CHAPTER 2

Islamic Finance Country Index 2014

The Islamic Finance Country Index (IFCI) is a composite ranking that reflects the state of IBF in different countries. More importantly, it highlights the leaders in the industry. The IFCI was initiated in 2011 with the aim to capture the growth of the industry, and provides an immediate assessment of the state of the IBF industry in each country. It is also a means to compare countries in this sector. As more countries open up to IBF, the Index provides a benchmark for nations to track their progress against other nations. The IFCI shows the growth of IBF in an objective manner making it a useful tool for industry analysis and comparative assessments. It is the first, and only, index of its kind in the industry, and has proven to be very popular amongst regulators, analysts, researchers and industry players all over the world. For example, the Central Bank of Indonesia has quoted it on a number of occasions in various conferences.

IFCI ranks countries based on available information for different variables across each country in a manner that avoids any bias affecting the outcome.

Data

There are over 70 countries involved in Islamic finance in some capacity. However, due to limitations related to the authenticity, availability and heterogeneity of the data, we have only been able to rank 36 countries in the year 2011, 42 in the year 2012, 43 for the year 2013 and 42 for the year 2014. In all cases, the data has been collected from various secondary sources, including central bank websites, individual Islamic financial institution's published accounts, various agencies and national newspapers, and information portals like IFIS, Bloomberg and Thomson Reuters. Tables 1 and 2 evidences the eight variables used for IFCI 2014 together with their weights.

Weights

Data was collected on eight variables for 42 countries. The data was organized and coded to enable multivariate analysis and construction of IFCI using SPSS. The data was then tested to see if it contained any meaningful information to draw conclusions from. In order for factor analysis to be applicable, it is important that the data fits a specification test for such an analysis. The Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy is used to compare the magnitudes of the observed correlation coefficients in relation to the magnitudes and partial correlation coefficients. Large values (between 0.5 and 1.0) indicate factor analysis may be useful with the data. If the value is less than that, then the results of the factor analysis might not be very useful. For the data we used, we found the measure to be 0.85, which made it reasonable for us to carry out the factor analysis. Bartlett's test of sphericity is another specification test which tests the hypothesis that the correlation matrix is an identity matrix indicating that given variables are unrelated and therefore unsuitable for structure design. Smaller values (less than 0.05) of the significance level indicate that factor analysis may be useful with the data. For the purpose of IFCI 2014, this value was found to be significant (0.00 level) which means that data was fit for factor analysis. Factor analysis was run to compute initial communalities to measure the proportion of variance accounted for in each variable by the rest of the variables. In this manner we were able to assign weights to all 8 variables in an objective manner. By following the above method, we have been able to remove the subjectivity factor in the index as now the data speaks for itself, and the statistical method comes up with the weights. The weights used in IFCI 2014 are similar to IFCI 2013. These weights points to the relative importance of each constituent variable of the index in determining the rank of an individual country. Hence, it is natural to assume that countries which have a large number of Is-

VARIABLES	DESCRIPTION
Muslim Population	Represents the absolute number of Muslims living in a country
Number of Institutions involved in Islamic Finance Industry	Represents both banking and non-banking institutions involved in Islamic finance in a country
Number of Islamic Banks	Represents fully fledged Islamic banks in a country of both local and foreign origins
Size of Islamic Financial Assets	Represents all assets relating to the industry in a country
Size of Sukuk	Represents total outstanding sukuk in the country
Regulatory and Legal Infrastructure	Represents the presence of regulatory and legal environment enabling IFI to op-erate in the country on a level playing (e.g., Islamic banking act, Islamic capital markets act, takaful act etc.)
Central Shari'a Supervisory Regime	Represents the presence of a state-representative body to look after the Shari'a-compliancy process across the IFI in a country
Education and Culture	Represents the presence of an educational and cultural environment conducive to operations of the IFI (this could be formal Islamic finance qualifications, degree courses, diplomas, and dedicated training programmes)

Table 1: Description of Variables Chosen

VARIABLES	% Weights (2013)
Number of Islamic Banks	21.8
Central Shari'a Supervisory Regime	19.7
Number of Institutions involved in Islamic Finance Industry	20.3
Size of Islamic Financial Assets	13.9
Size of Sukuk	6.6
Muslim Population	7.2
Education and Culture	5.7
Regulatory and Legal Infrastructure	4.9

Table 2: Weights

lamic banks, a central Shari'a supervisory authority, and a number of institutions involved in Islamic finance will rank high because they have a high weightage in the index compared to other variables.

The Model

The model used for the IFCI index is as below:

$$\text{IFCI (Cj)} = \sum^{i=8}_{i=1} Wi.Xi$$

Where

C = Country
j = 1, 2, ..., 43
W = Weight for individual variable
X = Variable

With these minor changes in the data set, and resulting changes in the weights assigned to the variables used, the above model generated some interesting results. Exhibit 3 and 4 provide a comparison of the ranking of the countries for the years 2013 and 2014.

