

# **The Power of Synergy: How Islamic Banking Drives the Advancement of Halal Industry**

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To support the implementation of Halal Industry Master Plan 2030 (HIMP 2030), Islamic finance, along with halal traceability services, talent development/upskilling services, standards, accreditation and certification services, and logistics services, has been identified as one of the key enablers through its innovative Islamic financing structures. It is said in the HIMP 2030, which was developed to catalyze Malaysia's strength towards the development of her halal industry holistically, that the domestic halal market growth is estimated to reach US\$113.2 billion, while the global halal market is expected to grow to US\$5.0 trillion. The report documents that Malaysia is endowed with a competitive advantage to fully capitalize on this timely opportunity given her comprehensive halal ecosystem. Moreover, the plan also emphasizes the roles of Islamic finance as facilitator of funding to encourage quality; high-performing home-grown enterprises; innovative and competitive halal industry offerings; and induce balanced, inclusive, and sustainable socio-economic growth, essentially to help Malaysia achieve her Vision of becoming global leader of the halal industry.

# HOW ISLAMIC BANKING DRIVES THE ADVANCEMENT OF HALAL INDUSTRY



## Working capital financing options

Offer various working capital financing options, such as Ijarah, Murabaha, bay' al-Istisna, bay' Salam, etc. to help assuage working capital problem



## Working capital financing options

Use equity participation modes to become partners in limited halal businesses by providing them with capital and expertise to foster their growth



## Align banking, zakat, and tax goals

Offer corporate internet banking platforms for managing payables and receivables, including zakat payment capabilities and tax planning advisory services



## Financial support for halal certification

Offer financial support to halal businesses, especially halal SMEs, to cover the costs of obtaining halal certification



## Streamline payroll and payments

Simplify payroll and payments for halal businesses by offering tailored salary accounts and related services



## Facilitate international market access

Facilitate international market access through various mechanisms for international transactions

On this basis, the synergistic effect of Islamic finance and halal industry has been amplified by a multitude of discerning individuals and relevant institutions. Notably, the former Deputy Finance Minister, Datuk Mohd Shahrir Abdullah, in his keynote address at the launch of the report "Islamic Finance and the Development of Malaysia's Halal Economy" on October 3rd, 2022 emphasized that the development of halal industry requires the integration of Islamic financial products and services. With its diverse range of financial products and services, there is no doubt that Malaysia's highly developed Islamic finance market is indeed crucial for the development of halal industry. In fact, when one retrospect and think about the agony of suspense within which many halal businesses found themselves during the Covid-19 pandemic, one will come to the term that the synergy between Islamic finance and halal industry is indeed crucial now more than ever. Interestingly, this claim is supported by Quranic 5 verse 2, where Allah Says, "And cooperate with

one another in goodness and righteousness, and do not cooperate in sin and transgression. And be mindful of Allah. Surely Allah is severe in punishment."

### **How Islamic Banking drives the advancement of halal industry**

Islamic finance has been contributing to the expansion of halal industry with the aim of exposing halal businesses, especially those that are unaware, to numerous opportunities currently available with Islamic finance. In truth, the promoted synergy between Islamic finance and halal industries is mutually beneficial, since Islamic banks, which prohibit the charging of interest and investment in haram (forbidden) businesses, ensure the flow of surplus funds into productive investments found throughout the value chain within halal industry.

Islamic banks have been contributing to the advancement of halal industry by providing access to shari'ah compliant financing of working capital and cash flow management, investing in halal businesses, helping aligning banking, zakat, and tax goals, streamlining payroll and payments, supporting halal certification, collaborating with halal industry stakeholders, and facilitating international market access.

### **Working capital financing options**

One of the prevalent challenges facing halal businesses, especially halal SMEs, is the working capital problem. To help assuage this problem, Islamic banks offer various working capital financing options, such as *Ijarah*, *Murabaha*, *bay' al-Istisna*, *bay' Salam*, etc. These financing options also help halal businesses with the necessary liquidity to manage their cash flow effectively. Specifically, Islamic banks offer *Murabaha* financing, also known as cost-plus-profit arrangement, where assets or goods are purchased and sold to them at an agreed-upon prices, including a profit margin, without having to pay interest. Halal businesses are, therefore, allowed to repay in installments, thereby creating necessary working capital to procure inventory or equipment. Islamic revolving financing, such as Islamic overdrafts or Islamic lines of credit, is also

offered by Islamic banks to help halal businesses meet their working capital needs. *Bay' al-Salam*, also known as forward sale contract, where Islamic banks agree to purchase certain goods from halal businesses at the time of contract with upfront full payment so that the proceeds can be used to meet their working capital needs.

