IFN Fintech Survey 2022

From July to September 2022, over 200 Islamic fintech founders and CEOs were invited to share their forecasts and observations on the Islamic fintech industry as part of the annual Islamic Fintech CEO and Founder Survey. Responses came in from Europe, Southeast Asia, the Middle East, North America and Africa.

Key highlights:

- A majority of Islamic fintech leaders (92%) are optimistic, if not highly optimistic, about the growth opportunities for Islamic fintech despite challenging macroeconomic conditions, which some believe, have created new prospects for Halal digital financial and investment services.
- Malaysia maintains lead as most conducive Islamic fintech ecosystem; how other jurisdictions, particularly the UAE and Indonesia, have closed the gap significantly indicating growing maturity of the global Shariah fintech landscape.
- Access to funding remains the biggest challenge faced by Islamic fintech start-ups in scaling up, exacerbated by difficult market conditions driven by geopolitical upheaval, followed by regulatory barriers and a lack of Islamic finance literacy.
- Over two-thirds of start-ups surveyed intend to raise funding over the next 12 months.
- About 35% are seeking funding of at least US$5 million over the next year to fuel their expansion strategy.
- A majority (78%) believe investors hold Islamic fintech businesses in a positive light.

(Cautious) optimism runs high

Despite the world teetering on the edge of a recession amid persistent severe macroeconomic challenges, founders and CEOs of Islamic fintech companies are surprisingly bullish about the growth trajectory of their verticals, although this is not without concerns.

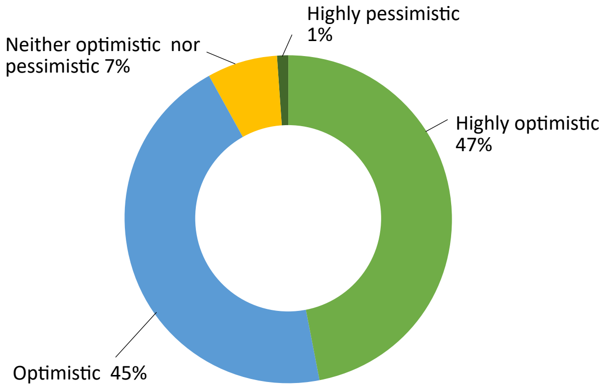
The lion's share (47%) are highly optimistic while 45% are positive that their sectors would continue to grow during the 2022/23 period. The sentiments are in line with industry projections — the global fintech market is expected to be worth US$332.5 billion by 2028, from US$112.5 billion last year, demonstrating a compound annual growth rate of 19.8% during the forecast period, according to Vantage Market Research.

The projections come amid record-high inflation and multiple financial crises in emerging and developing markets, which have forced the hands of central banks across the world to simultaneously raise interest rates, with a degree of synchronicity not seen in the last 50 years, according to the World Bank. Analysts believe rates will continue to hike well into 2023, but it may not be enough to tame global inflation back to pre-pandemic levels.

"Unless supply disruptions and labor-market pressures subside, those interest-rate increases could leave the global core inflation rate (excluding energy) at about 5% in 2023 — nearly double the five-year average before the pandemic," a World Bank study found.

"Global growth is slowing sharply, with further slowing likely as more countries fall into recession. My deep concern is that these trends will persist, with long-lasting consequences that are devastating for people in emerging market and developing economies," said World Bank Group President David Malpass. While still cautiously bullish, none of the respondents are disillusioned about the challenges that lie ahead, given a global economic downturn, trade disagreements and logistical challenges.

Chart 1: How optimistic are you on the growth of your sector over the next 12 months?



"Despite the ongoing challenges presented by the Ukraine conflict, we have a positive market outlook as the global economy exits the extremely difficult last two years," opined one UK-based director.

A fellow UK-based peer echoed a similar sentiment. "Every year is challenging in its own right. The challenge of the next 12–18 months is demonstrating product–market fit and setting the foundations for scaling up across market share, products and geographies."

"The next 24 months, the outlook for Islamic fintech is slight gradual growth in the GCC and ASEAN countries, but there is huge growth expected in Africa. Consumer and investor sentiments are still wait and see, and of caution," observed one Islamic fintech founder based in Malaysia.

An Australia-based practitioner shared: "The general outlook is to consolidate and apply survival mode at the moment, [and] meanwhile push for more innovation and productivity in order to battle the bear market and have access to funding opportunities that will help in the continuous growth of our business and the ethics we are eager to broadcast."

