



# **World Islamic Banking Competitiveness Report 2013**

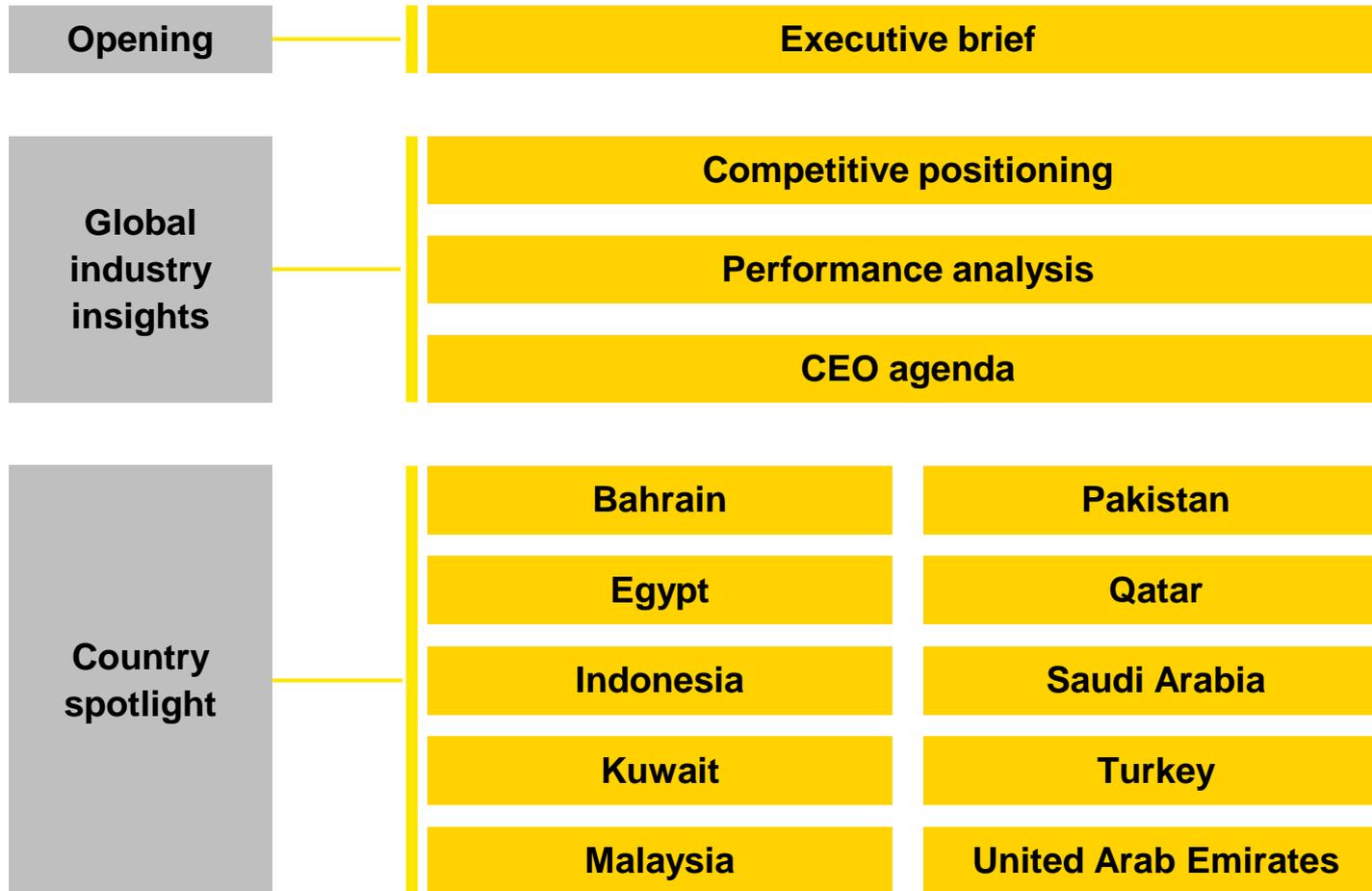
*Growing Beyond*  
**DNA of Successful Transformation**

December 2012

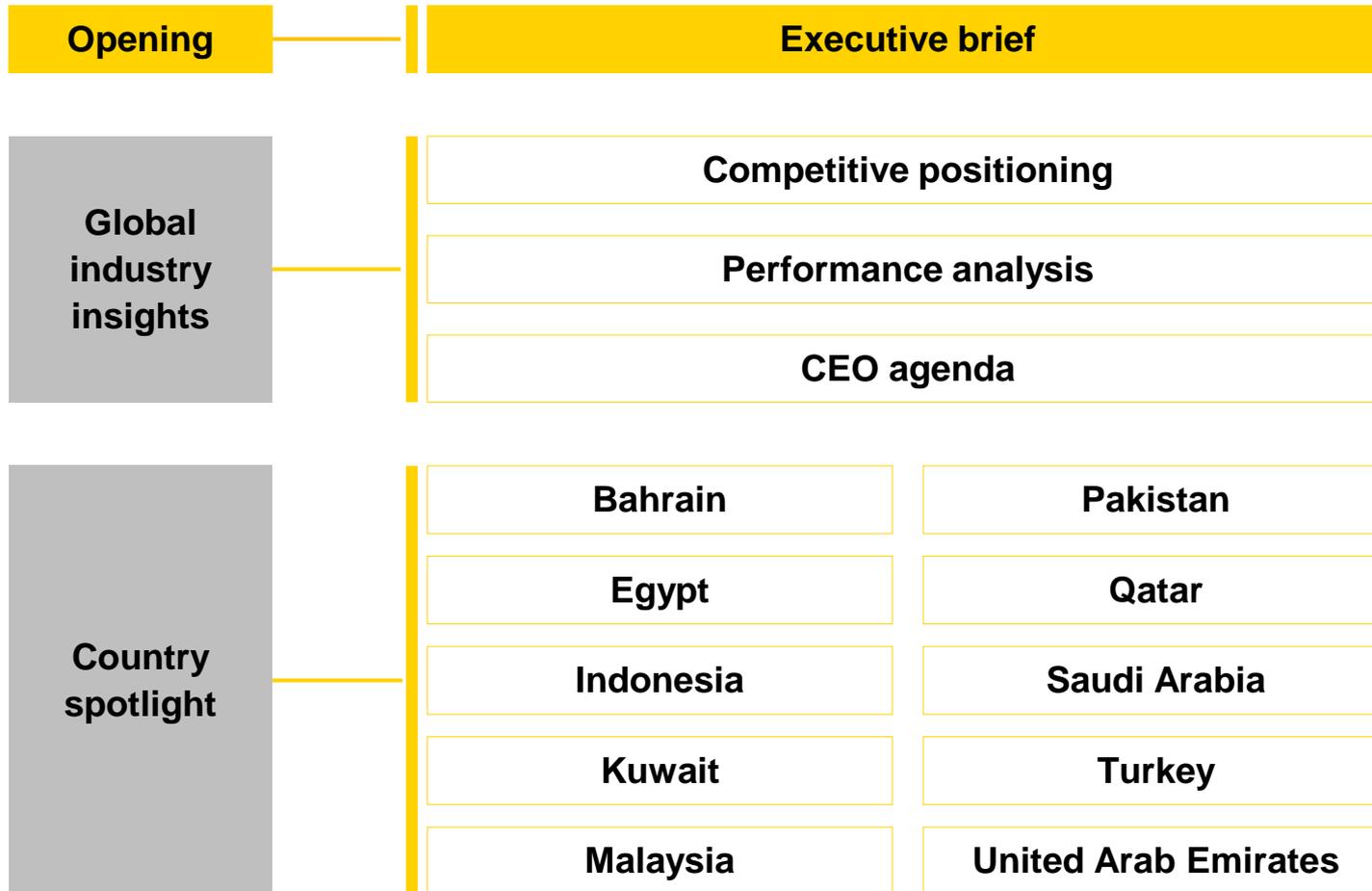
 **ERNST & YOUNG**  
*Quality In Everything We Do*

# Report structure

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# Report structure



# Executive brief

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Islamic banking assets with commercial banks globally grew to \$1.3 trillion in 2011, suggesting an average annual growth of 19% over past four years (2011: 24%). The top four markets account for 84% of industry assets. The Islamic banking growth story continues to be positive, growing 50% faster than the overall banking sector. High potential international markets – each in different stages of development and therefore requiring different penetration strategies - include Saudi Arabia, Malaysia, Qatar, Turkey and Indonesia.

