Islamic Finance and the Development of Malaysia’s Halal Economy

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Acronyms

ADB  Asian Development Bank
ASEAN Association of Southeast Asian Nations
BPS  Business Pulse Survey
BNM  Bank Negara Malaysia
BRTT Business Reducing Term Takaful
BPJPH Badan Penyelenggara Jaminan Produk Halal
BPMB Bank Pembangunan Malaysia Berhad
CAPEX Capital Expense
CAGR  Cumulative average growth rate
CCM  Cooperative Commission of Malaysia (SKM)
DDI  Domestic Direct Investment
DLT  Distributed Ledger Technology
DOSM Department of Statistics Malaysia
DRMSB Damansara REIT Managers Sdn Berhad
ECF  Equity crowdfunding
EIP  Eco-industrial park
EPF  Employees Provident Fund
EPU  Economic Planning Unit
ESG  Environmental, Social, Governance
FDI  Foreign Direct Investment
FHC B Foreign Halal Certification Body
Fintech Financial Technology
F&B  Food and beverage
GDP  Gross Domestic Products
GHG  Greenhouse Gas
GII  Global Innovation Index
GIEI Global Islamic Economy Index
GMV  Gross Merchandise Value
GVC  Global Value Chain
HACCP Hazard Analysis Critical Control Point
HALMAS Halal Malaysia
HDC  Halal Development Corporation Berhad
HE  Halal Economy
HTPP  Halal Technology Transformation Program
HIMP 2030 Halal Industry Master Plan 2030
HIP  Halal Integrated Platform
HLO  Halal Logistics Operator
HOPE Halal Outreach Program for Entrepreneurs
ICD  Islamic Corporation for the Development of the Private Sector
ICM  Islamic Capital Market
IFDI  Islamic Finance Development Indicator
IFI  Islamic Financial Institution
IFSB Islamic Financial Services Board
INCEIF International Centre for Education in Islamic Finance
ISRA  International Shariah Research Academy for Islamic Finance
JAKIM  Jabatan Kemajuan Islam Malaysia
KWAP  Kumpulan Wang Persaraan (Retirement Fund)
LDC  Least-developed Countries
MAFI  Ministry of Food and Industries
MASSIVE  Market Access Incentive
MATRADE  Malaysia External Trade Development Corporation
MDEC  Malaysia Digital Economy Corporation
MEDAC  Ministry of Entrepreneur Development and Cooperative
MHC  Malaysia Halal Certification
MIDA  Malaysian Investment Development Authority
MIHAS  Malaysia International Halal Showcase
MNC  Multinational Corporation
MQA  Malaysian Qualification Agency
NBFI  Non-bank Financial Institution
NGO  Non-government organizations
NIA  National Investment Aspiration
OIC  Organization of Islamic Cooperation
PE  Private equity
PENJANA  Pelan Jana Semula Ekonomi Negara
PNB  Permodalan Nasional Berhad
PRInce  International Product Registration Incentive
PuTRA  Product Transformation Program
P2P  Peer-to-peer lending
REIT  Real Estate Investment Trust
R&D  Research and development
SC  Securities Commission Malaysia
SDGs  Sustainable Development Goals
SESRIC  Statistical, Economic and Social Research and Training Center for Islamic Countries
SIRCs  State Islamic Religious Councils
SME  Small Medium Enterprise
SMIIC  Standards and Metrology Institute for Islamic Countries
SSFS  Shariah Compliance SME Financing Scheme
TDA  Trade Descriptions Act 2011
12MP  Twelfth Malaysia Plan 2021-2025
UNIDO  United Nations Industrial Development Organization
VC  Venture Capital
VBI  Value-based Intermediation
WEF  World Economic Forum
WIEF  World Islamic Economic Forum
WTO  World Trade Organization
GLOSSARY OF ISLAMIC FINANCE TERMS

Principles of Islamic Finance

Prohibition of interest (Riba): The premium (interest) that the borrower must pay to the lender along with the principal amount as a condition for the loan or an extension. (i) Riba al-Fadl: Riba in hand-to-hand or barter exchange. (ii) Riba al-NasiNas: Riba in money-to-money exchange provided exchange is delayed or deferred, and an additional charge is associated with such deferment.