Islamic banks also offer *bay' al-Istisna* to enable halal businesses to acquire, construct, or manufacture assets/properties by providing progressive payments, allowing them to access working capital needs. Islamic banks have also initiated Islamic supply chain finance, including Islamic factoring or Islamic reverse factoring, through which halal businesses are supported in managing their cash flows along the supply chain. With respect to invoice financing, invoice financing solutions, such as *Tawarruq*, are offered by Islamic banks to enable halal businesses convert their outstanding invoices into immediate cash where the bank purchases the invoices from them at a discount and pays them upfront, providing immediate liquidity to manage cash flow requirements under *Tawarruq* arrangement. Also, Islamic trade finance, such as Islamic letters of credit and Islamic trade guarantees, is also available to facilitate halal businesses' import and export activities, thereby providing necessary working capital support to help halal businesses cover the costs of goods and ensure smooth trade transactions.

### **Investment mechanisms**

Though there are limited records of Islamic banks investments in halal business through equity participation modes, such as *Musharakah* (joint venture) and *Mudarabah* (profit-sharing arrangement), due to the risks inherent in them; nonetheless, Islamic banks use these investment contracts to become partners in limited halal businesses by providing them with capital and expertise to foster their growth and development. With *Musharakah* investment, the Islamic bank and halal business pool their capital and share profits and losses based on agreed-upon ratios. In the case of *Mudarabah* investment, capital is provided by the Islamic bank while halal business contributes expertise and effort, resulting in profits sharing based on predetermined ratios. Through these equity financing models, Islamic banks become strategic partners and

investors in halal businesses and as such, they share in both risks and rewards. Using these investment mechanisms, dedicated venture capital funds are set aside for investment in startups and emerging halal businesses, particularly to provide early-stage financing to innovative halal businesses.

In addition to equity financing, investment funds that are managed in accordance with shari'ah principles are also established by Islamic banks and dedicated to investment in halal businesses. These funds provide avenues for the interested individuals and institutions to invest in a diversified portfolio of halal businesses, such as those in food and beverages, cosmetics, pharmaceuticals, or Islamic finance itself. Similarly, Islamic banks have been facilitating the issuance of *Sukuk* to raise funds for halal businesses. *Sukuk*, which are also called Islamic bonds, represent ownership interests in an underlying asset or project, and the returns to investors are generated from the cash flows of the asset or project. Here, Islamic banks play a vital role in structuring and underwriting *Sukuk* issuances, allowing halal businesses to raise funds through capital markets for their expansion, infrastructure development, and other financing needs.

### **Align banking, zakat, and tax goals**

Islamic banks help halal businesses to align their banking, zakat, and tax goals. Islamic bank operations comply with shari'ah principles and ensure transparency, fairness, and ethical conduct. This suggests that engaging with Islamic banks will ensure that halal businesses' banking activities are compliant with shari'ah principles, thereby aligning their financial practices with their religious and ethical goals. They provide halal businesses with corporate internet banking platforms that offer robust and user-friendly interfaces for managing payables and receivables. Besides, Islamic banks also facilitate the payment of zakat, which is an obligatory charitable contribution in Islam. There are often dedicated zakat departments or units within Islamic banks that usually provide guidance on the proper calculation and payment of zakat. These departments, therefore, provide advisory services on zakat issues and ensure that halal businesses accurately fulfill their religious obligations. In addition, they also provide advisory

services and help halal businesses to navigate tax obligations in a shari'ah-compliant manner. Islamic banks do this by providing guidance on tax planning strategies that align with Islamic principles while, at the same time, ensuring compliance with relevant tax laws and regulations. As financial advisor to their halal business customers, Islamic banks provide avenues for halal businesses to meet with their bankers annually to discuss their plans for growth as well as to perform an annual account review in which Islamic banks evaluate halal businesses expenditures and identify areas for further improvement.