This year, we launch the EY Islamic Banking Universe that tracks industry performance across core Islamic finance markets with a combined GDP of \$5 trillion in 2011. Islamic banking assets are forecast to grow beyond the milestone of \$2 trillion by 2014.

It is however a different story when it comes to profitability. The industry's average ROE was 12% compared to 15% for conventional in 2011. Islamic banks continue to grapple with multiple challenges relating to sub-scale operation, asset quality, negative operating income from core activities and a weak risk culture. The severity of performance challenge has prompted several institutions to initiate wide-ranging transformation programs. We call it the new 3 R's for the industry:

- ▶ Regulatory transformation – involving compliance risk, capital optimization, integrated balance sheet management and liquidity management
- ▶ Risk transformation – around Shari'a governance, single data management framework, segment specific risk models and fund transfer pricing capabilities
- ▶ Retail banking transformation – strengthening customer centric operating model, channel integration and technology enablement

The turnaround could take 2-3 years and shareholders and management need to be making commitments now to capitalize on the positive outlook. Successful transformation around 3 R's could potentially increase the profit pool of Islamic banks by 25% by 2015.

Beyond numbers, Shari'a governance and responsible innovation require urgent attention, and sukuk is developing to be an effective instrument for capital management and growth. The industry is still in transitory stage and a lot more needs to be done to demonstrate the *impact* of Shari'a compliant system on businesses and economies. The coming up of populous and diverse markets like Indonesia, Egypt and Pakistan would help and regulatory authorities and multilateral institutions will need to play a more central role to facilitate this transition.

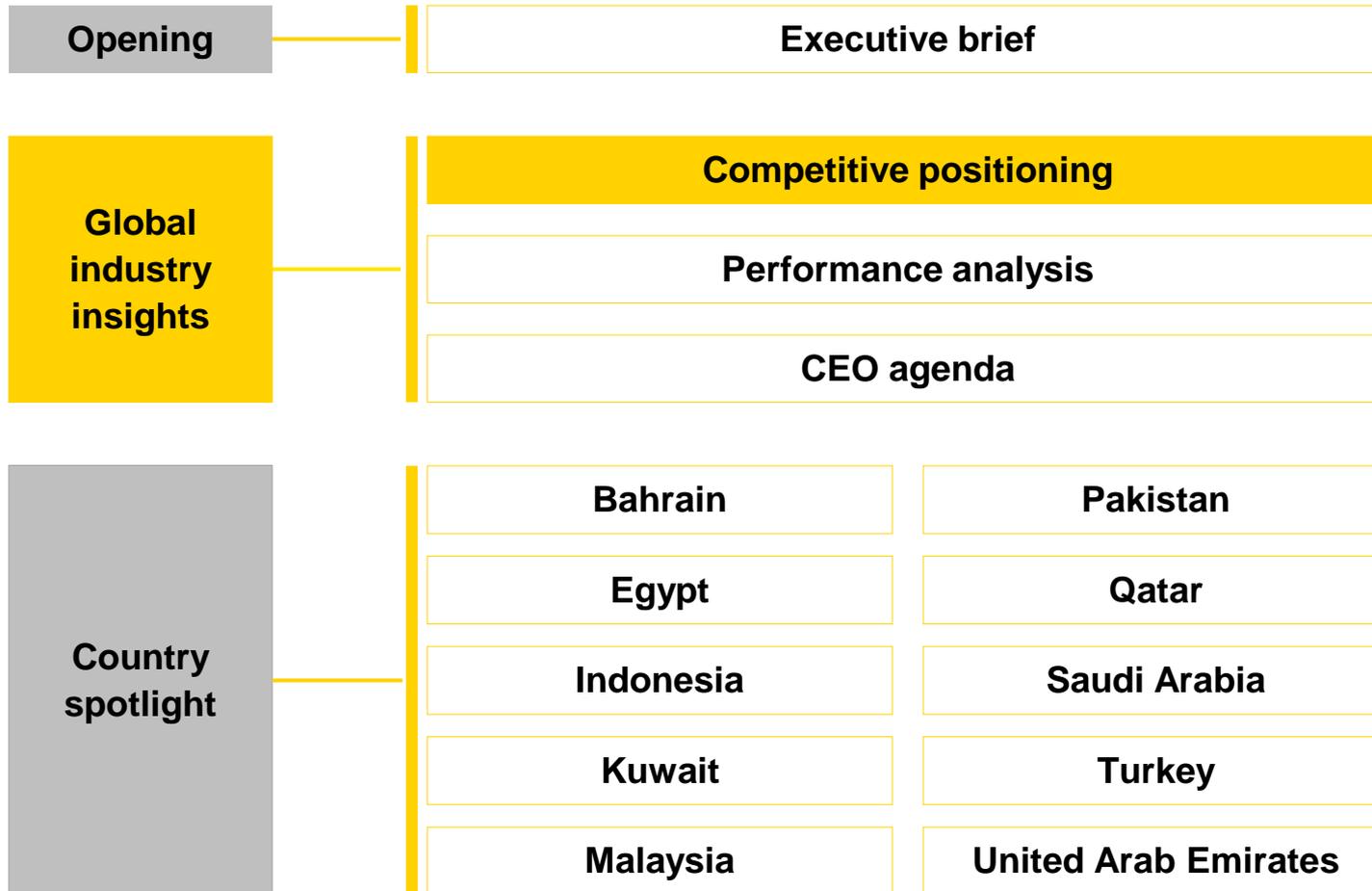


Ashar Nazim  
Partner, Islamic Banking Excellence Center  
Ernst & Young , MENA



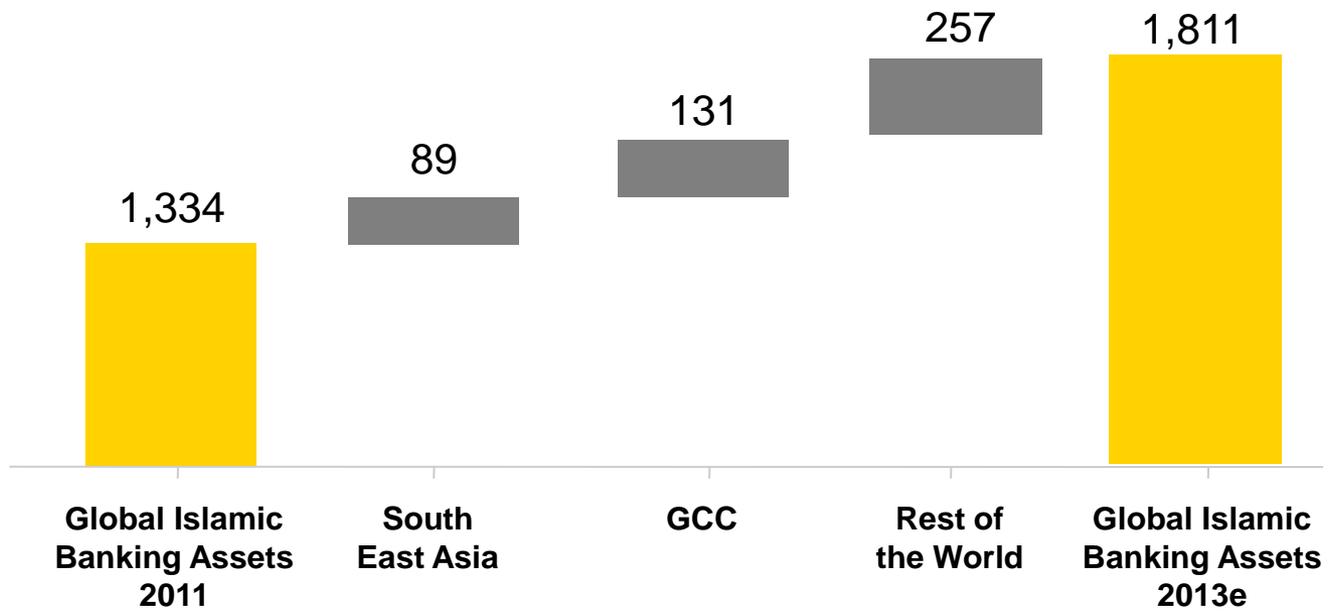
Gordon Bennie  
Partner, Financial Services Leader  
Ernst & Young , MENA