Prohibition of speculative behavior (Gharar): Uncertainty in contractual terms and conditions is forbidden. However, risk-taking is allowed when all the terms and conditions are clear and known to all parties.

Ban on financing certain economic sectors: Financing industries deemed unlawful by Sharia—such as liquor, pork, and gambling—is forbidden.

The profit-and loss-sharing principle: Parties to a financial transaction must share in the risks and rewards attached to it.

The asset-backing principle: Each financial transaction must refer to shari’ah-compliant tangible assets (like real estate) and/or intangible assets like usufruct (e.g., leasehold rights) or services (e.g., toll road concessions);

Takaful (Islamic Social Solidarity Scheme): A mutual guarantee in return for the commitment to donate an amount in the form of a specified contribution to the participants’ risk fund, whereby a group of participants agrees among themselves to support one another jointly for the losses arising from specified risks.

Retakaful: A form of Islamic reinsurance that operates on the Takaful model.

Kafalah: A contract of guarantee used to provide assurance as to performance or liabilities.

Wakalah (Agency): An agency contract where the customer (principal) appoints an institution as agent to carry out the business on his behalf. The contract can be for a fee or without a fee.

Murabahah: A sale contract whereby the institution sells to a customer a specified asset, whereby the selling price is the sum of the cost price and an agreed profit margin. The murabahah contract can be preceded by a promise to purchase from the customer.

Commodity Murabahah or Tawarruq: A murabahah transaction based on the purchase of a commodity from a seller or a broker and its resale to the customer on the basis of deferred murabahah, followed by the sale of the commodity by the customer for a spot price to a third party for the purpose of obtaining liquidity, provided that there are no links between the two contracts.
**Ijarah:** A contract made to lease the usufruct of a specified asset for an agreed period against a specified rental. It could be preceded by a unilateral binding promise from one of the contracting parties. An *ijarah* contract is binding on both contracting parties.

**Musharakah:** Equity participation contract. Different parties contribute capital, and profits are shared according to a pre-determined ratio, not necessarily in relation to contributions, but losses are shared in proportion to capital contributions. The equity partners share and control how the investment is managed, and each partner is liable for the actions of the others.

**Mudaraba:** A partnership contract between the capital provider (*rab al-mal*) and entrepreneur (*mudarib*) whereby the capital provider would contribute capital to an enterprise or activity that is to be managed by the entrepreneur. Profits generated by that enterprise or activity are shared in accordance with the percentage specified in the contract, while losses are to be borne solely by the capital provider unless the losses are due to misconduct, negligence or breach of contracted terms.

**Salam:** The sale of a specified commodity that is of a known type, quantity and attributes for a known price paid at the time of signing the contract for its delivery in the future in one or several batches.

**Istisna':** The sale of a specified asset, with an obligation on the part of the seller to manufacture/construct it using his own materials and to deliver it on a specific date in return for a specific price to be paid in on lump sum or instalments.

**Vocabulary of Islamic Finance**

**Halal:** Allowed and permitted by Islamic law

**Tayyib:** Wholesome, pure, healthy and safe.

**Sukuk (certificates of ownership):** Certificates that represent a proportional undivided ownership right in tangible assets, or a pool of tangible assets and other types of assets. These assets could be in a specific project or specific investment activity that is *shari’ah* compliant.

