Towards establishing an Islamic retail bank in a Muslim-minority country

Prospects and challenges in Mauritius

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Abstract

Purpose – The purpose of this research study is to explore and analyze the factors that will favour or constrain the introduction of an Islamic Retail bank in a Muslim-minority country such as Mauritius. This research attempts to fill the gap in the empirical literature on the setting up of an Islamic Retail bank in a Muslim-minority country. It recognizes upfront that Islamic banking offers an alternative banking system that is attractive to both Muslims and non-Muslims.

Design/methodology/approach – The research adopts a mixed approach to address the prospects and challenges of establishing an Islamic Retail bank in Mauritius.

Findings – The research finds that there are various prospects for an Islamic retail bank in Mauritius for Muslims and non-Muslims, including enabling legal, fiscal and regulatory framework, the financing of small- and medium-sized enterprises and the issuance of *ṣukūk* (Islamic investment certificates). The research also finds that the development of an Islamic retail bank in Mauritius face various challenges. Some of these challenges are lack of Sharīʿah-compliant liquidity instruments and inter-bank deposits, lack of knowledge and understanding of Sharīʿah-compliant products and the enforcement of Islamic contracts in court.

Originality/value – This in-depth study appears to be comprehensive and will help in developing a solid foundation for establishing an Islamic retail bank in Mauritius.

Keywords Challenges, Mauritius, Prospects, Islamic retail banking, Muslim-minority country

Paper type Research paper

Introduction

Mauritius, a small island in the Indian Ocean, is a Muslim-minority country with mixed population of Europeans, Africans and Asians. It is emerging as a major international business platform in this region of the world, aided by the fact that its population of 1.3 million inhabitants has the highest adult literacy rate for the whole of Africa. The Mauritian economy is one of the fastest growing economies in sub-Saharan Africa. With the right policies implemented at the right time in its economic history, Mauritius is today categorized as an upper-middle income country with a per capita income of US$9,760 (Doingbusiness.org, 2018). Mauritius is recognized by international organizations for continuous improvement in its regime for doing business. The country is today acclaimed as a leading

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investment destination, a reputed international financial centre and a gateway to Africa (BOI, 2017). It is also an international and regional arbitral jurisdiction of choice, which was made possible with the collaboration of the London Court of International Arbitration in 2010 (MIAC, 2014).

Despite provisions in the Banking Act 2004 that allow banks to conduct Islamic banking business in Mauritius subject to certain conditions, there are only two entities offering any such services. One is an Islamic investment bank, and the other is a conventional retail bank offering Islamic banking business to a very limited extent through an Islamic banking window. This deficit is mainly due to the general lack of awareness of the Islamic banking approach and the widespread, convenient and efficient banking services offered by conventional banks in the island. However, there are no retail Islamic banking facilities. There is one co-operative society that offers Islamic financial services, but these are restricted to its members only, and financing is limited.

The aim of this research is to explore and analyze the factors that will favour or constrain the introduction of an Islamic retail bank in Mauritius. The premise is that establishment of a full-fledged Islamic retail bank in the country would cater for the needs of Muslim and non-Muslim individuals, businessmen and small- and medium-sized enterprises (SMEs), help meet the United Nations' Sustainable Development Goals and provide for better financial inclusion.

Research objectives

This study aims to achieve the following objectives:

- to unveil the potential market for an Islamic retail bank in Mauritius;
- to determine the extent of knowledge, level of awareness and perception of Muslims and non-Muslims in Mauritius regarding Islamic banking and finance;
- to examine the local population's criteria for selecting a bank and for switching banks; and
- to determine the prospects and challenges in setting up an Islamic retail bank in Mauritius.

Methodology

To achieve the research objectives outlined above, this paper undertakes a combination of two research methods. First, it carries out a comprehensive review of the existing literature and theory. The theoretical framework of this study is constructed through the literature review. The main literature sources are journals, books, reports, theses and bank regulators' papers. It must be recognized upfront that there is a dearth of published literature on Islamic banking and finance in Mauritius. Second, it conducts an empirical study to extract the opinions and perceptions of respondents, both Muslims and non-Muslims, on patronizing an Islamic retail bank in Mauritius. Both quantitative and qualitative data analyses are used for this second part. An online survey is used in this context to obtain primary data from a selected group of banking customers. In addition, semi-structured interviews from a target sample of bankers, financiers, professionals, academics and Sharīʿah scholars are used to substantiate and compare the survey findings.

Consumer behaviour and Islamic banking patronizing behaviour

Empirical research using different methodologies and approaches has been carried out in different parts of the world to examine the criteria influencing consumers in selecting their banks (Haron *et al.*, 1994; Che and Mohd, 2003). Understanding how customers select banks is important as it assists banks in identifying the appropriate marketing strategies needed to attract and retain customers (Al-Mossawi, 2001).