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One potential scenario shows global Islamic banking assets with commercial banks to reach \$1.8 trillion in 2013 (2011: \$1.3 trillion), representing average annual growth of 17%

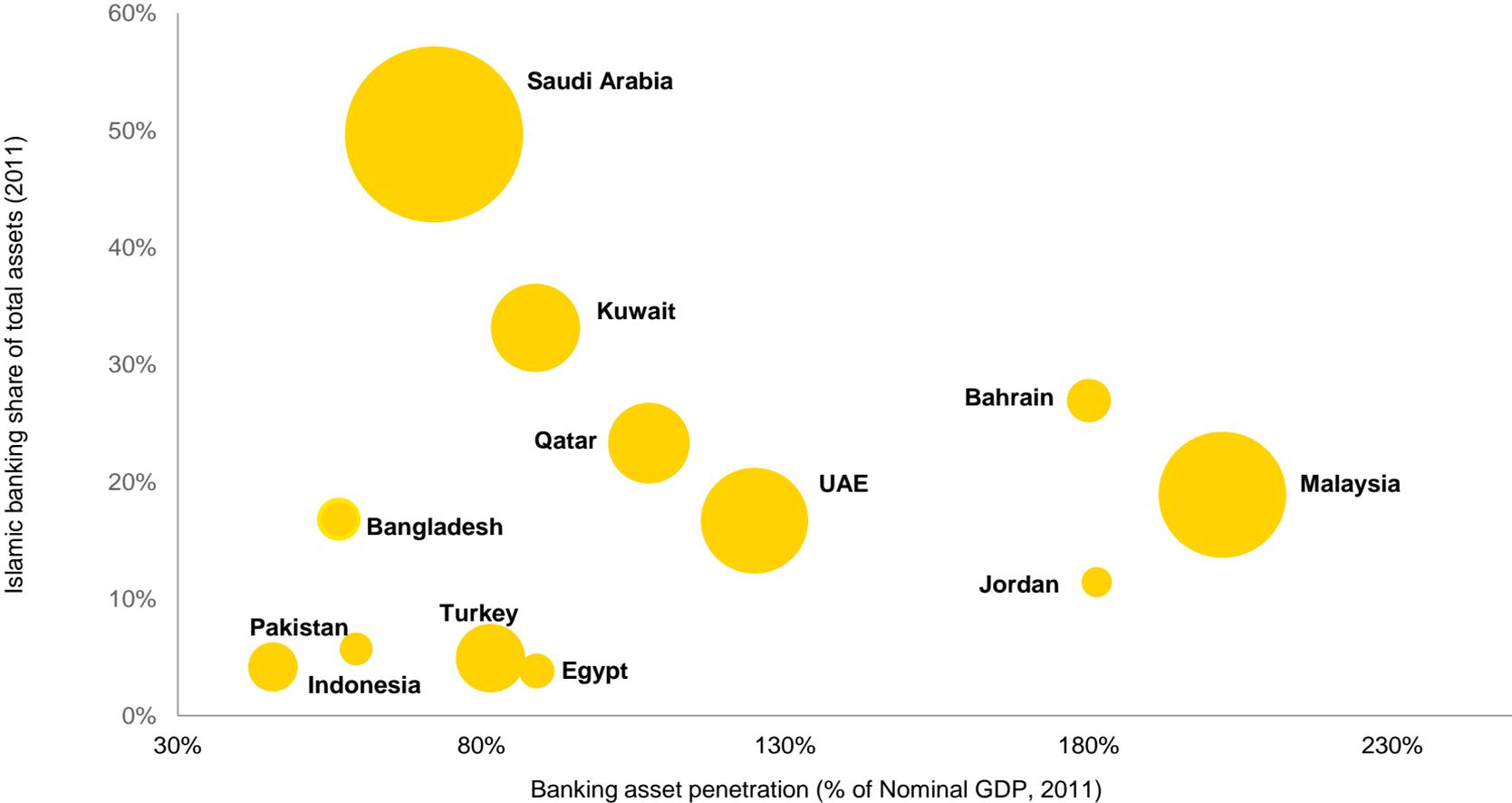
Islamic banking asset growth (US\$b)



Source: IMF, The Banker, Central Bank Reports, EY Universe

**Islamic banking growth outlook continues to be positive, growing 50% faster than overall banking sector in several core markets. In Saudi Arabia, market share of Islamic banking assets is now over 50%**

**Banking asset penetration (% of Nominal GDP) and Islamic banking market share of total assets (%) in 2011**

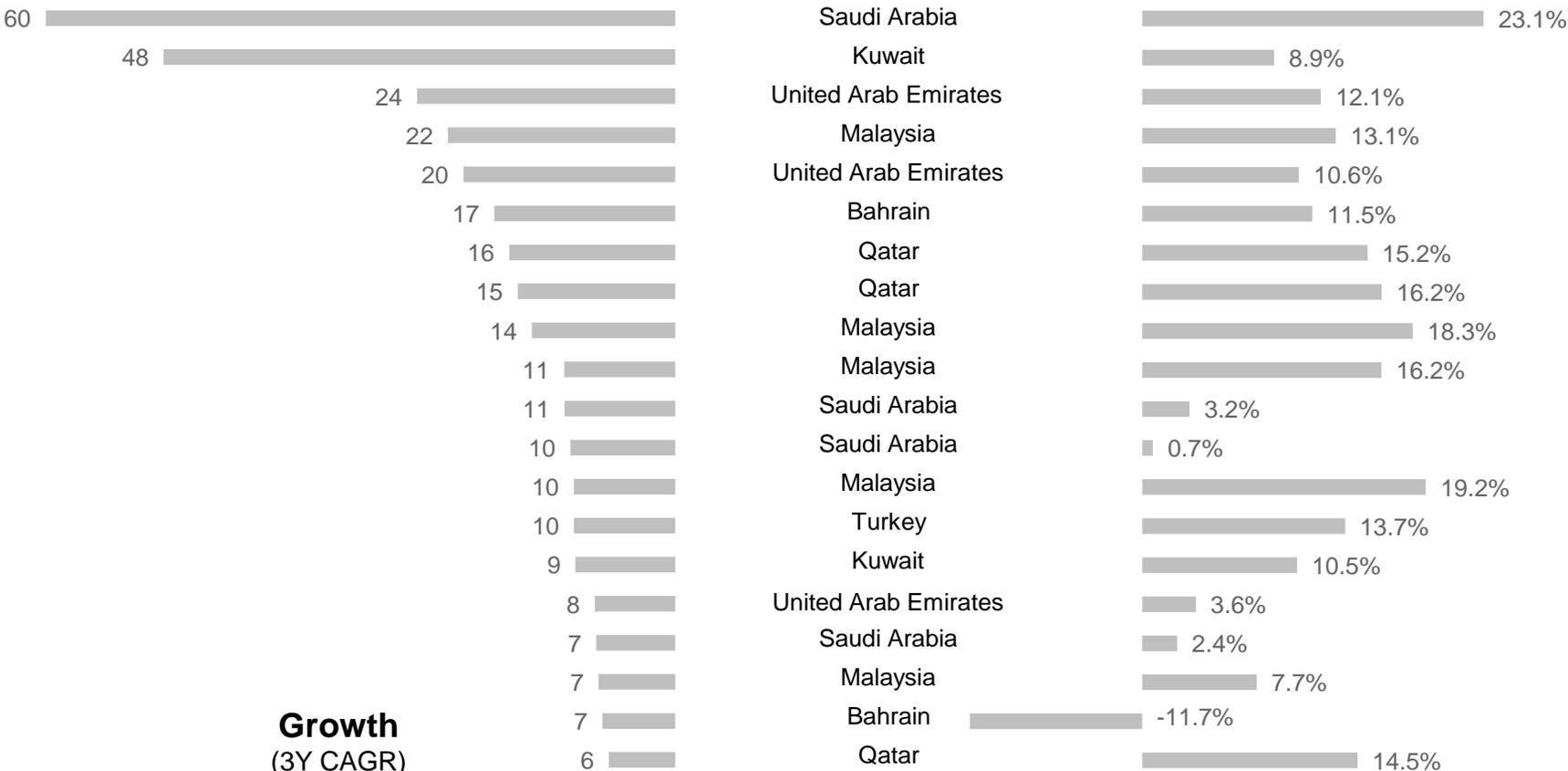


Size of circles denote the relative size of Islamic banking assets in 2011

Source: Central Bank Reports, Ernst & Young Analysis

# Top 20 Islamic banks make up 55% of the total Islamic banking assets and are concentrated in 7 countries, including GCC, Malaysia and Turkey