### **Financial support to cover the costs of obtaining halal certification**

Islamic banks provide financial support to halal businesses, especially halal SMEs, to cover the costs of obtaining halal certification. Islamic banks understand that certification expenses can be significant and offer financing options to assist them in meeting these costs. This support helps interested halal businesses to comply with halal standards and obtain the necessary certification. Moreover, Islamic banks often provide guidance and advisory services to halal businesses on the requirements and processes involved in obtaining halal certification. They similarly assist halal businesses to understand the necessary steps, documentation, and compliance criteria to meet halal certification standards. With their extensive networks and connections within the halal industry, Islamic banks often facilitate introductions, provide referrals, and assist halal businesses to navigate halal certification landscape. They help businesses connect with the relevant certification bodies, such as JAKIM, enhancing the certification process, and fostering industry collaboration.

### **Streamline halal businesses' payroll and other payments**

Islamic banks also help to streamline halal businesses' payroll and other payments by providing salary account solutions tailored to the needs of halal businesses as well as a Wages Protection System (WPS) that ensures timely and transparent salary payments to employees, including fund transfers and payroll reports. This system enables halal businesses to accurately and timely

transfer employee salaries directly to their bank accounts, while maintaining transparency and compliance with labor regulations. In doing this, Islamic banks ensure that the payment processes adhere to Shari'ah principles by providing halal businesses with a convenient and compliant solution for managing payroll. They also provide support for electronic fund transfer facilities that allow halal businesses to receive payment electrically from customers, pay salaries, and transfer money to vendors or employees. With this electronic support, halal businesses are able to ensure faster and secure transactions, while at the same time reduce the administrative burden of holding much cash or physical checks.

### **Facilitate international market access for halal businesses**

Islamic banks play a crucial role in facilitating international market access for halal businesses through various mechanisms. They do this by providing trade finance solutions that help facilitate international transactions for halal businesses. These solutions include letters of credit, documentary collections, and trade financing facilities. By offering shari'ah-compliant trade finance services, Islamic banks enable halal businesses to import and export goods, manage international payment flows, and mitigate risks associated with cross-border trade. In addition, Islamic banks offer foreign currency services, such as foreign currency accounts, currency exchange, and hedging instruments, that allow halal businesses to manage their international transactions in different currencies. Islamic banks assist businesses in navigating currency fluctuations, minimizing foreign exchange risks, and ensuring smooth international financial operations. Beyond this, Islamic banks also provide advisory services to halal businesses seeking to expand their operations into international markets.

They offer guidance on market entry strategies, international trade regulations, foreign market analysis, and risk assessment. Islamic banks leverage their expertise and global networks to support halal businesses to identify opportunities, understand cultural nuances, and comply with international business practices. Furthermore, they play an active role in building networks, creating business matchmaking platforms, and facilitating collaborations between halal

businesses and their international counterparts. Islamic banks often establish investment platforms or funds that specifically focus on international halal business opportunities. These platforms attract investors seeking shari'ah-compliant investment options in the halal industry as well as to provide funding for halal businesses that intend to expand their international presence. In this case, Islamic banks act as catalysts by channeling investment capital into viable international halal ventures.

## **Conclusion**

Islamic banks have been playing a crucial role in the advancement of the halal industry, both in Malaysia and beyond. With their adherence to shari'ah principles and commitment to ethical and responsible banking practices, Islamic banks offer a unique value proposition that aligns with the principles and requirements of the halal industry. As discussed, Islamic banks provide vital financial support to halal businesses, helping them access capital for growth, expansion, and to access international markets. By offering diverse financing options, such as *Murabaha* (cost-plus financing), equity financing, investment funds, *Sukuk* issuance, *Ijarah* (lease), etc. Islamic banks have immensely help halal businesses to meet their funding needs and drive innovation, job creation, and industry development. Thus, their commitment to ethical finance, compliance with shari'ah principles, and focus on responsible and sustainable practices make them indispensable partners in driving the success and global expansion of the halal industry.