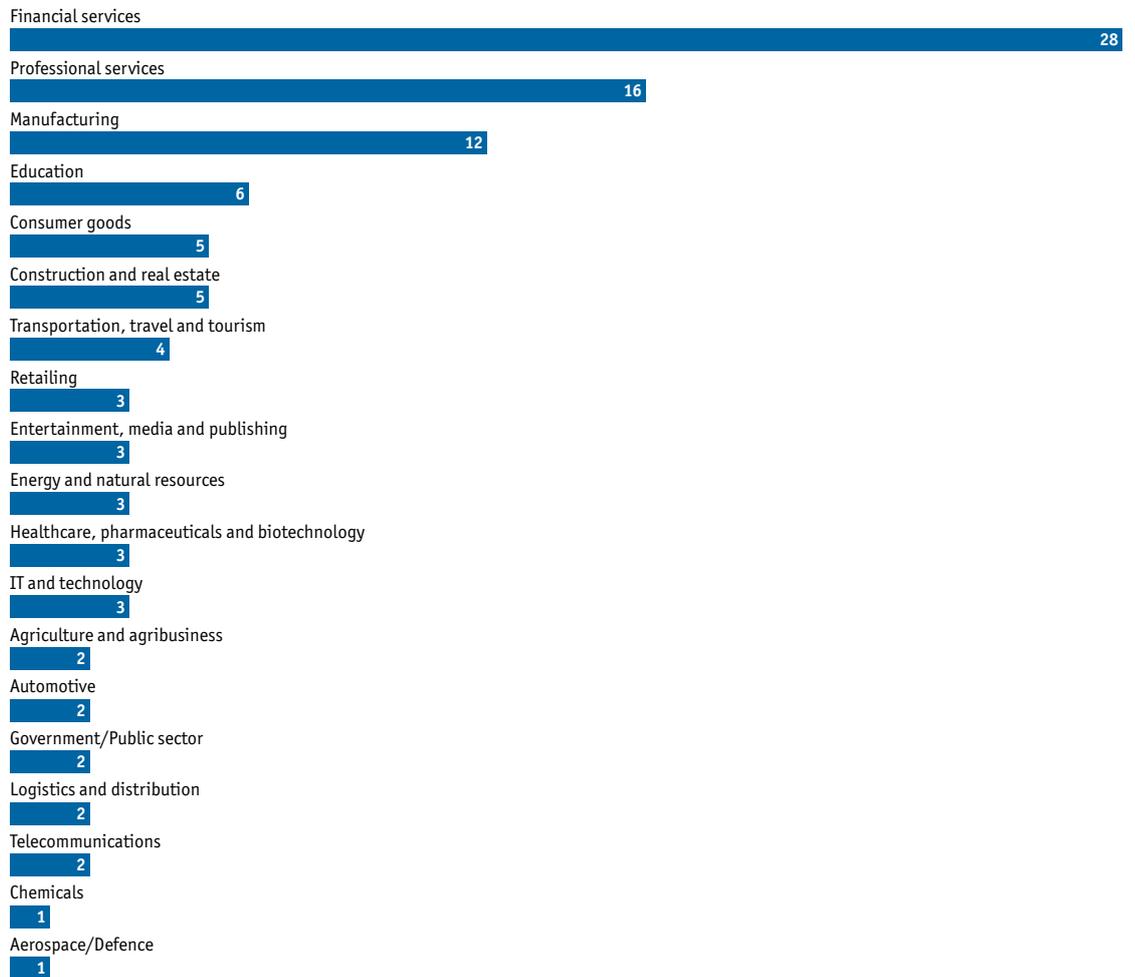
In which region are you personally located?

(% respondents)



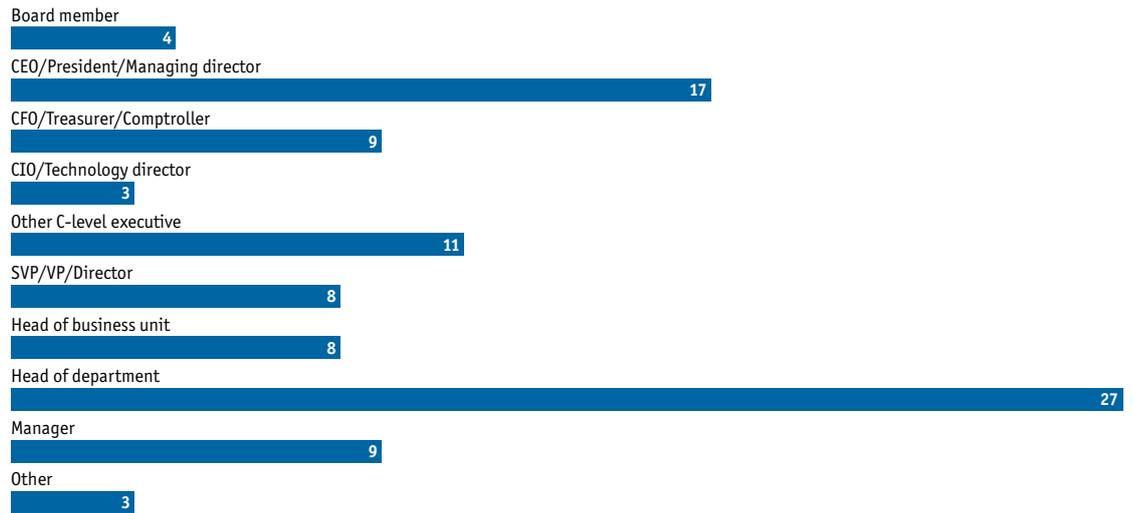
What is your primary industry?

(% respondents)

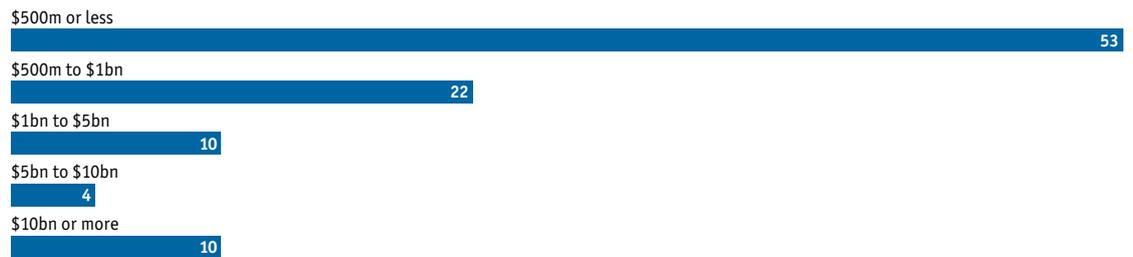


Which of the following best describes your title?

(% respondents)

**What are your company's annual global revenues in US dollars?**

(% respondents)



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