## Total Assets 2011 (US\$b)      Bank's Home Market      Average ROE (2008 – 2011)

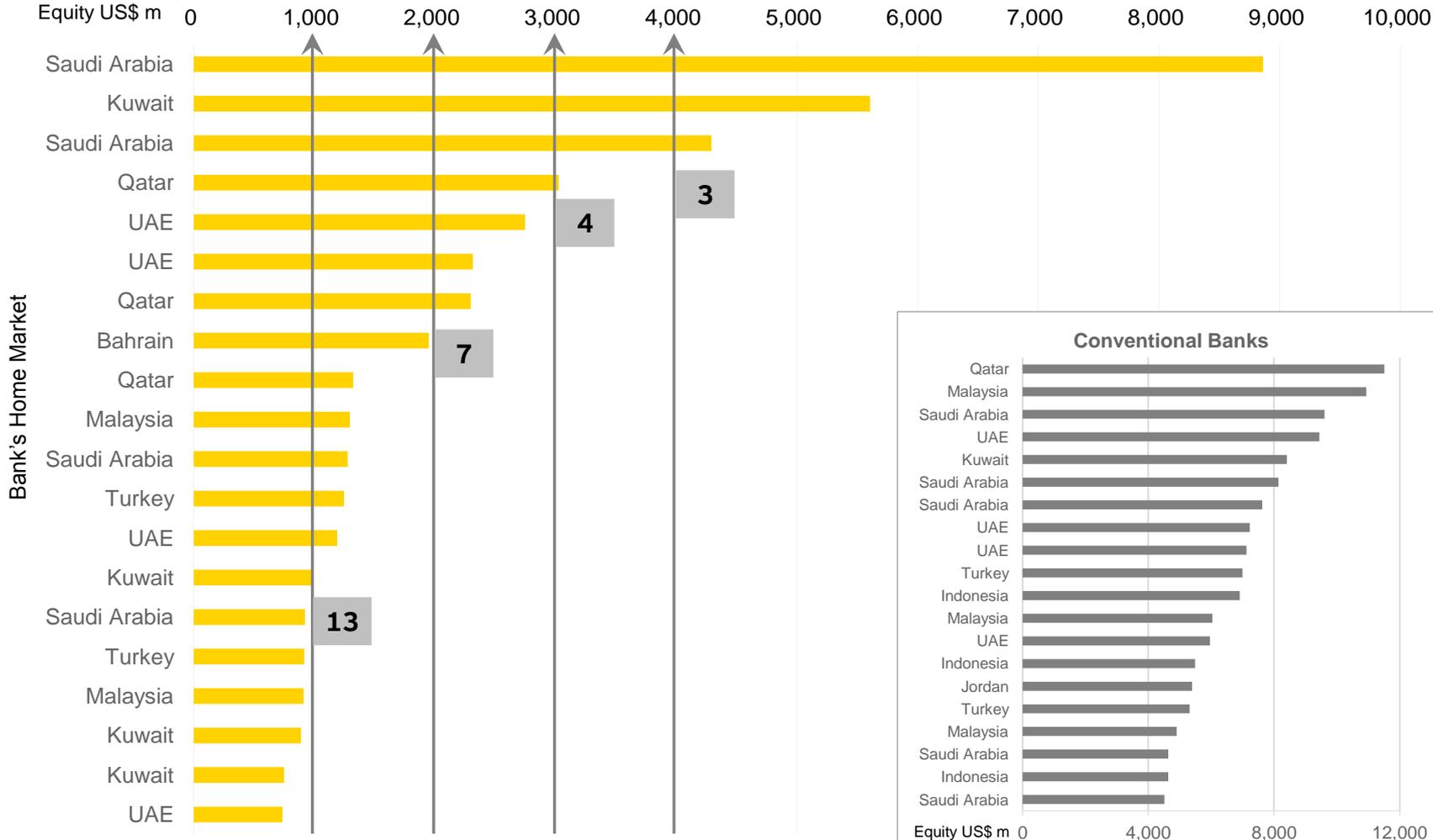


**Growth**  
(3Y CAGR)

16.2 %	US\$ 17b	Leading Islamic Average	11.6%
13.9%	US\$ 65b	Comparable Conventional Average	15.3%

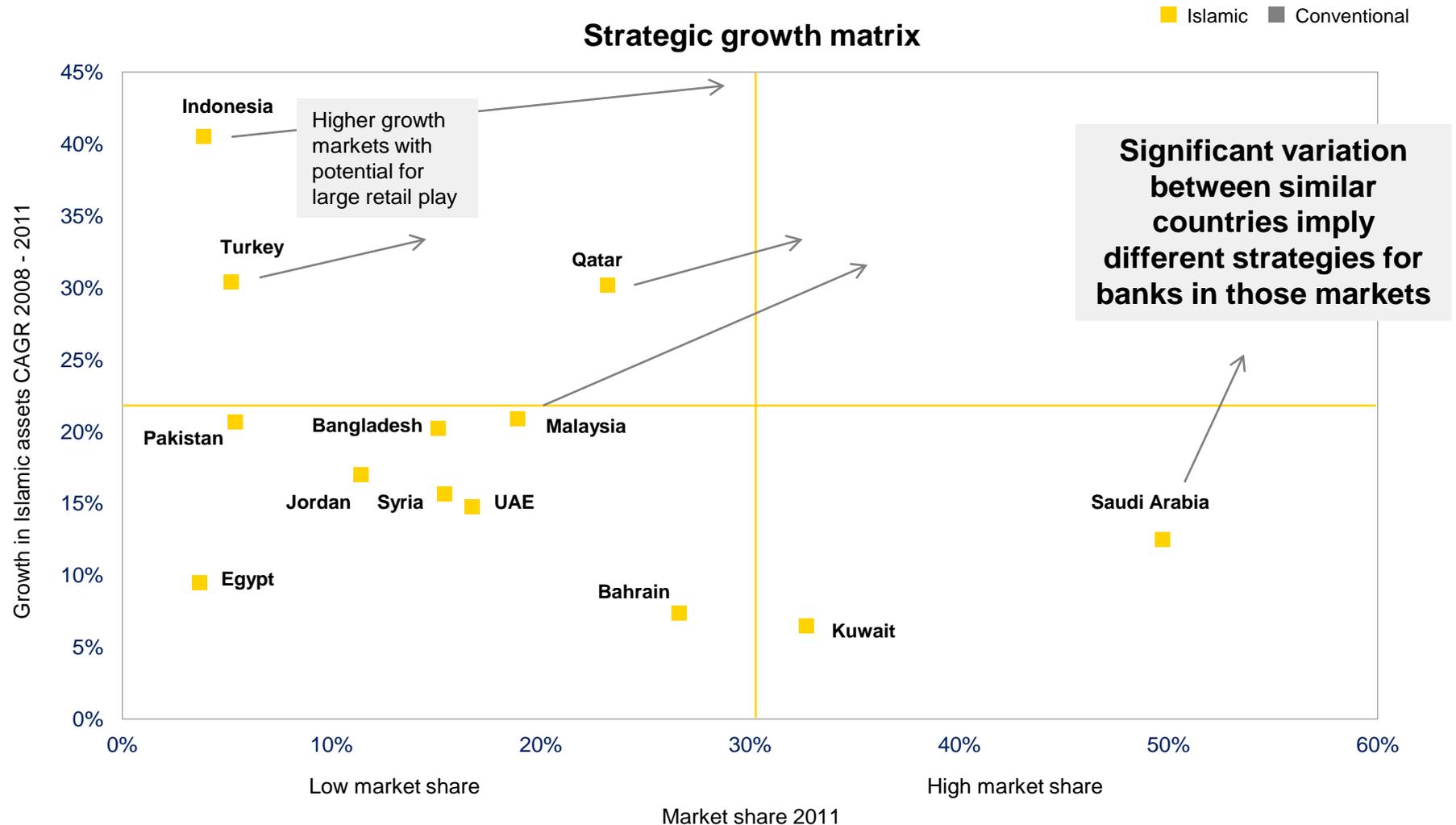
Source: Company Reports, EY Universe (Note: analysis excludes Iran assets & institutions)

# 13 Islamic banks have an equity base of more than \$1 billion. Building regional institutions and participating in larger transactions requires the industry to scale up



Source: Company Reports, Ernst & Young Analysis, EY Universe

# There remains considerable potential for growth with some strategic quick wins possible; retail specialization, regional diversification, transformation of middle-tier conventional banks to Islamic...



