FinTech –Fast moving force for Islamic Financial Intermediaries

The evolution and widespread applicability of FinTech development is a paradigm shift for the banking sector. Keeping up with its pace should be a matter of concern for every entity which is likely to be affected. FinTech firms can be classified as:

a) Information technology and software firms supporting and facilitating the financial sector firms more so termed as bank technology service providers and

b) Tech-startups and small innovative firms substituting the regular financial intermediary, the ease of accessibility to which can cause 'disruptions' for mainstream banks and banking systems.

As we quote in our recent eNewsletter "The reason FinTech is "so hot" is down to the fact that it is moving financial operations from the boardroom to the internet. Banks have time to adapt but that time is running low. Customers don't want to go to 100 different companies to get their lending, investments and payments controlled. They want to come to a name and an institution they know and recognise. Banks have to act to utilise that brand recognition." Chris Skinner states.

According to CB Insights, a research firm, global investments in FinTech has grown from $4 billion in 2013 to approximately $12 billion at the end of 2014. Nearly all aspects of financial services can be substituted by FinTech companies from deposits and lending to capital raising and investment management, from market provisioning payments to insurance services. Peer-to-peer lending(P2P) and crowdfunding are two forms of online lending platforms which have gained considerable momentum in the past few years in developed markets, the growing popularity of which is moving to emerging markets as well where the need of low cost financing is on the rise.

Islamic finance can act as an alternative to the conventional financial system. The major features of Islamic finance, like asset-backing, the bans on uncertainty (Gharar) and interest or usury (Riba), and risk and profit sharing seem to provide a more resilient financial system. Under Islamic banking, lending and borrowing are fully asset-backed and there is no scope for debt transfer (swaps) or speculative transactions beyond the real value.

The reason why Islamic banks have not felt the full brunt of the global credit crisis is that it is difficult to get loans from Islamic banks unless the loans are deemed prudent, growth promoting and beneficial to society.

Islamic finance, or financial services that conform to the tenets of Islam, offers a potential market of 1.5 billion Muslims that should continue to offer opportunities for foreign and domestic banks. In the last five years, Islamic finance has grown by 15 to 20 percent annually, with an estimated $270 billion in assets, controlled by approximately 300 Islamic banks in more than 25 countries.

It is worth noting that crowdfunding firms in the Islamic regions, like Beehive in the UAE and Blossom Finance in Indonesia providing Shariah compliant services aim to provide low cost alternative financing to small and medium enterprises. Each company connects creditworthy businesses looking for funding with smart investors to build mutually beneficial partnerships of growth by applying the innovative crowdfunding approach to eliminate costs and complexity of banks. In the UAE, the SME market is underserved more so by Islamic banks, so the potential for Shariah compliant tech startups to act as a lending platform for SMEs remains high. In addition, the trend is for banks to collaborate with crowdfunding and FinTech organisations so as to enhance their service and offer alternative channel of e.g. funding to their customers. This indeed is expected to increase further while expanding to other industries like Insurance market and Wealth Management. The aforementioned examples also show that FinTech companies can act as a competitor as well as a facilitator to the conventional and Islamic financial intermediaries and now is the time that formal channels of lending and financial intermediaries should realign their business models and strategy in order for them to stay competitive and profitable.

The presence of Islamic banks in dual banking systems has both positive and negative impacts for stability when increased competition is being introduced, according to an IMF working paper. The empirical study builds on literature which tries to tease out the impact of competition on stability. From a theoretical perspective, the question revolves around how banks will react in the face of greater competition or potential competition. This theory claims that by introducing greater competition could benefit overall financial stability by reducing the competitive standing of the existing banks and easing credit terms for companies who would be able to repay at a higher frequency (lower loan losses).

FinTech has been continuously disrupting the conventional ways of the finance industry all around the world. And on this same note, its impact in the Islamic finance sector is expected to be massive; as it could ultimately transform how Islamic finance is regarded in the Muslim community. It was reported in the GCC's leading publication that there are new business ventures considered to be a combination of IT-based alternative financing and Shariah-compliant financing principles.

One good example of a well-known Islamic venture is Beehive, as mentioned earlier, being the first platform for peer-to-peer lending with an independent Shariah certification. According to Craig Moore, CEO of Beehive, their platform uses crowdfunding's innovative technology to remove the complexity and cost of traditional finance. Beehive won the Disruptive Entrepreneur Awards 2016, Start-Up Business Category, organized by SME World Summit. Furthermore, Kapital Boost, awarded the Social Enterprise Startup of the Year at the inaugural ASEAN Rice Bowl Startup Award in 2015, and Club Ethis, a finance-based realty crowdfunding venture are also included in the list of Shariah-compliant Islamic innovative ventures. They both operate in Singapore.

"Muslims comprise approximately a quarter of the global population, and yet Islamic-based financial assets consisted of only less than one percent of total global financial assets," a finance expert observes. Digital investing could be an additional way to allow Muslim investors around the world to invest in a Shariah compliant way.

Online investing is still a market of very limited dimensions in the few Muslim countries where it has been established – especially compared to the Western ones – and it is almost non-existent in many others. However, after Malaysia regulated the sector, a couple of platforms operating in a Shariah compliant way have launched and are currently gaining traction. Although a few platforms, operating according to Islamic finance, have launched, the distance to cover before digital/online investing becomes mainstream is still quite long.

It is evident that there is room to enter for more online investing portals wanting to operate according to Islamic finance. In fact, the Shariah compliant financial sector is growing faster (as mentioned above) than banking assets as a whole, growing at an annual rate of 17.6% between 2009 and 2013, and is projected to grow by an average of 19.7% a year to 2018. We therefore expect to see more digital/online investing conducted under Islamic finance principles in the next few years.

As the market is growing, the trends are changing and for the businesses to remain competitive they would need to adjust their products and services to reach various locations, with new technology and a new approach to younger age while complying with the regulatory regime and offering comprehensive reporting. This is a trend that was anticipated by the Profile Software team that has early enough developed platforms for alternative finance and Islamic finance. Profile Software is successfully addressing the ever-evolving market requirements not only through its investment in developing innovative platforms but also through its people, a team of subject matter experts who understands the Islamic and conventional alternative finance marketplace. The Alternative Finance platform developed competitively incorporates both banking and investment management functionality while offering unique flexibility to meet the needs of startup firms as well as established ones that want to diversify in this industry meeting the competition challenges. In addition, Profile Software invests in new technologies such as mobile and cloud to offer a suite of uniquely positioned banking and investment management solutions.