Most conducive Islamic fintech ecosystems — Indonesia edges forward

Last year, Malaysia was the clear winner when it came to being the most prefered destination for Islamic fintech, far outperforming its peers by a large margin — almost 40% of the survey respondents in 2021 singled out Malaysia as the most conducive Islamic fintech ecosystem, ahead of the UAE by almost 25 percentage points.

This year, however, the playing field has become more leveled. Malaysia still leads with a 24% market share, closely followed by the UAE at 20%, while Indonesia rose (12%) up in the rankings from fifth in 2021 to third, displacing the UK to fourth at 10%, followed by Saudi Arabia (9%).

The closing of the gap between last year's forerunner with its peers is good news as it suggests the industry is maturing as a global collective.

These top five ecosystems in the last 12 months each achieved notable progress. Malaysia, for example, issued its much-anticipated digital bank licenses, two of which would comply fully with Islamic principles, as well as released digital Takaful and insurance guidelines; the UAE formed the Dubai Virtual Assets Regulatory Authority to regulate businesses relating to virtual assets; Indonesia introduced more stringent P2P finance laws to weed out unhealthy players; the UK proposed changes to the Alternative Finance Order to broaden its scope with a view of benefiting P2P platforms; while Saudi Arabia issued new crowdfunding rules and licensed digital banks.

The rankings are largely in line with current standings. The top five prefered Islamic fintech destinations of CEOs and founders are indeed currently the top five largest markets for Islamic fintech by headquarters. As at the 20th October 2022, the IFN Islamic Fintech Landscape identified 51 Islamic fintech service providers in Indonesia, 49 in Malaysia, 41 in the UK, 32 in the UAE and 27 in Saudi Arabia.

Funding remains the biggest challenge

Access to capital remains the most difficult challenge to navigate for most Islamic fintech start-ups. Thirty-eight percent of respondents identified funding as their biggest hurdle to scaling up, followed by regulatory barriers and low Islamic finance literacy. And this year may be even more challenging due to weak macroeconomic conditions.

"Equity markets continue to be an issue but our biggest cause for concern is access to capital to grow," said a CEO of a Halal digital investment management company.

A Malaysian fintech start-up agreed. "It would be a tough market as the economy slows down and funding dries up. However, it is also refining our business model and building our fundamentals right."

This optimism to take advantage of slow market conditions is also seen in other regions. In Nigeria, one start-up admitted that its major challenge would be the lack of funding due to the spillover effect of a looming recesssion in the US and the Russia–Ukraine war slowing markets down; however, it

