

SMEs and Islamic Modes of Financing

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The importance of SME's in the industrial development of Pakistan

- SME's constitute nearly 90% of all enterprise in Pakistan
- Employ 80% of non-agricultural labour force
- 30% contribution to GDP

What do SME's need at a macro level:

- The creation of a conducive and enabling regulatory environment
- Development of industrial sectors
- Provision of Business Development Services to SME's in all areas of business management

Source: SMEDA

... in addition SME's need to find a way to become bankable to facilitate expansion ..



Constraints of SME's

- Unlike large enterprises in the formal sector, SME's are constrained by financial and other resources. Banks account for only 7-8% of the funding requirements of SME's
- This inherent characteristic of an SME makes it imperative that there should be a mechanism through which it may get support in different functions of business including technical upgradation, marketing, financial and human resource training and development



The suitability of Islamic finance for SME's

- Islamic finance is an ideal solution as it is either asset based or equity based – both types contribute to productive use of assets
- Islamic banking has a greater propensity of involvement in SME's therefore the support functions are more readily available
- Islamic finance encourages risk sharing and partnership which make SME's a natural fit

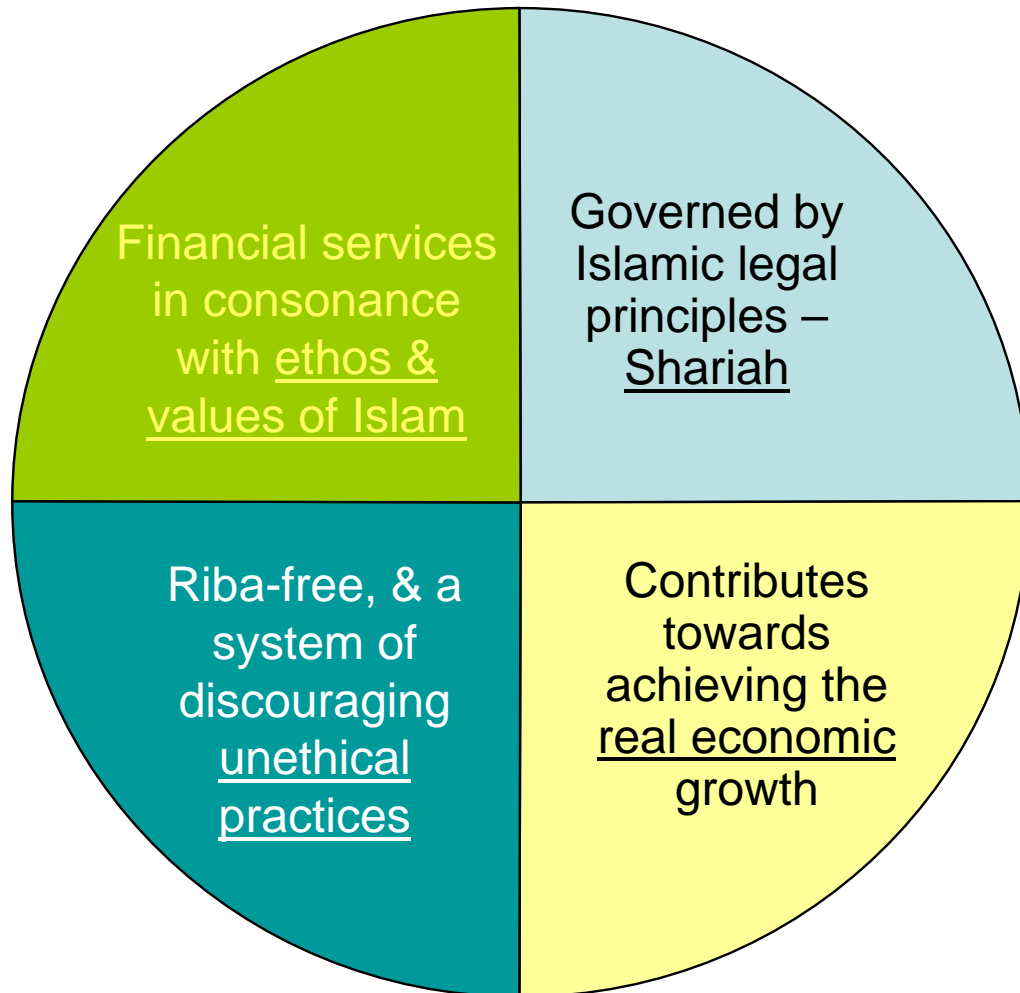


Introduction:

1. Islamic Finance
2. About Emirates Global Islamic Bank



What is Islamic Finance?





