

Islamic Banking, Accounting And Finance International Conference– The 9thiBAF 2020

How Far the Islamic Banking Sector Contribute to Halal Industry? The Comparison with
Conventional Banks on Trade Finance Products

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Abstract

Malaysia is well known with Halal industry due to government's efforts to facilitate the development of Halal industry. Halal industry in Malaysia is acknowledged due to its efficiency in the regulatory framework as well as its diversity of the sectors, ranging from products (food and beverages, consumer products, pharmaceuticals, cosmetics and others), and services (such as logistics, tourism and banking sectors). The Halal industry contributes 7.5 percent to Malaysia GDP in 2017. As the Halal practice should be applied in the whole chain of Halal production and distribution, the Islamic banking sector is proposed to support the whole halal industry through their funding. This support plays some roles towards the integration, and accelerating the growth of the Halal industry. While it is expected that conventional trade finance products are diverse and contribute more to Malaysia businesses, not much is known on the evolvement of the Islamic trade financing compared to conventional banks. This study explores the trends of growth in the usage of Islamic and conventional trade finance products.

Keywords: Islamic finance, Islamic banking, Halal industry

1. Introduction

The global Halal industry market value is increasing yearly. The worldwide market value of Halal products worth USD45.3 billion in 2016 (Statista 2019). Large numbers of Muslims populations and an increase of Muslim awareness on Shariah compliance contributes to an increasing in the current growth of Halal industry. In Malaysia, the industry started in 1970s for Halal sectors and in 1980s for Islamic banking and takaful sectors. Extensive experience led industry to set up the comprehensive regulatory framework, governance and Halal certification process. Malaysian Halal certification and logo is recognized and accepted by the global Halal market.

In addition, the Islamic banking sector in Malaysia is well known for its diversity in terms of products and services. Islamic finance (which covers Islamic banking, takaful, money and capital market) in Malaysia is ruled systematic regulatory as well as governance framework. As banking institutions gain deposits and channel them for financing and investment purposes, the Islamic banking sector was urged to contribute to Halal industry through their funding.

From the academic discussion, the basis for Halal integration, Halal ecosystem and Halal economy agenda in the context of synergizing Halal sector and Islamic finance emerged since 2005 (Evans 2005, Ahmad 2008). Sultan Nazrin Shah in World Halal Conference in 2018 also stressed on the need for 'true Halal economy, that integrated all Halal aspects in Halal business model. The stress was to integrate Islamic funding in Halal value chain.

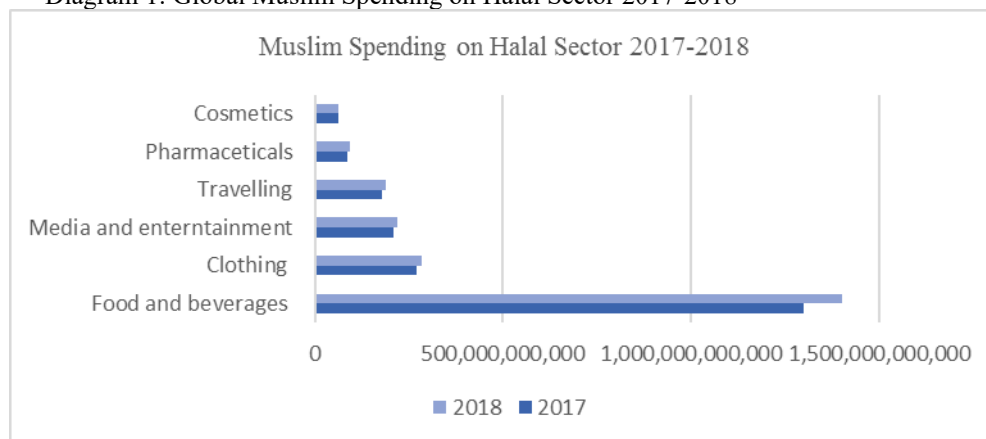
One of the contributions of the Islamic banks in Halal sectors can be made through their product and services offering such as trade finance products to support trade activities. While there are limited studies on Islamic banking contributions on Halal industry, this paper attempts to (i) examine on the trend of Islamic trade finance products and services and (ii) compare it with conventional trade finance trend in terms of trend of funding. As conventional banking sector was operated much longer compared to Islamic banking sector, there is no argument that conventional trade finance products contribute more to the whole industry in Malaysia. However, comparing the trend of the trade financing products on both sectors will provides indicators on whether there are increasing trends in offering. This paper is

structured as followings. This paper starts with introduction, literature review and research methodology, followed by current trends and ended with the conclusion.

2. Literature review

Halal refers to an action or object that are allowable in Islamic Law. As Muslims need to fulfil their religious obligations, they should apply all Islamic teachings in their daily life including the way of their spending and consumptions. The data in Diagram 1 shows that Muslims spend their money most in food and beverages, followed by clothing, media and entertainment, travelling, pharmaceuticals and cosmetics. The amount of their spending is increasing every year. The supply of Halal products and services come from many countries including from non-Muslim countries such as Brazil, Australia, New Zealand, India and others. New comers such as Korea and Japan also put their interests on the industry.

