

Growing Interest in Islamic Funds

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Islam is a religion of complete code of life, be it social, cultural and behavioral. Thus the Shariah, the Islamic Law, is an integral part of our daily life including the mode of business. Earlier, Muslims were able to establish riba free financial system to finance consumer needs which worked effectively for decades. However, as the financing needs got more complex, the Islamic System was overshadowed by the conventional interest based financing system. But as said 'People want what they cannot have' – this led to the desire of Muslims to bring their financial activity in accordance with religious values and beliefs, which subsequently resulted in re establishing Shariah compliant approved investment vehicles. Besides, the stability and resilience exhibited in the wake of financial crisis by Shariah compliant financial industry has led to its wider recognition as a viable and competitive component of the financial system. The innate strengths of the Shariah compliant financial system of being based on productive economic activity and devoid of excessive leverage and imprudent risk taking have been key drivers of its significantly improved acceptability and increasing share in the global financial system. Among the Shariah compliant investments vehicles, Shariah compliant mutual funds are one of the fastest growing segments in the world yet these are still in their infancy stage.

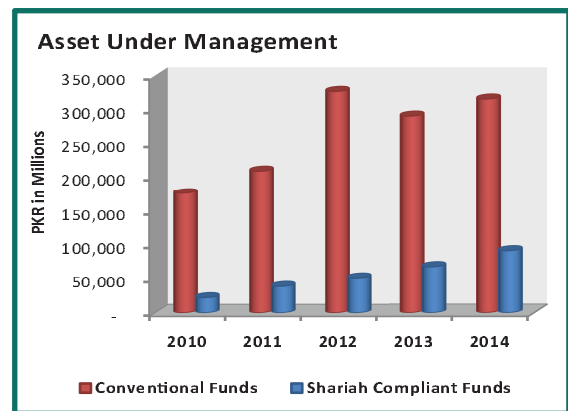
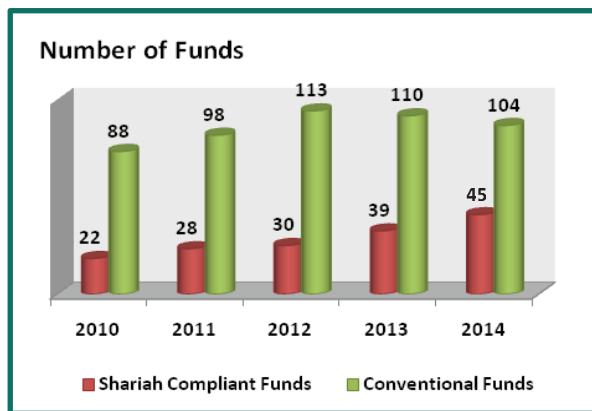
Shariah Compliant Funds - Worldwide

According to the Thomson Reuters Research 2013, the Assets under Management (AUMs) have significantly increased over the last five years but remain a fraction of total Shariah compliant finance assets. Countries like Malaysia, Saudi Arabia and Luxembourg are considered as leading hubs for Shariah compliant funds and constitute almost 70% of the Islamic funds globally. The largest market share of the Shariah compliant mutual fund industry is held by Malaysia with more than 263 funds managing AUM of US\$ 10,164 million, followed by Saudi Arabia and Luxembourg having 163 funds with US\$ AUM 6,056 million and 111 funds managing AUM US \$ 3,401 respectively. Pakistan till 2013 had 28 funds and assets worth US \$ 664 under management.

Shariah Compliant Funds - Pakistan

The launch of first Shariah compliant Fund in 1995 paved the way for Shariah compliant mutual fund industry in Pakistan. Since inception, the industry is steadily picking its momentum. From 2003, the AUMs from PKR 921 million grew to PKR 92,268 million as of June 30, 2014. The average growth rate for five years for Shariah compliant funds is around 39% in terms of AUM as compared to 16% for conventional funds. The remarkable growth is due to recent fund category of Shariah compliant fund of funds which increased by 17 times from last year. The market share which was merely 11% in 2010 has now grown to 23% as of FY 2014. In terms of number of funds under management, currently 45 Shariah Compliant funds are there as compared to 104 under conventional category. However the average growth rate for Shariah compliant funds is 3 times higher than conventional funds.

Domestically, much like internationally, Shariah compliant funds industry is growing at a pretty fast pace and has acquired about 24% market share of the asset management industry as of June 30, 2014.



Considering all the facts, it is clearly evident that Shariah compliant funds are growing; however, to sustain and further boost the growth momentum, significant changes in the architecture of the industry are still needed.

Shariah Compliant Funds – Challenges

Though Shariah compliant funds continue to perform steadily, a number of challenges mar their way. Amongst many, the most important are:

1. **Product Development:** Since the Shariah compliant financial products do not allow engaging in excessive leveraging or risk taking activities, the product portfolio somewhat gets limited.
2. **Perception:** The industry perception is still not very positive largely due to limited awareness and similarities between conventional and Shariah compliant products.
3. **Capacity Building:** Need for specialized trainings, practitioners, the development of Industry best practices and standards
4. **Lack of Investment Opportunities:** Limited investment instruments / avenues particularly in debt (SUKUKS) side.

Shariah Compliant Funds – Rethinking 4Ps, solution to the challenge

The challenges above can be overcome if the efforts are focused on rethinking 4Ps (Product, Place, Price and Promotion) as it is said by the traditional marketing wisdom that any effort to connect with audience must address the 4Ps.

1. Product:

- a. **Product Diversification** is the key for a sustainable growth. To date, Shariah Compliant equity, income, money market, asset allocation, balanced, index tracker, fund of funds and capital protected funds have been introduced. Going forward, Ijarah funds, Commodity funds, REIT, Murabaha Funds are present in the International Islamic Funds Market.

(Sources: IFSI Stability Report 2013 published by Islamic Financial Service Board)

- b. **Product Standardization:** As mentioned earlier, the perception of Products being Shariah compliant is still vague in the investors' minds; efforts are needed to establish a centralized Shariah Advisory Board for endorsement of the products and establishing best practices. This has been achieved with the establishment of Shariah Advisory Board (SAB) recently in 2013 for promoting Islamic Financial Products by SECP.

2. Place:

Unlike banks, there aren't any Islamic Banking Branches specifically established for the customers needs. Considering the investors base, development of retail outlets specifically for the Islamic products is not feasible. However, the Islamic banking branches and the Wealth Management Departments of Banks can help a maximum outreach.

3. Price:

To foster the growth of this market, measures like no-load or fixed load, tax incentivisation should be provided for a specific length of time. Not only price, the benchmarks like Shariah compliant Indices should also be established for all categories of funds which would help in assessing the performance of Shariah compliant funds.

4. Promotion:

The reservations about the Islamic products are actually halal can only be resolved if the facts are certified by the Centralized body like Shariah Advisory Board. Besides, needs for specialized training and educated sales staff having requisite technical knowledge cannot be ignored. Channels must be established in this regard. Recently, Islamic Financial Workshops have been conducted by the SECP that yielded positive results. More measures are required to be taken.

Conclusion

The statistics, from the inception of the Shariah Compliant mutual funds shows optimistic calculation, growth in these funds has outpaced that of the other conventional funds, however reforms are required in product development, structure and regulatory framework.