As Islamic banks are relatively new institutions compared to their conventional counterparts, customers' understanding and awareness, as well as their assessment and perception of the specificities of these banks, determine the extent of their adoption of the banks' products and services. Customers' positive perception towards Islamic banking is crucial because Islamic banks must compete with long-established conventional banks in a dual-banking system (Dusuki and Abdullah, 2007). Moreover, Islamic banks have the mission of contributing to socio-economic development through the delivery of financial services according to the principles and teachings of Islam. It is thus essential for them to study and understand customer behaviour, as well as their attitudes and perceptions, to successfully attract customers and gain larger market share. It must be stressed that customers' attitudes, perceptions and behaviour will have a significant impact on the survival of Islamic banks.

Because of competition among retail banks and sophisticated customer demand, it has become essential for banks to determine the factors that are relevant to customers' choice and criteria for selecting or doing business with an Islamic bank. According to Saini *et al.* (2011), in today's competitive environment, it is imperative that bank managers develop the ability to determine the critical bank selection factors for the segments of the market they wish to attract and serve. Many studies have found that the selection criteria for doing business with Islamic banks differ among different types of consumers and vary between countries.

Prospects for Islamic banking and finance in Mauritius

Islamic finance has been present in Mauritius since 1998, when the small Muslim community of 14 per cent (now 18 per cent) of the total population started receiving services from the Al Barakah Cooperative Society Limited, an Islamic cooperative credit union. The Islamic cooperative offers tailor-made *murābaḥah* schemes, *ḥajj* saving accounts and *istiṣnāʿ* financing (Gelbard *et al.*, 2014).

In October 2005, the government set up a Steering Committee to explore the possibility of establishing Islamic financial services in Mauritius. This committee proposed review and amendment of the legislative framework to facilitate the introduction of Islamic banking. A Malaysian expert on Islamic banking and finance – Dato Ahmad Tajuddin, former CEO of Bank Islam Malaysia, seconded by the Islamic Development Bank – was then called in to streamline the Islamic banking regulatory framework. The proposals were finalized, and the Finance Act 2007 brought the necessary amendments into the legislation in June 2007. The main acts which were amended were the Banking Act 2004 and the Bank of Mauritius Act 2004. They made provision for banks to either operate as full-fledged Islamic banks or offer Islamic banking services through window operations (Rassool, 2011).

A working group on Islamic banking was then set up to work on guidelines for conducting Islamic banking business in Mauritius. The objective was to design a simple and standard regulatory framework within which Islamic banking could develop and integrate in a seamless manner with the conventional financial system. The working group was broadly based and included representatives from the banking industry. Those guidelines were finalized and issued to the industry in June 2008.

Furthermore, the Public Debt Management Act 2008 and the Value Added Tax Act 1998 were amended in 2009 to allow the government to issue sovereign *ṣukūk* and to exempt *murābaḥah* transactions from double taxation. HSBC, in collaboration with HSBC Amanah, was the first bank to launch an Islamic banking window in May 2009, offering Sharīʿah-compliant funds and Islamic current accounts to its global clients. In the same year, the Bank of Mauritius granted an Islamic banking licence to Century Banking Corporation, making it the country's first full-fledged Islamic investment bank. The latter started operations in March 2011. The country also became a member of the Islamic Financial Services Board in 2009 and a member of the International Islamic Liquidity Management Corporation (IILM) in 2010 (Abduh and Ramjaun, 2015).

Everyone in Mauritius, Muslims and non-Muslims, could benefit from the development of Islamic banking and finance in the island. An Islamic retail bank could serve the local retail market by providing savings and investment products, consumer financing, business funding and housing finance. The Governor of the central bank of Mauritius, the Bank of Mauritius, in his speech at The Mauritius Islamic Finance Forum (MIFC) Premier Event in Islamic Finance in July 2005, mentioned that the characteristics of Islamic banking are well suited to SMEs, an economic sector where Islamic banking could play a catalyst role in giving a boost to entrepreneurship (Roi, 2005a).

Mauritius has the potential of becoming an active player in the global Islamic finance industry. It is regarded as one of the most successful and stable democracies in the region and is well placed to offer Sharīʿah-compliant financial products and services in both onshore and offshore markets. Indeed, a combination of fiscal and non-fiscal factors has made Mauritius particularly attractive as a jurisdiction for structuring Islamic financial products (Rassool, 2011). A few Sharīʿah-compliant global funds have already been set up in the country because of their attractive taxation regime. Mauritius generally imposes a flat income tax rate of 15 per cent. Other opportunities in Mauritius include the issuance of *ṣukūk* using a special-purpose vehicle (SPV). According to Uteem (2009), an SPV can be set up in Mauritius as a company holding a Global Business Licence One or a Global Business Licence Two or as a trust.