**Waqf:** A *waqf* is a trust established when the contributor endows the stream of income accruing to a property for a charitable purpose in perpetuity

**Sadaqah:** Recommended contributions

**Qard hassan:** Benevolent loan free of any charge

**Zakat:** An obligatory financial contribution disbursed to specified recipients that is prescribed by the *shari’ah* on those who possesses wealth reaching a minimum amount that is maintained in their possession for one lunar year.
Executive Summary

Overview

The halal economy (HE) plays an important role in Malaysia’s economic growth, contributing 7.5 percent to the Gross Domestic Product (GDP) as of 2020. Under the Twelfth Malaysia Plan, 2021-2025 (12MP), one of the key strategies to boost Malaysia’s economic growth is enhancing the competitiveness of the halal industry to capture a more significant share of the global halal market. The term halal refers to anything that is permissible or lawful under Islamic Law that dictates the way of life of a Muslim (a follower of the Islamic faith). Hence, the scope of the HE is broad and can be defined as an industry that is involved in the provision of halal products and services, including food, clothing and fashion, cosmetics and personal care, travel, and financial services. Consequently, Islamic finance is both parts of the broader HE (Hassan et al., 2021) and can facilitate the development of the HE.

This report requested by Bank Negara Malaysia (BNM) explores the role of Islamic finance in supporting the development of Malaysia’s HE with the objective of informing policy discourse on enhancing existing strategies to increase access to Islamic finance solutions to underserved HE enterprises. The report comprises the following chapters, (1) the current state of the HE; (2) the financing ecosystem of Malaysia’s HE, (3) enhancing Islamic finance for the HE in Malaysia; and concludes in Chapter 4 with a set of recommendations for stakeholders in Malaysia. While the recommendations focus on Malaysia, they may also be relevant for other developing economies where the HE and Islamic finance are prominent.

State of the Global HE

The HE has expanded in recent years and forms a unique segment of the global supply chain driven by faith-based demand. Most Muslims prefer certified halal foods and products as a religious obligation, while non-Muslim consumers cite hygiene, sanitation, quality, and safety as the main reasons for purchasing halal products (Rusydiana and As-Salafiyah, 2020). The State of Global Islamic Economy Report (GIER) 2022 estimates that the world’s 1.9 billion Muslims spent the equivalent of US$2 trillion in 2021 across the halal food, pharmaceutical, cosmetics, fashion, travel, and media/recreation sectors. Despite the continued uncertainty related to the pandemic, this spending reflects an 8.9 percent year-on-year growth from 2020. It is forecast to grow by a further 9.1 percent in 2022 (excluding the Islamic finance sector) (DinarStandard, 2022). The growing Muslim population worldwide therefore presents an opportunity for significant growth in the demand for halal products and services.
The consumption patterns of young people and increased digital connectivity are key drivers of future domestic and cross-border trade in the HE. According to 2020 United Nations (UN) estimates, OIC member states are home to 338.3 million youth, or 28 percent of the world’s total youth population, which is projected to grow to 30.7 percent by 2030 (SESRIC, 2020). Many Muslim-majority countries from the MENA and South-East Asia regions had a higher internet penetration in 2020 than the global average of 59 percent. Indonesia, Malaysia, and Saudi Arabia are OIC countries with the highest global e-commerce and m-commerce adoption, above the worldwide average of 76.8 percent and 55.4 percent, respectively (DinarStandard, 2021b). This millennial youth is the most globally connected generation, tend to have higher purchasing power and can afford a diverse range of halal goods and services (Charoenchang, 2019).

Several OIC economies have strengthened certification frameworks for scrutinizing the halal integrity of products imported into their countries. In many OIC countries, designated national bodies, such as the UAE’s Emirates Authority for Standardization and Metrology, Saudi Arabia’s Saudi Food and Drug Authority, Indonesia’s Badan Penyelenggara Jaminan Produk Halal, and Malaysia’s Jabatan Kemajuan Islam Malaysia (JAKIM), monitor and provide halal certification and accreditation to foreign halal certification bodies. In addition, several Muslim-majority countries are working on legal frameworks that will define halal and control the halal integrity of imported products. These efforts are useful in promoting greater general awareness of halal and strengthening the regulations for cross-border trade.