The impact of Islamic Finance

Shariah Prohibits ...	Encourages ...	Impact
Increase of money on money (Riba)	Trade / Exchange of commodity	Real economic growth / Equitable distribution of wealth
Uncertainty (Gharar)	Transparency	Awareness of rights and obligations
Injustice (Zulm)	Fairness	No exploitation
Risk-free return	Equity participation / PLS	Sharing of risk and reward
Financing Haram activities	Shariah compliant business	Community development



The differentiation

CONVENTIONAL BANKING

1. Finance based
2. Cash backed
3. Lender, borrower contract
4. Interest / prohibited activities based investments
5. Profit from customer penalties

ISLAMIC BANKING

1. Faith and finance based
2. Asset backed
3. More of a Partnership
4. Halal investment avenues
5. Penalties chanalized to Charities



Islamic Banking Industry - Pakistan

DEPOSITS
Rs. 124 Billion

ASSETS
Rs. 178 Billion

FINANCING
Rs. 114 Billion

MARKET SHARE
3.6%

GROWTH
100%+ P.A.

SBP VISION

“12% by 2012”

Approx. Rs. 600 Billion



About Emirates Global Islamic Bank (EGIBL)

- Commenced operations in Feb. 2007
- Sponsored by Emirates Investments Group Sharjah, UAE and Al Rajhi family, Saudi Arabia
- Shariah Committee:
 - Justice Khalil-ur-Rahman Khan
 - Mufti Abdullah Siddiqi
 - Mufti Ehsan Waqar
- Services: Retail, SME, Corporate & Investment Banking



EGIBL's Business Priorities

- Primary focus on SME's, Agriculture and Consumer Finance
- Target segments are middle markets (small to medium ticket size)
- Branch expansion is focused towards small towns and rural areas

