Malaysian and Indonesian Corporates Engage with Islamic Finance

Lachlan Colquhoun, East & Partners Asia - *26 January 2015*

The rise of Sharia finance, and in particular the growing popularity of sukuk bonds issued by sovereign entities, has been a well documented story, but to what extent has Islamic finance been embraced by corporates in Muslim countries?

The increasing penetration of Sharia products among Malaysian and Indonesian corporates was the focus of a recently-published inaugural report by East & Partners Asia (E&P Asia). The results of this research were highly enlightening and lifted the lid on a segment of Islamic finance ignored before now.

The report showed the extent to which private corporates in both countries are increasingly turning to Sharia products as part of their funding mix and delivered some surprising results on the drivers for that change. Although both deeply Muslim communities, finance - as ever - is not just a religious issue, but is driven by a whole range of factors from official sanction through to cost.

E&P Asia interviewed just over 1000 corporates in both countries, and these extended from small and medium-sized enterprises (SMEs) through to the top Institutional businesses in both countries. Malaysia's Bank Negara has published a forecast that Sharia compliant financial assets in that market will grow to represent around 40% of all financial assets by 2020.

Current Sharia compliant assets in Malaysia are estimated at US$130bn, representing around one fifth of total banking assets. To make Bank Negara's target will require the participation not just of sovereign agencies, but the country's private sector as well. Penetration in Indonesia has not been as high, with Sharia assets at around US$20bn, although there has been a significant acceleration over the past decades.

The research confirmed that Malaysian corporates are significantly more engaged with Sharia products than their counterparts in Indonesia. This was particularly the case among the larger institutional businesses in Malaysia, which are most engaged of all segments across both countries. While Indonesian corporates hold, on average, more total bank debt, Sharia compliant debt comprises a greater percentage of the debt held by private Malaysian companies.

The gap between Sharia penetration between the countries is expected to grow sharply over the next year, with Malaysian volumes forecast to growth the more rapidly of the two. Much of this growth will come from businesses replacing conventional western style finance with Sharia compliant products. Forecast Malaysian 'conversion rates' are generally two times higher than the levels planned by Indonesian corporates.

Malaysian corporates, for example, report that they plan to convert around one quarter of their conventional bank lending and outstanding bonds into Sharia compliant forms within the next year.

Debt the Main Driver

For corporates in both countries, the Sharia story is much more about debt than it is about equity, where the penetration levels are at around 5% or below. The differences extend to the competitive dynamics of the market. In Malaysia, for example, Islamic units of major global banks are prominent providers of Sharia products to corporate Malaysia. Indonesia, by contrast, is more dominated by specialist Islamic providers with no links to conventional banks, either local or global.

Where wallet share - or the percentage of a customer's spend which goes to any one provider - is increasingly fragmented in terms of conventional finance, wallet share in Islamic finance is tighter, with clients more loyal to their providers. This is particularly the case in Indonesia, where a primary provider can expect to receive around 90% of a customer's wallet.

In terms of the drivers for engagement, it might come as a surprise that religious motivation is not the largest factor. Across the two markets, cost savings are the leading motivating factor, followed by liquidity, service, and finally by religious drivers.

Providers are spending more 'face time' with clients in explaining the benefits of Islamic finance, and product ranges are expanding. These are key factors in developing momentum for the uptake of Sharia products, particularly in Indonesia.

The research also charted customer satisfaction, which was high enough across most attributes - although providers were marked down for pro-activity and innovation. Providers in Malaysia would seem to be more in tune with the market, with customers more satisfied on attributes they rated as having higher importance.

Although the momentum to Islamic finance is strong, there are still barriers. Complexity, compliance and consistency feature large in corporate responses to questions on barriers and hurdles.

Nevertheless, the push towards Islamic finance for corporates in both South-East Asian nations is inexorable. A combination of official encouragement, particularly in Malaysia where Bank Negara has positioned itself as a champion, combined with the universal driver of cost means that the uptake is largely to increase, and the product range will widen.

Another certainty is that competition will intensify. With larger and larger volumes moving into the Sharia compliant world, it can be sure that the market will attract the global players, who will bring the same fierce competition to the Sharia markets as they do to others around the world. Back to top