Chapter 10
Determinants of Islamic Banking in Africa: An Econometric Analysis

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ABSTRACT

The global financial crisis of 2007-2008 depicted that conventional banking has many weaknesses. Hence, there has been much debate on the strength of Islamic banking to confront such crises. There are various advantages of using Shari’ah-compliant financial products pointed out by researches. Moreover, people who abide by their religious belief are mainly those who demand such financial services. But research relating to the determinants of Islamic banking is scant. This chapter examines the determinants of Islamic Banking in Africa over the period 2005-2018. The result shows that if the share of the Muslim population is high compared to other religions, Islamic banking is better diffused. Furthermore, important determinants of Islamic banking obtained from the results are the growth rate of the country and the extent to which the financial system is developed. Interestingly, it is observed that interest rate affects the diffusion of Islamic banking as it represents an opportunity cost.

1. INTRODUCTION

In 2017, there are at least 1,389 full-fledged Islamic financial institutions and windows offering in the Islamic finance industry. Also, out of the industry’s total assets, Islamic banking accounted for 71%, or US$ 1.7 trillion in the same year. This share is seen to keep growing as there are major mergers and acquisitions which is being formed in the major markets such as Malaysia and the Gulf countries (GCC). Another innovation in this field is the application of technology to renovate the Islamic banking sector. Several digital-only Islamic banks are being launched which is seen as a major breakthrough in this sector. Such innovation will definitely help the basic traditional Islamic banks to enter other countries mainly in the regions of Europe or Africa.

DOI: 10.4018/978-1-7998-1611-9.ch010
The diagram in Figure 1 clearly shows the increasing growth in global Islamic finance assets. Given favorable economic conditions, the global IFSI has grown significantly and the industry’s assets have exceeded USD 2 trillion. Consider Table 1.

Referring to Africa, it is recognized to be a region that will record tremendous growth in Islamic banking, as many conventional banks are opening Islamic windows. More so, such development is supported by the different African countries government. One of the fastest growing segments of the financial market industry comprises of Islamic finance and the Shari’ah-compliant financial products that form the core of Islamic banking. More so, these products also form the important part of Islamic Banking. (Čihák & Hesse, 2010).

While both Islamic banking and conventional banking are important, Islamic banking is now expanding on a larger scale to become a market that could compete with the conventional banking in many countries. Islamic banks are highly considered as a substitute to conventional banks in Islamic countries and countries with a percentage of Islamic population. Many countries are adopting full fledged Islamic banks and if not, the conventional banks have launched Islamic windows with important amount of Shari’ah-compliant financial assets.

Islamic banking is seen to grow massively in Africa. Assets related to Islamic banking is seen to increase by 10 percent in the future in total African banking assets (Moody’s). For instance, Sudan register 100 percent Islamic banking assets while Djibouti has 20 percent of Islamic banking assets. In total there are at least 80 Islamic financial institutions in Africa with the greatest number in the north of Africa mainly in Sudan. Nigeria, Senegal and Kenya have implemented banking, legal and regulatory frameworks to boost growth in their Islamic banking sectors. Moreover, there are a number of well-established conventional banks across Africa which have Islamic windows in which Shari’ah-compliant products are provided. These include Absa Bank of South Africa, Ecobank Chad and Sterling Bank Plc of
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