EGIBL is gearing up to become a major player in the SME sector

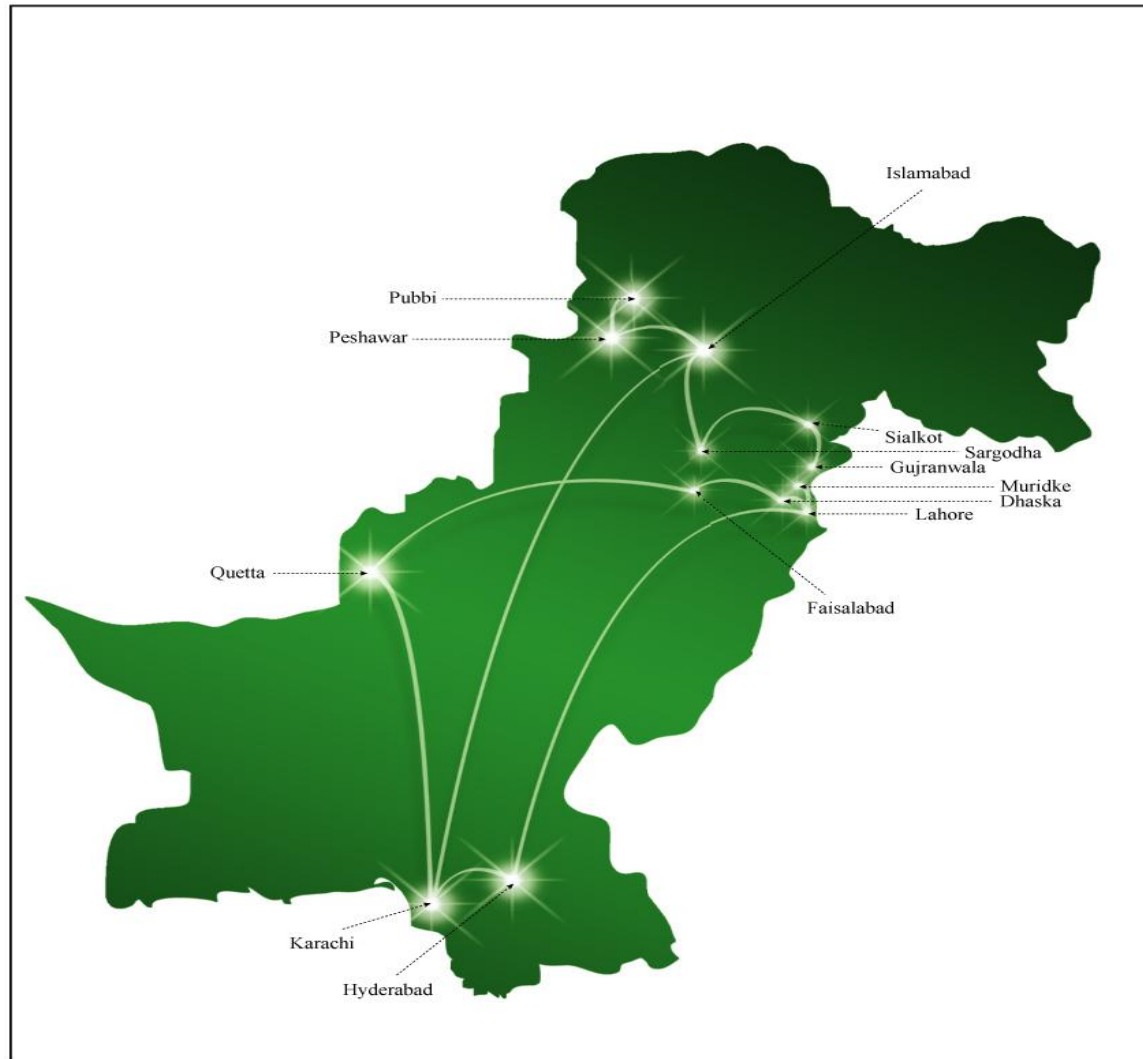


Branch Network

25 branches, 13 cities

... and growing

1. Karachi (7)
2. Hyderabad
3. Quetta
4. Islamabad (2)
5. Lahore (5)
6. Faisalabad
7. Gujranwala
8. Sialkot
9. Sargodha
10. Peshawar (2)
11. Pubbi (Rural, NWFP)
12. Daska (Rural, Punjab)
13. Kamoke (Rural, Punjab)





Islamic Modes of Financing

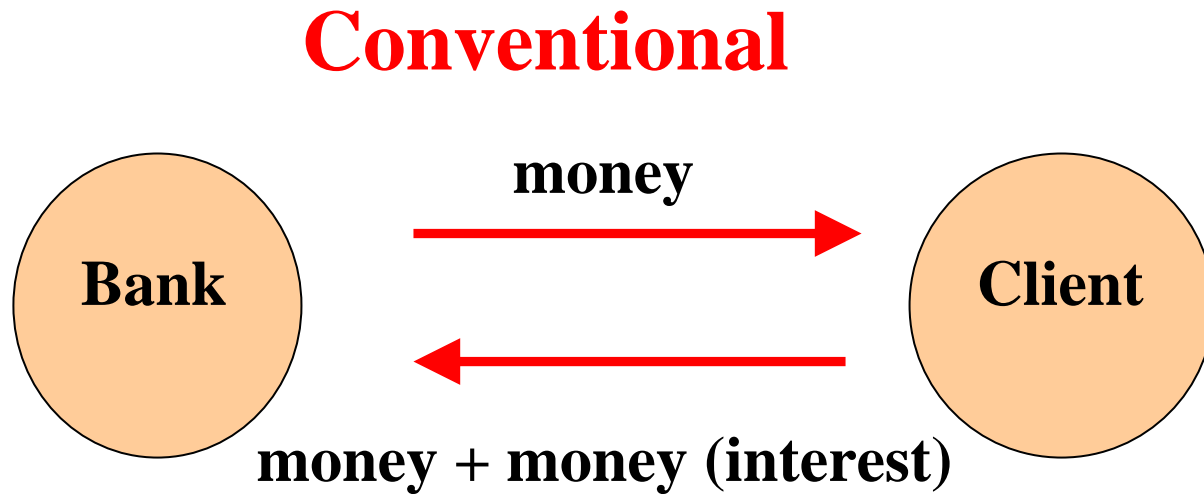


Islamic concept of ‘Loans’

- Loan (*Qard*) can only be interest free i.e. the borrowing and repayment amount should be exactly equal
- Loans are given with the intention of helping and not profit making
- If the debtor is unable to repay, waiver of such loan is advisable