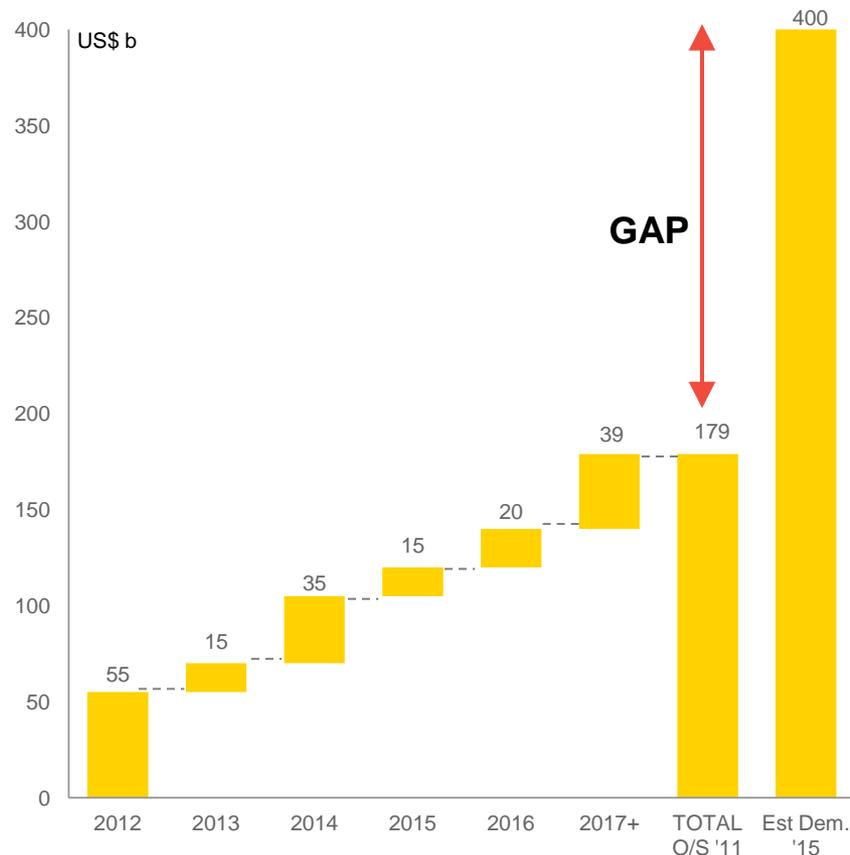
Source: Company Reports, Ernst & Young Analysis, EY Universe

Market Share = Islamic Assets / Total Banking Assets

# Demand for sukuk instruments will continue to grow, outpacing global supply and providing opportunities for banks to establish and grow their Islamic fixed income advisory platforms

Trend

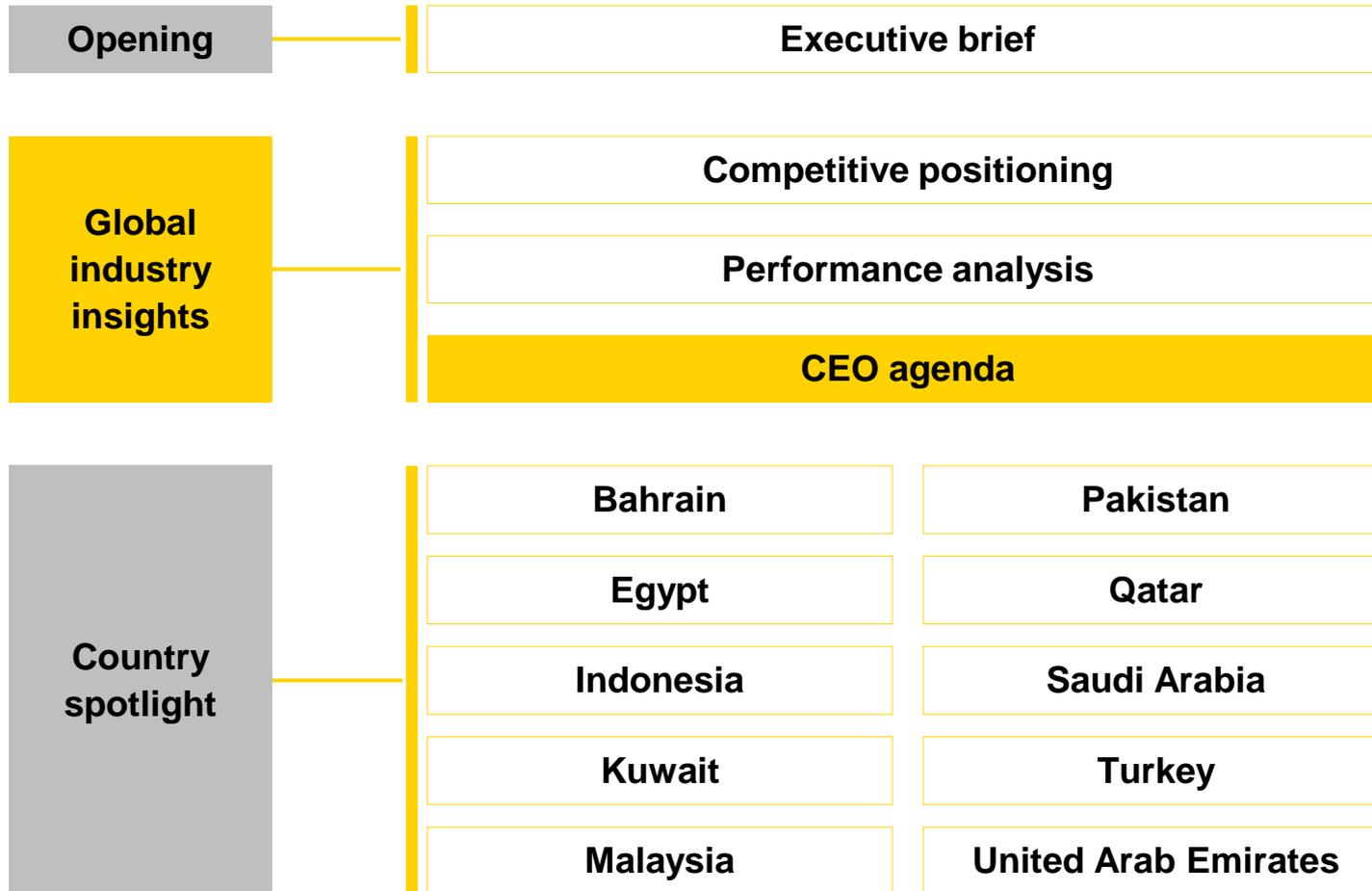
## Outstanding Sukuk maturity profile and estimated demand by Islamic banks



- Based on current growth forecast, Islamic financial institutions will require at least US\$ 400b of short term, credible, liquid securities for liquidity and capital management purposes, by 2015
- Including other investor classes, global sukuk demand could be in excess of US\$ 600b by 2015
- 2012 would see in excess of US\$ 110b in new issuance – a record year but still short of industry demand
- Market opportunity will drive more Islamic banks to set up international platforms to offer Islamic fixed income advisory services