Analysis

It is the fourth consecutive year that the top three countries have remained unchanged, with Iran (1), Malaysia (2) and Saudi Arabia (3). Iran has an index value of 82, remaining the leading country across all the variables as its entire banking and finance sector is operating under Shari'a law. Total Islamic financial assets in Iran reached USD476 billion, the highest for any country. It is interesting to see that it is a country with the largest AUM yet it is a country which is ignored

by the industry. The media fails to capture developments, and showcase its experience and expertise in the field. Representatives from Iran remain limited at global conferences highlighting closed nature of the economy, much due to the sanctions imposed. Nevertheless, Iran has developed a very interesting domestic model which is helping its IBF industry to flourish without depending on the international market.

Malaysia is seen by and large as a leader in the IBF industry. Malaysia passed a new comprehensive law, the Islamic Financial Services Act Malaysia 2013, which came into force in May 2013. Malaysia with the strong support of Bank Negara Malaysia continues to develop strong independent brands including INCEIF, ISRA, and the most recent Finance Accreditation Agency (FAA) which aims to offer accreditation services to banks and financial institutions globally. Malaysia is also home to the highest number of sukuk issuances.

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	2014	2013	Changes
Iran	1	1	0
Malaysia	2	2	0
Saudi Arabia	3	3	0
Bahrain	4	6	2
Kuwait	5	7	2
United Arab Emirates	6	4	-2
Indonesia	7	5	-2
Sudan	8	9	1
Pakistan	9	8	-1
Qatar	10	11	1
Bangladesh	11	10	-1
Turkey	12	13	1

Table 3: Changes in Index Value

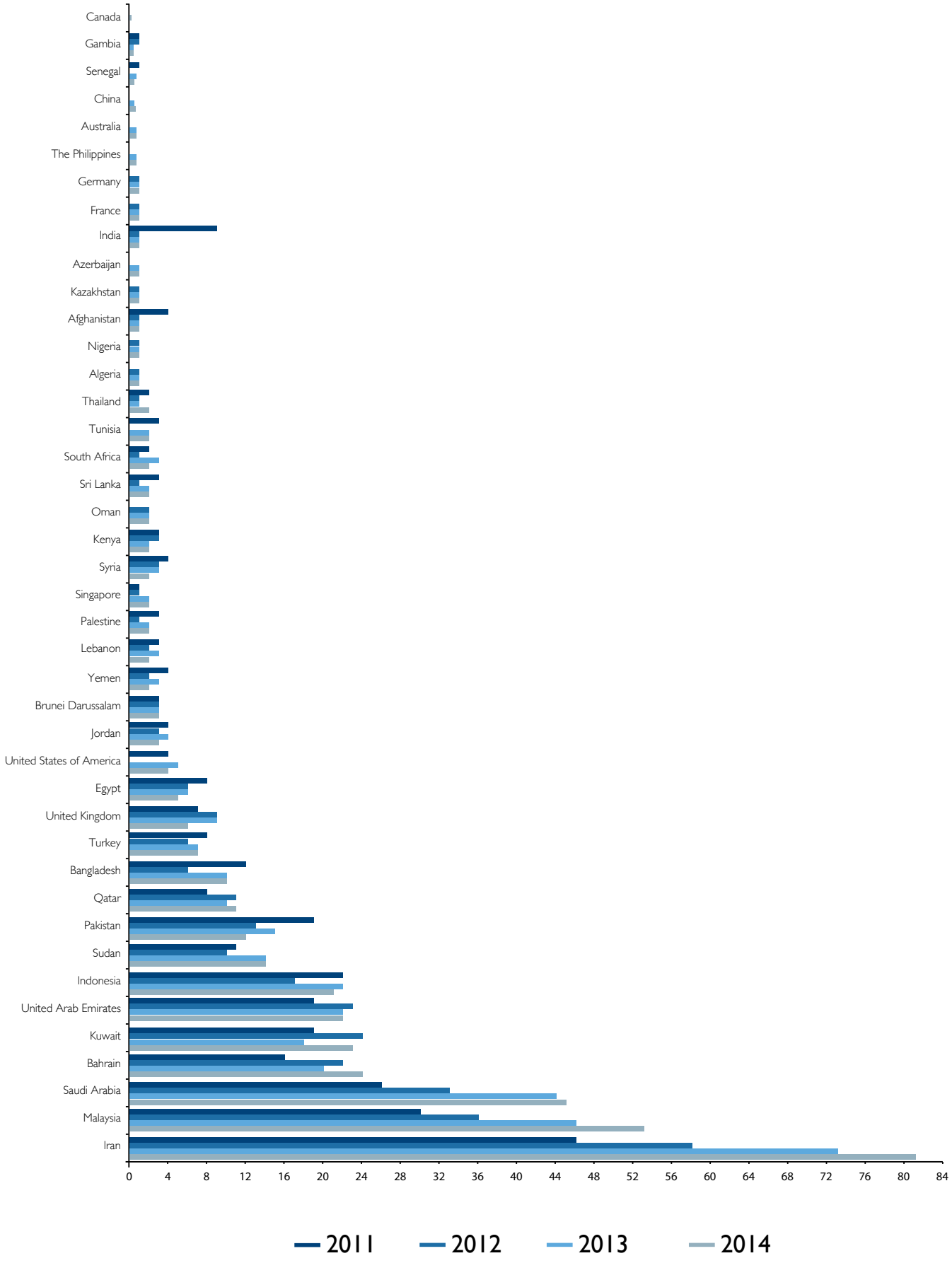

Figure 1: Index Value