Chapter 5

Islamic Banking in North Africa: Emergence, Growth, and Prospects

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ABSTRACT

Investors from North Africa are interested in financial products with ethical focus and specific risk profile and are in accordance with their religious convictions. This chapter reviews the status of Islamic banking (IB) in North Africa in which the governments have started introducing fundamental legal and regulatory frameworks to promote the development of Islamic finance. The study also discusses the prospect of Islamic banking in these jurisdictions. To fulfill the objectives of the proposed study, a qualitative research was performed. The empirical approach of this study analyzed the financial position of different banks in North African countries. Overall, Islamic finance can be an ideal opportunity for financing infrastructure and development projects in North Africa.

INTRODUCTION

Since its inception, Islamic finance has steadily developed in the Muslim and non-Muslim globe. Therefore, its principles, the respective values of Islam, can have a universal vocation. Particularly Muslims customers need financial solutions that are in accordance with Shari’ah. After the subprime crisis, the Islamic finance industry has experienced a period of evolution and progress. Several factors positively affect the growth of Islamic finance, which can have a significant effect on a continent’s economic trajectory, such as population growth, raised consumer spending power, and the prevailing place of Islam in a continent’s demographic.

To date, the Islamic banking continues to be the important sector in the finance industry (Thomson Reuters, 2016b). So including traditional banks with Islamic windows, total Islamic banking represents approximately 75% of total Islamic financial assets.

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Islamic finance is based on five pillars: three prohibitions and two injunctions.

Briefly, the prohibitions are as follows: (i) *Riba* (interest or usury); (ii) *Gharar* and *Mayssir*, meaning undue uncertainty which refers to excessive risk-taking or hazard (due to asymmetric information); (iii) The banning of funding and trading in transactions and products considered as illegal or impure (such as alcohol, gambling and pork). However, the injunctions (or obligations) included Sharing profits and losses (PLS) between all economic parties and the “Asset-backing” principle according to which financial operation should be associated with real economic operation.

The Islamic financial system operates in ways that are different from the logic of conventional finance and require respect for the ethical principles of *Shari‘ah*, which result in an Islamic banking intermediation different from conventional ones.

According to Rafik Al Masri (1995): “Islamic banks must not only condemn usury (*Riba*) but must apply Islam in all its orders and prohibitions, in its fields of activity”.

The liability and asset structure of an Islamic bank based on different functions and services provides an overview of its activities and intermediation capacities.

Islamic financing instruments are generally structured in two categories: equity techniques founded on the principle of profit and loss sharing (PLS) (*Musharakah* and *Mudarabah*) and trade finance techniques (*Murabahah*, *Istisna*, *Salam* and *Ijara*). Banking activity presents specific risks as a result of the specific structure of banking assets and liabilities (Khan & Ahmed, 2001; Sundararajan & Errico, 2002; Iqbal & Mirakhor, 2011).

The traditional methods of Islamic finance, namely the *Mudarabah* and *Musharakah*, are similar to the principal-agent model. According to Chapra (2007), financial intermediation based on the PLS principle is a different model from traditional intermediation. According to this structure, Islamic banks act as agents when they collect deposits (investment accounts) and play the role of principal when they lend on a PLS basis.

The Islamic *Shari‘ah* does not prevent the existence of intermediaries who collect funds from savers and then place them with the entities that need them. Islamic banks must fully and effectively perform the specific functions assigned to them and maintain the specific characteristics of the Islamic financial system. It is widely perceived as a competing form of financial intermediation.

Actually, Africa represents the second-highest populated part of the globe. Thereby, the mobilization of both natural and economic resources as well as economic diversity is part of the efforts to enhance economic dynamism in the area. The demographic of Africa enables a great need for Islamic financial services and products. The growth momentum of Islamic finance in Africa is synchronized with the growing interest in Islamic finance on a global scale. Islamic financial sector in this region is expected to reach USD 6 trillion in assets in the perspective of 2020 on a global scale. The northern part of Africa covers Egypt, Libya, Tunisia, Algeria, Morocco and Mauritania. Islamic banking in this region has greater developing potential that should drive Islamic finance in Africa. This is due in part to the predominance of the Muslim community, and also to the history of Islamic finance that started in Egypt (Rafay & Farid, 2017). This Arab country has the longest history of modern Islamic bank in the North Africa since 1963, the establishment date of Mit Ghamr Bank, even if this region has an underdeveloped Islamic financial activity compared to the Gulf and Southeast Asia region. The Islamic finance outlooks in North Africa are not restricted to banking sector but also exist in microfinance and *Sukuk*. After Arab countries’ spring, development strategies must be amended and focus on the poverty reduction and the promotion of the microfinance. The Islamic finance is being more and more admitted as an alternative financing mode for economic expansion. Overall, Islamic microfinance contributes to satisfying the financing needs of the
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