Source: IFIS, Standard & Poors, Bloomberg, ThomsonReuters, EY Analysis

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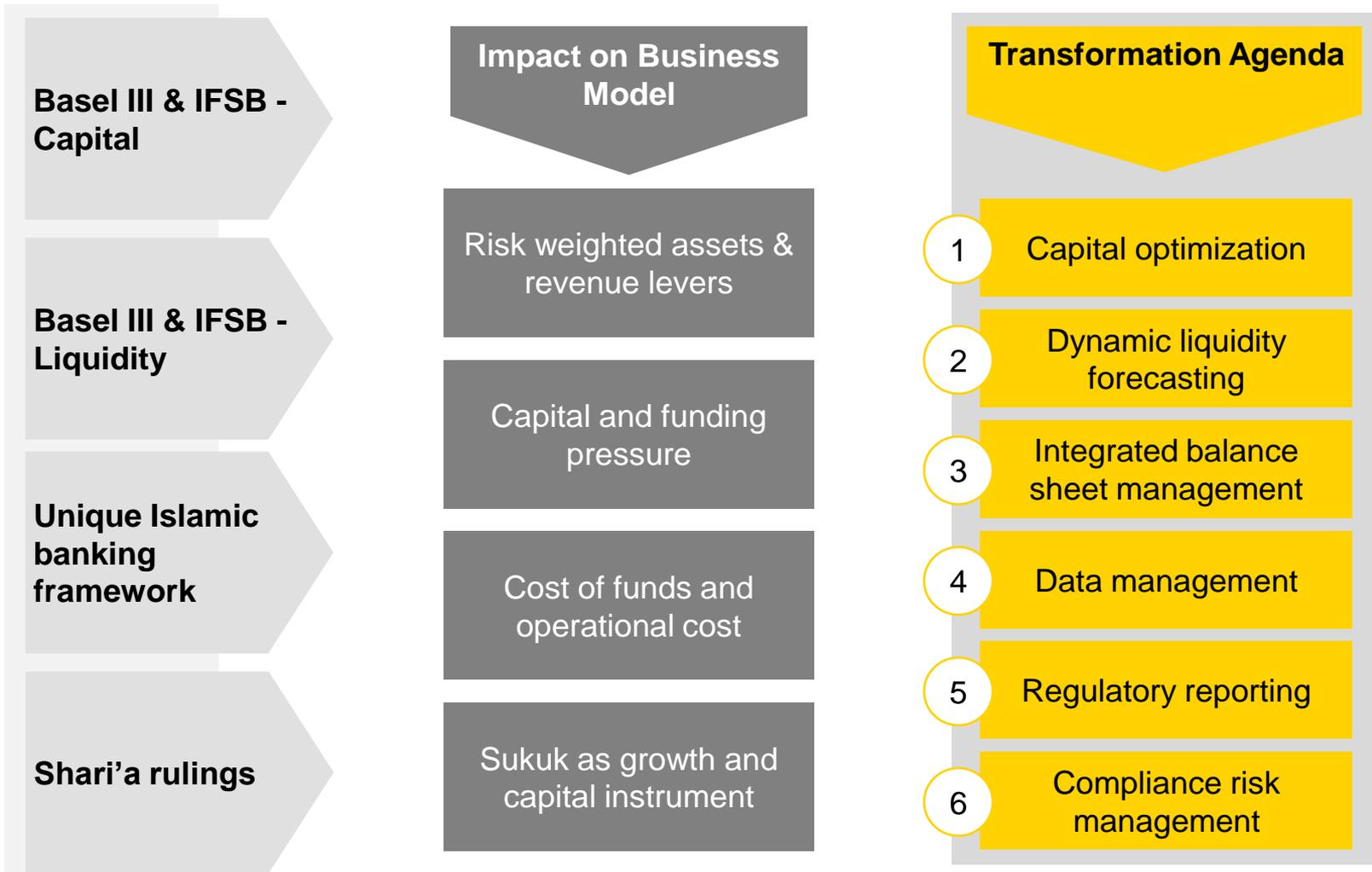
# The severity of performance challenge demands wide-ranging transformation of business practices around the 3 R's

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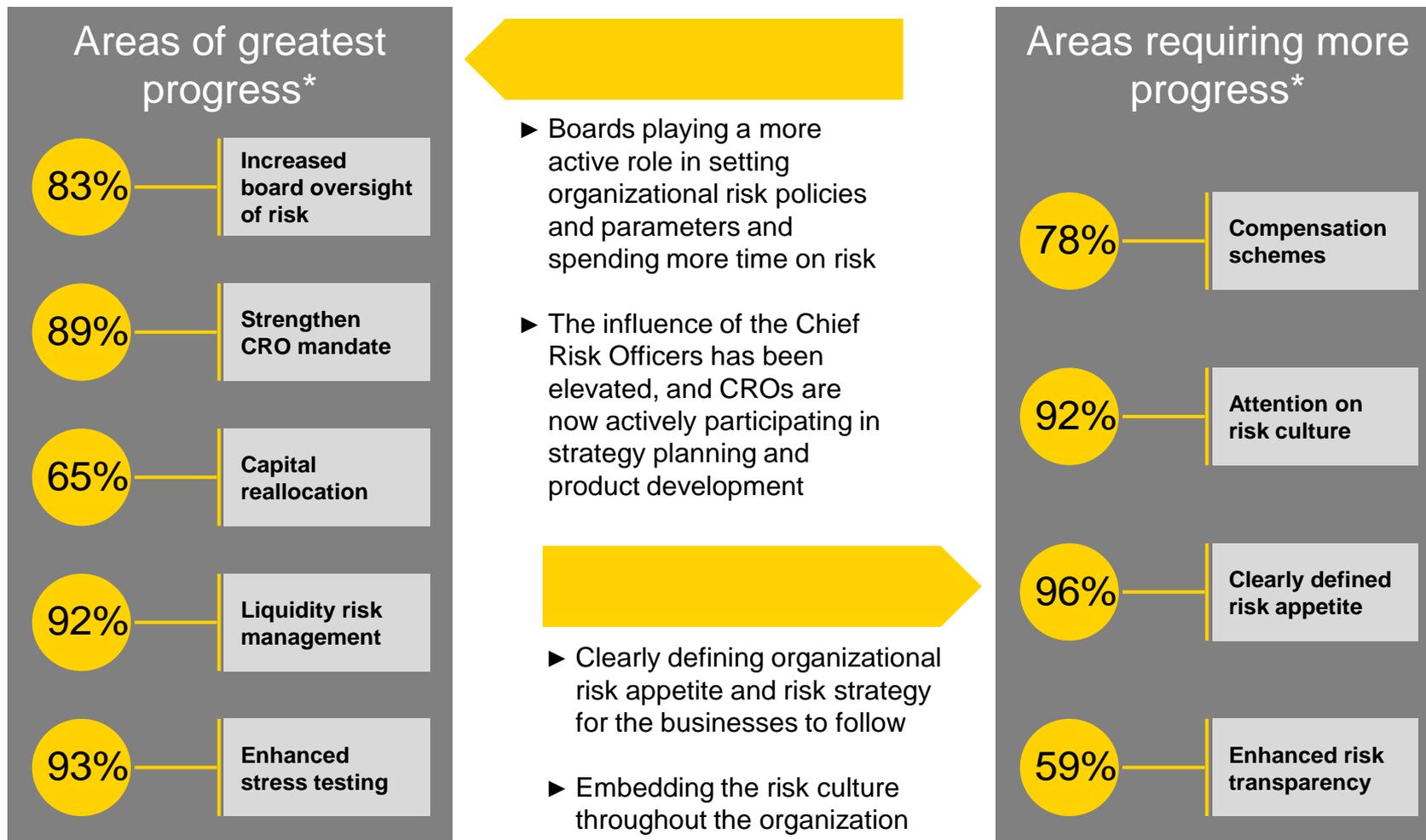


*Faced with mounting pressure to improve sub-par ROE, many institutions are tempted to cut or delay the much needed change agenda. The danger is that banks will miss the limited window they have to implement their future blueprint*

