GATEWAY's Newsletter

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Sharing our in-depth understanding of Islamic markets and principles with the belief that business is most successful when principles guide profit

Blockchain will reshape industries and transform the way organisations manage data

CONTENT

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BLOCKCHAIN: BEYOND THE HYPE

Over the past couple of years, blockchain technology has attracted a lot of attention in the business world. But what makes blockchain so important? Why will blockchain potentially reshape industries and transform the way organisations manage data?

It's important for business leaders to understand the key aspects of the technology that make it so unique and transformative. Blockchain is often described as a distributed ledger or a database of transactions without a single authority. Although technically correct, it's not the strongest case for blockchain as there are far better and faster ways to log transactions than, the existing first generation of blockchain technology.

What truly makes blockchain so valuable is linked to how records are added to the database; 1) The blockchain is a network of computers that store and verify new records instead of a single computer or server, 2) every transaction is linked to the previous transaction, creating complete traceability, 3) it is a peer-to-peer network with no single 'controller' making the rules or having the ability to change the data or record of transactions.

These key factors make the data on the blockchain immutable and impartial. The data is shared among the parties either publicly or privately and cannot be changed or manipulated by anyone. With the blockchain you, your suppliers, partners and clients can completely trust the data. Reputation is nothing more than the result of past transactions. The blockchain enables the logging of all transactions securely and transparently.

Organisations in an increasingly competitive digital world, can leverage the blockchain to improve reputation and confidence among all their stakeholders.

FINANCIAL LITERACY FOR SUCCESS

There is a growing trend towards inclusion of financial literacy as part of school curriculum for K-12. *'Financial literacy is 'a combination of awareness, knowledge, skill, attitude and behaviour necessary to make sound financial decisions and ultimately achieve individual financial wellbeing.'* Organisation for Economic Co-operation and Development (OECD).

While there is much research done on the need for financial literacy, there is very little academic research on the effectiveness of such financial literacy programs.

However, there are several books written and programs developed by individuals and based on what worked for them that has also proven to have helped and influenced many with financial freedom. These books and programs highlight the negative impact of debt, movement towards entrepreneurship, power of generosity in wealth creation, daily habits to practice spirituality, the importance of a service attitude and impact, and the role of a growth mindset backed by faith and belief. The lessons and recommendations these individuals share is a list too long to recreate here but generally what describes a lot of features of an Islamic Economy.

While the academia will take time to catch up, what we know with certainty is that Financial Literacy programs cannot be limited to knowledge and skills of managing personal finance. It should take a holistic approach that not only aims to equip the students with the required financial knowledge and intelligence but also reflects the values and attitude towards money and wealth drawn from what has worked for those who are successful. The purpose of the program should instil the mindset to Dream Big and chase after their dreams while building healthy habits around physical and mental health, faith and relationships. It should nurture little minds towards a sustainable development of our world.

POINT OF VIEW

WHAT FUTURE ISLAMIC BANKING?

Has that great experiment of the 1970s and 1980s now run its full course? Was it ever really possible to marry-up notions of "banking" with a religion that prohibits a fundamental of banking: *interest?* What was the religious basis that underpinned Islamic banking? There are no references to "Islamic banking" in Qur'an and Sunnah.

"… the chickens have come home to roost and the whole banking model is now looking decidedly shaky."

When we were writing the national banking law of a certain Arab country at the turn of the millennium, we deliberated very carefully about what exactly a "bank" is and consulted many academic treaties on the subject in order to find a working definition. As much as we tried to twist the rules to accommodate "Islamic banks" it was clear that a bank had two prime characteristics: (i) it took *deposits* (<u>not</u> investments like mudaraba) from the public and (ii) it *loaned out* that money (<u>not</u> purchased commodities for re-sale to customer) *with interest.* That's classic banking: deposits on the liabilities side of the balance sheet offset by loans on the asset side. It was obvious to us that what Islamic bankers were doing was not "banking". So, after referencing taking deposits and making loans in the law, it became necessary to write a few extra ambiguous words: "and Islamic banking" – frankly it was compromised legal-drafting because we could not make Islamic banks look and behave like banks.

Fast-forward nearly twenty years, the chickens have come home to roost and the whole banking model is now looking decidedly shaky. Here are just a few of the problems that arise when you try to squeeze the 'square peg' of Islamic banking into the 'round hole' of riba-banking:
(i) enormous regulatory constraints are imposed, particularly bank's obligations to comply with the capital adequacy rules under Basel III. These make the costs of the banking model extremely unattractive for Islamic banks;
(ii) many Islamic banks are under-capitalised compared to their longer-established riba-earning counterparts. This means their potential to compete with larger institutions on pricing (even on matters like innovation, customer service, branch networks, etc) is severely curtailed;
(iii) depositors who want investment-type products (such as mudaraba) may be better placing their monies with collective investment schemes operated by fund and asset managers. According to AAOIFI rules, unrestricted mudaraba holders at banks are quasi-equity owners and do not even have the protection of being ordinary unsecured creditors;
(iv) depositors who want safekeeping arrangements (equivalent to wadiah) should ask themselves whether Islamic banks, with weaker balance sheets and often subject to precarious cross-shareholdings, are particularly "safe". Are their deposits covered by an adequate deposit protection scheme?
(v) post-2008, the "bank" label has suffered considerable reputational damage. Although arguably Islamic banks performed better than riba-earning banks during this period, the value of being called a "bank" has diminished significantly in the public eye;
(vi) the rapid growth of fin-tech solutions and virtual operations means the traditional "bricks and mortar" banking citadel is now somewhat outdated, unnecessarily expensive and will probably not be attractive to younger generations.

We believe absolutely in the value of finance being provided according to Islamic precepts – we have never questioned this - but we do sincerely question whether the concept of "Islamic bank" is the right approach to providing Shari'a-compliant finance? It has to be said, the prognosis does not look good.

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