Diagram 1: Global Muslim Spending on Halal Sector 2017-2018



Source: Adapted from Thomson Reuters (2018/2019)

Looking at this background, countries such as Indonesia also realize on the potential of the Halal industry for their economy. Indonesia through its Indonesian Sharia Economic Masterplan 2019-2024 attempts to integrate Halal sector with Islamic banking and finance. Nisha and Iqbal (2017) among others highlighted some potential for Halal ecosystem including Islamic economic growth, Muslim life trends, intra-OIC economic growth and participation of the global players in Halal market.

In Malaysia, the Halal industry as the whole are regulated by the different regulatory bodies. Halal sector is monitored by Department of Islamic Development Malaysia (JAKIM) with supports come from other agency bodies at the federal and states level. The main act that guide this sector is Trade Description Act (2011). Islamic banking and takaful industry is guided by the Central Bank, Malaysia. The Islamic and conventional banking system work in parallel, but with different acts. The Islamic banking industry is guided by the Islamic Financial Services Act 2013 (IFSA 2013), while the conventional banking sector is guided by Financial Services Act 2013 (FSA 2013).

3. Research methodology

This paper used the secondary data as the main sources. It reviews publicized policy documents and gathered the Islamic banking data by the Central Bank of Malaysia, Islamic banking institutions' websites, academic journal papers, and online articles.

4. Current trends in trade finance

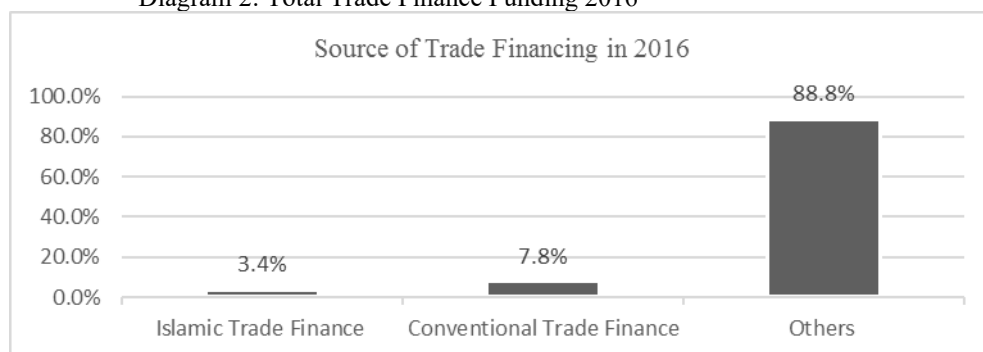
Trade finance is important for business entities to perform their export and import activities. Trade finance products and services can be in the form of funding and related supported activities including providing the guarantee to facilitate the trade activities. Islamic trade finance products can use several types of contracts including sales (murabahah), commodity murabahah (tawarruq), agency (wakalah) and guarantee (kafalah) contracts. Products can be varies, including Bills, Letter of Credit, Bank Guarantee, Shipping Guarantee, Trust Receipt, Invoice Financing, Banker Acceptance (Sale), Banker

Acceptance (Purchase), Inward Letter of Credit, Export Credit Refinancing, Foreign/Domestic Bills of Exchange Purchased, Onshore Foreign Currency Financing, Foreign Currency, Trade Financing, and Advance Against Trade (MIFC 2013). As there are 16 Islamic banking institutions in Malaysia, the majority of Islamic banking institutions offer the trade finance products.

As the data shows that there is an increasing trade activity, the data on funding from the source of trade finance provided by the Islamic banking sector was only at a small contribution. At the global perspective, Islamic trade finance has only funded 1.14 percent of the inter-OIC trade activities.

The similar trend is also shown in Malaysia. It is reported that Malaysia international trade was at RM1.835 trillion in 2019 (Matrade 2019), with the Halal industry export activities was estimated at RM40.2 billion and import value at RM40 billion (Halal Development Corporation Berhad 2020). Given with this total numbers, Syed Alwi (2019), highlighted that Islamic trade finance only attract 3.4 percent of funding, compared to conventional trade finance (7.8 %) and others (88.8%) (see Diagram 2). This summary of data shows that Islamic banking institutions yet unable to involve and contribute more to trade activities, in comparison with conventional trade finance or other types of funding.

Diagram 2: Total Trade Finance Funding 2016



Source: Adapted from Malaysian Reserve (2017)

5. Conclusions

Trade activities is the backbone of the Halal industry, as it covers the purchase activities of the material and the distribution of the selling goods. Funding to facilitate trade activities is important to support the global Halal trade activities. The preliminary study shows that there is a large gap of trade finance and services offering by Islamic and conventional banking institutions as well as other types of funding. As this study shows on this funding gap, future studies to explore the reasons leading to this situation should be done to help the policy makers and market participants to find the best solutions in reduce the gap in Islamic banking offering.

Acknowledgements

This study is funded by the Bank Pembangunan Malaysia. Research Code: USIM/BPMB/FEM/052002/41019

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