# Regulatory transformation – will deepen the divide between weaker and stronger banks. The impact of reforms will force the industry to adapt to radically different ROE expectations

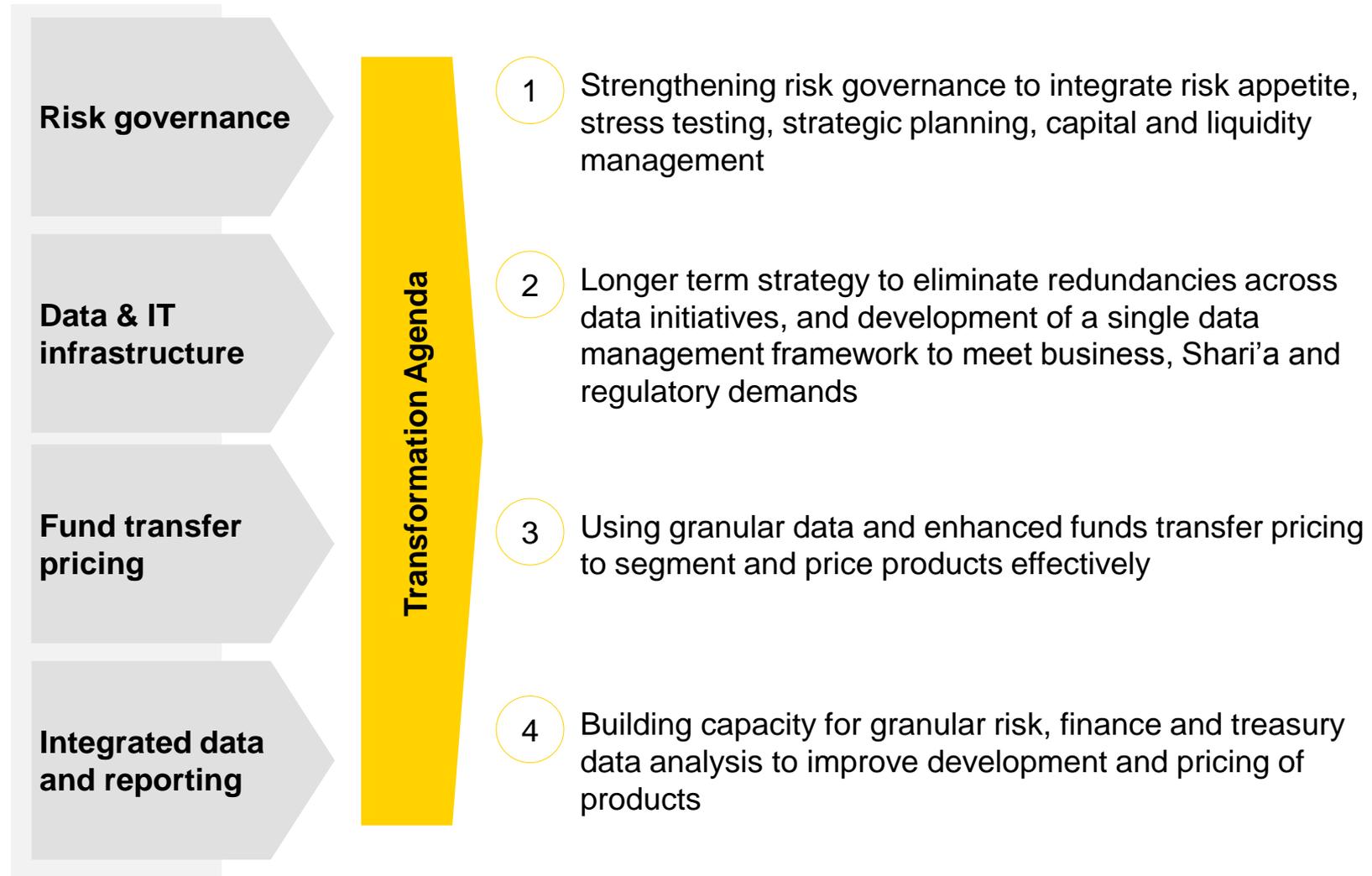


# The risk agenda has been elevated significantly as regulators require banks to implement comprehensive reforms. Islamic banks require more attention



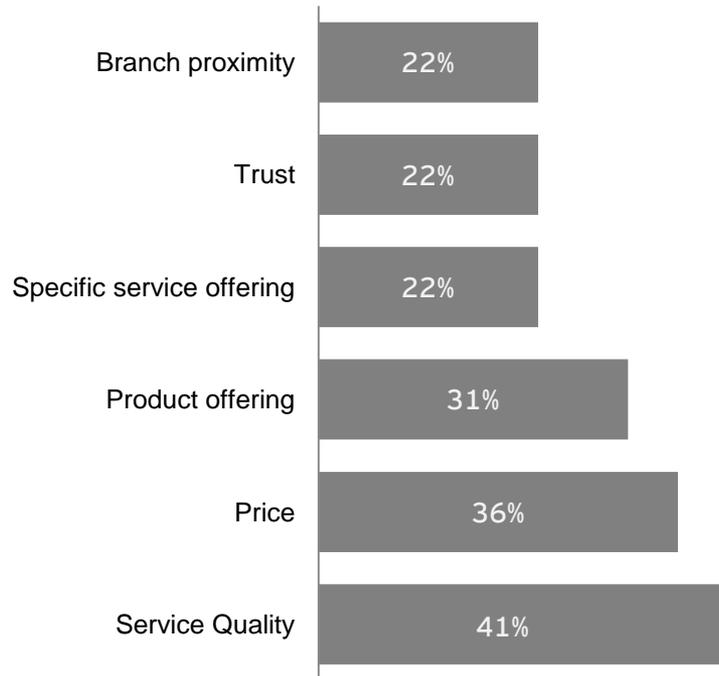
\* Source: Selected responses from Ernst & Young's survey on risk management practices

# Risk transformation – balancing models and judgment



# Retail – developing a ‘whole-customer’ view of requirements and profitability will be an essential capability for Islamic banks to improve performance

Banking activities customers most want their bank to improve\*



## Transformation Agenda

- 1 Customer centric operating model
- 2 Customer acquisition model (integrated onboarding strategy & process definition)
- 3 Product portfolio management (up sell and cross sell at customer level)
- 4 Sales force effectiveness
- 5 Integrated channel strategy (channel proposition, segment alignment, migration)
- 6 Customer data design and advanced pricing management

\* Source: Selected responses from Ernst & Young's global consumer banking survey

# Retail – technology will emerge as both an enabler and a differentiator despite all forms of capital expenditure being under heavy scrutiny

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## Technology to comply

As new regulatory requirements take effect, Islamic banks will need to become more data intensive. The quality and extent of data expected, the connectivity between functions, the level of risk assessment and the speed of delivery will prompt organization-wide change programs

