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Yaseen Anwar prods Islamic banks to diversify products, capitalize on inherent strengths

Mr. Yaseen Anwar, Acting Governor State Bank of Pakistan said today the Islamic Financial System has the potential to provide better banking and financial services than the conventional system provided it capitalizes on its own inherent strengths and avoids following the conventional system.

Addressing the inaugural session of Islamic Financial News Roadshow on Islamic Banking held at the State Bank of Pakistan, Karachi, Mr. Anwar said the current Islamic banking paradigm, both in Pakistan and elsewhere, is based on replication of conventional banking products. "While the replication of conventional products to make them Shariah compliant does pass the Shariah permissibility test, it is insufficient to achieve the larger objectives of Islamic financial system, particularly the broad-based and equitable distribution of economic gains," he added.

SBP Acting Governor asserted that total reliance of Islamic banks on debt-based fixed income products and minimizing the risks to almost close to those of the conventional system is not only blurring the distinction between Islamic and conventional finance but also making Islamic banks relatively less efficient than their conventional counterparts. "Thus to sustain the growth momentum, the industry will have to diversify its products mix by focusing on areas where it has comparative advantage rather than blindly following the conventional system," he observed.

While giving an example of Pakistan, Mr. Anwar said that 67% of Islamic banks' financing in the country is concentrated in the corporate sector through Murabaha, Ijarah, and Diminishing Musharaka. With most of the corporates having banking relationships with conventional banks, the Islamic banks have to offer significant price discounts to attract the corporate clients, he said and added that while this improves the quality of their financing portfolio, it reduces their profit margins and inhibits their ability to offer better returns to the depositors, he emphasized. It also restricts the access to finance to the well established businesses and corporates and leaves the SMEs and startup businesses financially excluded. "This is contrary to the natural business model of Islamic finance, which promotes risk and reward sharing and encourages financing to promising startups that is critically important for promoting entrepreneurial culture," he added.

SBP Acting Governor also pointed out that the present scope of Islamic banks' business model is confined to that of conventional banks which generally caters to the short term financing needs of the real economy through interest bearing instruments/facilities. While this scope is in line with the business model and deposit streams of conventional banks, it is not sufficient for Islamic banks which were originally conceived for catering to the genuine financing needs of the real economy through risk and reward sharing instruments, he added.

"As I said earlier, the Islamic banks with this narrow scope will find it difficult to compete with the conventional banks, which are giants when compared with Islamic banks and are highly efficient

and flexible in catering to such financing needs of the real economy,” he said and reiterated that the Islamic banks will have to expand their scope to offer both commercial and investment banking services to be financed by different streams of deposits.

Mr. Anwar said that there are numerous areas/sectors which could be explored to sustain and even accelerate the growth momentum of the Islamic banking industry. He said that Pakistan being an agrarian economy, agriculture is strategically an important sector for its economy having 20% share of GDP and a major source of livelihood for 65% of the country’s population living in rural areas. The sector is also largely un-served/under-served by banks; less than 20% of about 7 million farm households in the country have access to bank credit.

He stressed that the Islamic banks can capture a sizeable proportion of this market by reaching out to the growers either directly or through NGOs/MFIs. The IBIs are likely to have better acceptance in rural areas as the rural population is believed to be relatively more faith sensitive. Presently IBIs are largely concentrated in large urban centers and they will need to expand their outreach to smaller towns and rural/semi rural areas and optimally leverage the technology to serve the rural markets. Similarly, he said there is also great potential in the SME sector while Islamic banks can also have partnership with Federal and Provincial governments in developing/building the low cost housing projects, which are on the active agenda of federal and provincial governments.

Mr. Anwar said that SBP fully recognizes and appreciates the potential of Islamic banking in increasing the depth and breadth of the banking system and making it more diverse and stable. He said that it is an important component of SBP’s strategic goals and we are actively engaged with the industry as the regulator cum partner to catalyze and facilitate development of the industry on sound footings.

“We have plans to further improve our legal and regulatory framework to provide the necessary support and flexibility to this budding industry and enhance its commercial viability. There are additional plans to strengthen the Shariah compliance framework to improve the Shariah compliance levels in the industry and give comfort to the masses about the Shariah permissibility of Islamic banks’ operations,” he added.

The one-day seminar was attended, among others, by participants from financial institutions, Islamic scholars, academia, etc. besides senior officials of the State Bank.