Chart 2: Most conducive and supportive Islamic fintech ecosystems

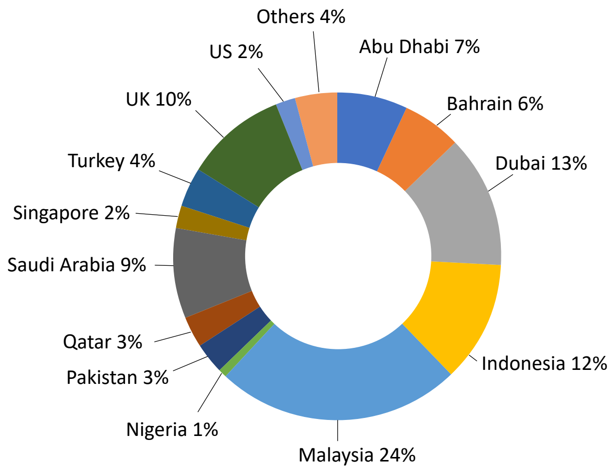


Chart 3: Biggest challenges Islamic fintech face in scaling up

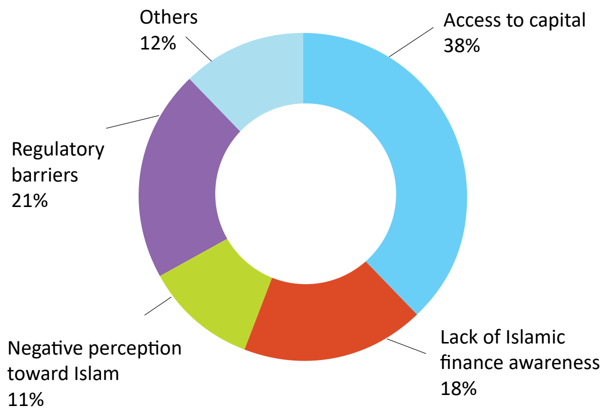
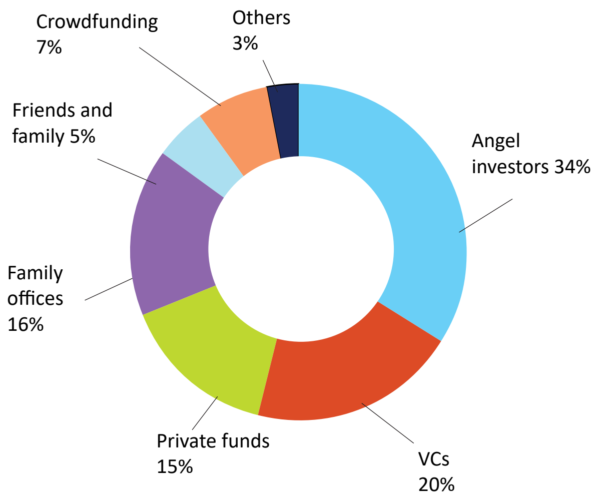


Chart 4: Types of investors sought by Islamic fintech start-ups



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Labuan IBFC is a wholesale financial, risk and wealth management intermediation centre that also boasts a wide range of business structures including solutions for fintech or digital businesses. It is also home to the world's first sukuk and is acknowledged as an Islamic financial hub.

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Labuan, also known as the 'Pearl of Borneo', offers a myriad of business and leisure opportunities. It is also a hub for financial tourism as its excellent location and compact structure offer easy connectivity between the financial district, and nature offerings.

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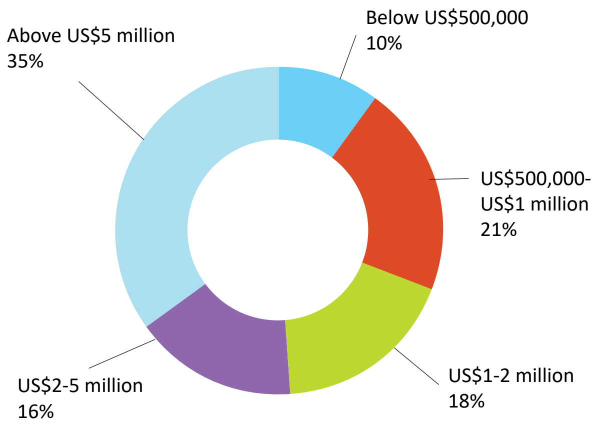
continues to see tremendous growth potential due to the infancy of the market.

Nonetheless, it must be noted that several notable funding rounds were closed in the last 12 months, reflecting the strong funding undercurrent for Islamic fintech service providers among investors, particularly conventional or agnostic investors. Bahrain-based Halal crytocurrency exchange RAIN raised US$75 million while the UAE's Tabby closed US$50 million in the second half of 2021. In Indonesia, ALAMI closed its pre-series B round while Ethis Indonesia raised US$3 million.

Despite perceived difficulty in accessing funding, over 71% of start-ups surveyed intend to raise capital over the next 12 months, with about 12% withholding from tapping the market. Almost 78% believe investors hold Islamic fintech businesses in a positive regard, fueling their confidence.

Founders and CEOs expressed a greater preference for angel investors (34%) over venture capital (VC) firms (20%) and family offices (16%). Despite business angels typically forking out much smaller-sized investments relative to VCs (US$25,000–100,000 versus millions in average), there are advantages to business angels over VCs that are more alluring to start-ups. For example, angel investments typically take place on a shorter timescale due to more relaxed due diligence processes unlike VCs which wrangle with relative bureaucratic inertia and fund economics, and angels tend to

Chart 5: Target funding amount of Islamic fintech start-ups over next 12 months



also provide better terms and are more open to more flexible deal structures.

Only 9% of start-ups surveyed are looking for single investors to fulfill their funding needs while the rest are looking for multiple investors, as expected based on respondents' preference for angels. In terms of funding ticket size, 35% of those seeking for funding over the next year are eyeing at least US$5 million, followed by the US$500,000-1 million range (21%) and the US$1-2 million range (18%).