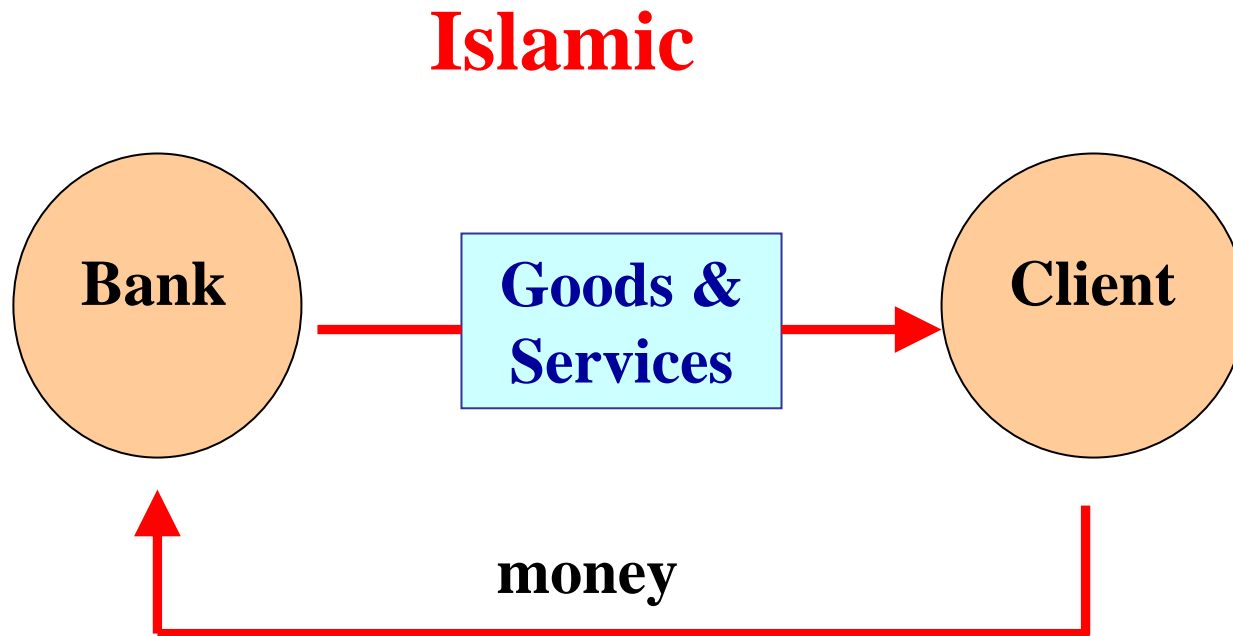


Conventional Financing / Lending





Islamic Financing





Islamic Modes of Financing

Profit & Loss Based

- Mudaraba
- Musharaka
- Diminishing Musharaka

Trade Based

- Murabaha
- Salam
- Istisna

Lease Based

- Ijarah



Profit and Loss based modes:

Mudaraba

- A partnership in profit between capital (Bank) and efforts (entrepreneur).
- Profit is shared on pre-determined ratios
- Loss is borne by the investor, the entrepreneur goes unrewarded

Application

- Financing of imports against L/Cs
- Export refinance
- Participation Term Certificates



Profit and Loss based modes:

Musharakah

- **Permanent Musharakah:** Partnership / equity financing: Bank and customer will jointly invest and share both risks and rewards in the venture
- **Diminishing Musharakah:** Whereby one partner periodically buys the other partners share in ownership as per pre-agreed terms.

Application:

- Joint ventures
- Property / House finance
- Fixed asset Finance



Trade based modes:

Murabaha

Sale of a commodity at cost plus a fixed profit rate on deferred payment basis

Application:

- Tangible goods financing
- Working capital / raw material financing on a short term basis



Trade based modes:

Salam

Sale of a homogeneous commodity through full advance payment against deferred delivery

Application:

- Agriculture Financing



Trade based modes:

Istisna

An agreement for heterogeneous processed goods allowing cash payment at spot, deferred or in advance (in lump sum or as per agreed schedule) and future delivery

Application:

- Construction project finance
- Manufacturing
- Export finance



Lease based modes:

Ijarah

Islamic alternative to the conventional operating lease.

Application:

- Long and medium term fixed asset financing



Challenges for Islamic Finance

- A paradigm shift from trade based modes of finance to partnership based modes of finance is required
- Training of Islamic bank staff to enable them to work with their clients as business partners
- Educating the customer about the Shariah requirements