Issues and challenges

The evolving nature of global banking is a serious challenge to Islamic banking. According to the governor of the Bank of Mauritius, the increasing integration of economic activities across national borders, along with the phenomenal progress in banking technology, has made banking systems across the world increasingly vulnerable. Banks have been losing some of their traditional businesses to other intermediaries, both non-bank financial institutions and other commercial enterprises, which are now offering an endless array of financial instruments (Roi, 2005b).

The governor, in his speech at the MIFC in July 2005, mentioned that the very fact that Islamic banking differs from conventional banking in important ways poses regulatory and supervisory problems. The risks taken by Islamic financial institutions are not directly comparable to those of their conventional counterparts. In most countries, including Mauritius, where conventional banks operate alongside Islamic banks, the same regulatory and supervisory standard is being applied to the extent possible. So far, the tendency has been to apply the standard set by the Basel Committee on Banking Supervision. It is, however, recognized that the same standard applied to conventional banking cannot be rigorously applied to an Islamic banking framework (Roi, 2005a).

The most comprehensive work on the challenges that an Islamic bank may face in Mauritius was carried out by Lallmahamood (2014). According to him, Islamic banks face the risks of surplus liquidity and also run the risks of being unable to fund their financing commitments and to meet demand for withdrawal of deposits. This is due to the lack of Sharīʿah-compliant liquidity instruments and inter-bank deposits and the less developed Islamic banking infrastructure in Mauritius. Because of the non-availability of Sharīʿah-compliant money market instruments and lender of last resort, Islamic banks are likely to face significant risks. Nonetheless, with Mauritius being a member of IILM since 2010, institutions offering Islamic financial services now have the option to subscribe to the IILM's short-term *ṣukūk* to address liquidity management issues.

Another challenge pertains to the lack of qualified Sharīʿah scholars well versed in Islamic banking and finance in the country, which may hamper the promotion and acceptance of Islamic banking products and services. There is also a shortage of professionals in the Islamic finance industry. Education and training are lacking, and no university in Mauritius offers a course or module in this discipline.

On the legal aspects, the enforceability of terms and conditions of Islamic finance contracts depends on the governing law of the country. In Mauritius, there is no precedent how a specific case or default will be handled. This adds to the legal risks of an Islamic bank operating in Mauritius as the contracts are new, not well understood and not yet tested in courts.

A new Islamic bank would further have to face heightened competition from well-established conventional banks that have over time built a good reputation and a pool of established clientele. These will act as a barrier to entry for a newly established Islamic bank. Moreover, Islamic banking windows of conventional banks have several advantages over full-fledged Islamic banks as they have less operating expenses and capital expenditure (Lallmahamood, 2014).

It is a fact that the lack of Sharīʿah-compliant highly liquid assets and the absence of Sharīʿah-compliant deposit insurance schemes for liquidity management tend to force many Islamic banks to hold a higher share of cash, which affects their profitability (Kammer *et al.*, 2015). This is very relevant to the Mauritius context, and Islamic banks would have to face this challenge and at the same time be competitive in the market.

Technology start-ups challenge financial institutions by promising their customers faster, cheaper, more convenient and innovative financial services. Currently, only a few start-ups that claim to offer Islamic financial services have become operational, but their number and size are expected to grow (IFSB, 2017). Conventional banks and Islamic banks in Mauritius will have to address the fintech challenge for their growth and survival.

Conclusion

This study has tried to fill the gap in the empirical literature on the setting up of an Islamic retail bank in a Muslim-minority country. The research aims to identify the main prospects and challenges in setting up an Islamic retail bank in Mauritius. The preliminary findings of the research have unveiled many prospects and challenges that will be put to test through an on-line survey questionnaire and semi-structured interviews.

Preliminary findings suggest that an Islamic retail bank in Mauritius would be beneficial for Muslims and non-Muslims. An Islamic retail bank could serve the local retail market by providing savings and investment products, consumer financing, business funding and housing finance. The other opportunities are enabling legal, fiscal and regulatory framework, the financing of SMEs and the issuance of *ṣukūk*. However, it faces many issues and challenges. One main issue is that the new banking institution would have to work in a conventional environment and face Sharīʿah issues related to monetary policy. Other issues and challenges relate to awareness and financial literacy, perception of customers and lack of Sharīʿah-compliant liquidity instruments and inter-bank deposits, lack of knowledge and understanding of Sharīʿah-compliant products and the enforcement of Islamic contracts in court. Besides, innovation in fintech will surely disrupt the way business is done, and the new Islamic banking institution would have to adapt accordingly.

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