## Technology to understand

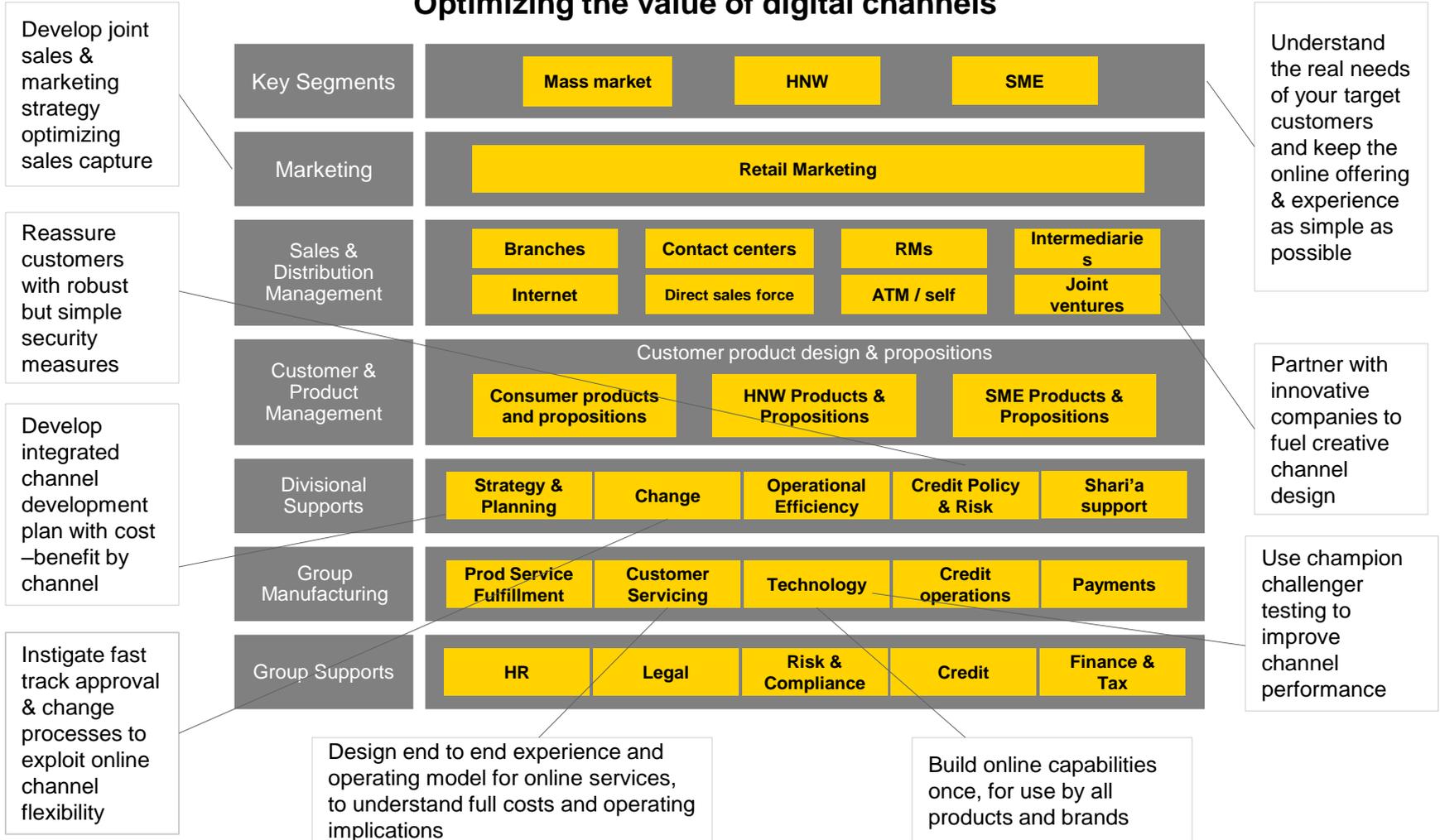
Islamic banks need to implement new systems for effective collection, management and mining of customer data

## Technology to deliver

Although some security concerns remain, technology will play an increasing role in the interaction between bank and customer via multiple channels. Increasing importance of smartphones in Islamic banking markets can no longer be ignored

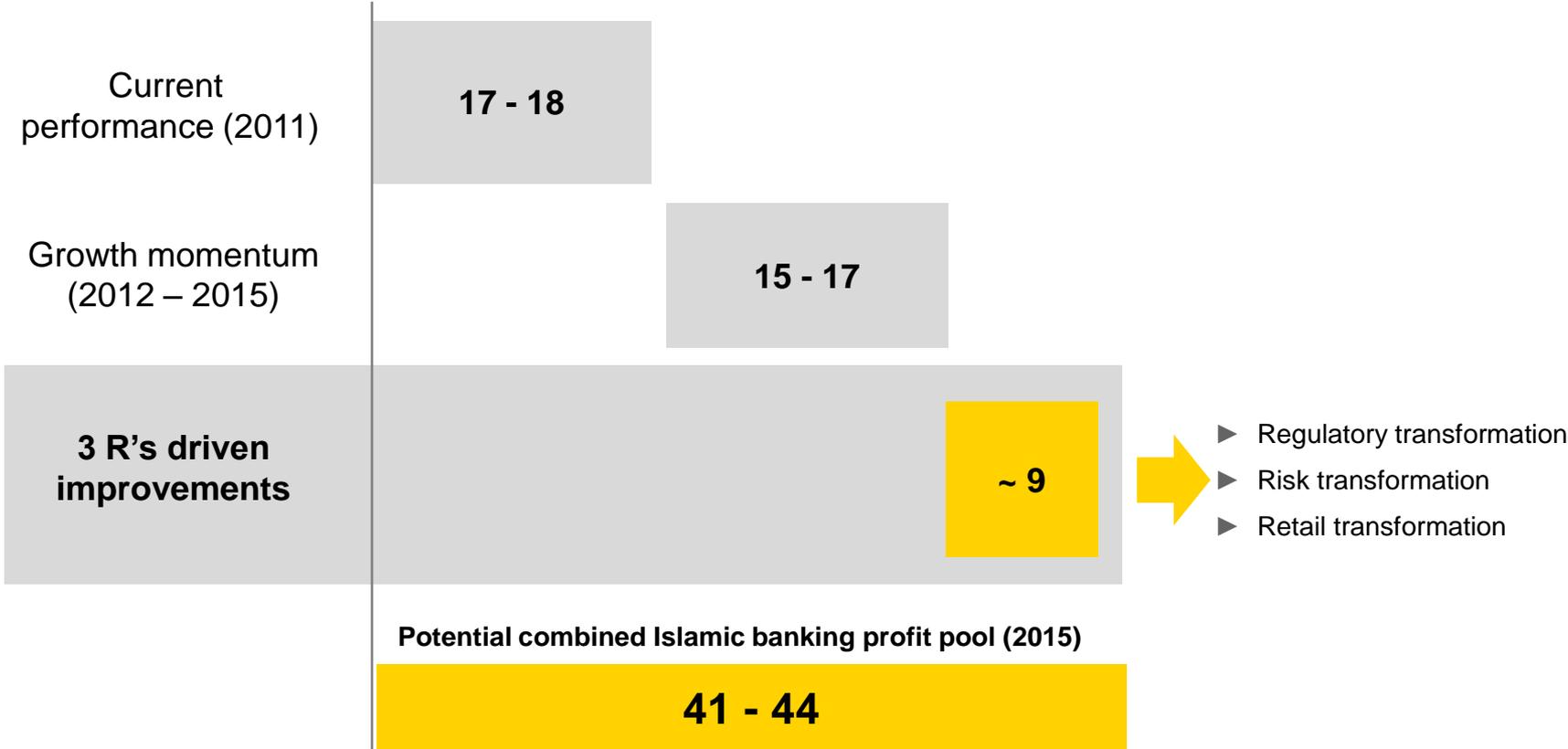
# Retail – the digital channel must now be at the heart of an integrated multi-channel offering to improve accessibility, cross sales and servicing

## Optimizing the value of digital channels



**A well executed transformation program would take 2-3 years to be implemented and embedded, and could improve Islamic banks' profitability by approximately 25%**

Global Islamic banking – estimated combined profit pool, 2015 (US\$ b)



# Ernst & Young Leadership – Islamic Banking Center of Excellence (and what they have to say)



*Game changer for us would be bold, fresh thinking that drives responsible innovation*

**Ashar Nazim**  
ashar.nazim@bh.ey.com



*Real progress will only come from greater integration with the real economy*

**Shoaib Qureshi**  
shoaib.qureshi@sa.ey.com



*Successful strategy execution is dependant on a bank's operating model being realigned to deliver on the new strategy*

**Abid Shakeel**  
abid.shakeel@bh.ey.com



*If the change does not happen at the right time, there will be nothing left to change*

**Shahid Mughal**  
shahid.mughal@om.ey.com



*Islamic banking is no rocket science but structuring real Islamic products requires sophisticated thinking*

**Nida Raza**  
nida.raza@bh.ey.com



*Market leadership will belong to those who can meet both commercial and Shari'a needs of their customers*

**Mustafa Adil**  
mustafa.adil@bh.ey.com



*Industry may potentially face an existential threat if it cannot manage its most important risk, i.e. Shari'a non-compliance*

**Sohaib Umar**  
sohaib.umar@bh.ey.com



*I wish my Islamic bank could deliver the same service levels that my previous conventional bank had to offer!*

**Noman Mubashir**  
noman.mubashir@bh.ey.com

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