State of the Halal Economy in Malaysia

Malaysia currently leads the overall Global Islamic Economic Indicator (GIEI) rankings with respect to the size of the halal economy (GIER 2022), particularly for Islamic finance, halal food, Muslim-friendly travel, and media and recreation sectors. The largest component of the HE in Malaysia is the food services sector, with business revenue in the sector estimated at US$31 billion (RM128.8 billion) in 2021 and is forecast to reach US$47.6 billion (RM201.02 billion) by 2025. Halal pharmaceuticals are also growing, with business revenues of US$4.0 billion in 2021 and are expected to grow to US$4.8 billion by 2025. Malaysia is regarded globally as a leader in halal pharmaceuticals due to establishing the world’s first halal pharmaceutical standard.

Malaysia's halal certification is globally recognized and is considered a valuable and credible resource providing a significant competitive advantage for Malaysian firms in the international arena (Dubé et al., 2016). The stamp of authenticity on halal products helps to reduce information asymmetries, avoids “halal washing,” and builds trust, especially in international trade.

The HE contributes significantly to Malaysia’s GDP but lacks the capacity to produce high-value-added products and services that can increase its competitiveness in the global HE market (Economic Planning Unit, 2021). Malaysia's halal industry is largely concentrated in the
halal food-related sector, with 28.9 percent of Malaysia’s halal export value in 2020 attributed to halal ingredients. It lacks diversification in other high-productivity sectors such as pharmaceuticals and medical devices. According to the Halal Development Corporation (HDC), there is a lack of product creation and innovation by Malaysia’s HE players. ¹ Most certified halal businesses in Malaysia are micro, small, and medium enterprises (MSMEs).² These businesses generally focus on a small local market and lack the capacity to develop their products for the export market.

**Islamic Finance and the HE**

**Malaysia’s highly developed Islamic finance industry providers offer a diverse range of financial products and services** and have been recognized as one of the five key enablers for implementing the strategies outlined in Malaysia’s Halal Industry Master Plan (HIMP) 2030. The percentage of halal-certified companies using Islamic bank financing nearly doubled between 2018 and 2021, growing from 21.9 percent to 41.3 percent. An estimated 20 percent of Malaysia’s Islamic capital market (ICM) securities are issued by HE enterprises as of 2021. As of September 2021, outstanding Islamic financing in the banking sector to HE enterprises exceeded US$ 5 billion comprised of food and beverage (F&B) enterprises (US$ 4 billion), followed by manufacturing (US$ 718 million), food premises (US$ 239 million) and pharmaceuticals (US$ 109 million).³ The growth in Islamic finance usage by the HE enterprises could be attributed to the targeted awareness and capacity building initiatives driven by Bank Negara Malaysia (BNM) in collaboration with key agencies such as HDC and JAKIM through the years.

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² According to news reports, 7,204 companies received halal certification from JAKIM in 2019 (Selangor Journal, 2019) and in 2021 the number of halal-certified SMEs were reported to be 7,000 (Jalil, 2021). However, these numbers represent the lower bound since not all halal-related companies would have obtained halal certification.

³ Lim Qian Pink, Anas Afifi Zulkefli and Faqrul Fithri Mohd Nasrudin, Bank Negara Malaysia. Data and analysis provided for this report.
ES Figure 1: Islamic versus conventional bank finance (by outstanding amount) by halal economy sector, 2021

Usage of Islamic financing offered by the banking sector for the HE varies greatly by sector and is more utilized by smaller halal certified businesses. According to data provided by BNM, more than two-thirds of outstanding bank financing to the HE sectors (except pharmaceutical) is conventional. On the other hand, non-SME businesses that are halal-certified predominantly used conventional finance, only 25 percent of outstanding bank finance to them was Islamic. In contrast, nearly two-thirds (65 percent) of the outstanding bank funding to halal-certified micro enterprises was Islamic as of September 2021, highlighting the role of Islamic finance in serving underserved segments.

Malaysia has captured a large share of global HE cross-border investments. Of 156 cross-border transactions in 2019-20, estimated at US$11.8 billion recorded in the GIER 2021 (DinarStandard, 2021b), 31 were in Malaysia. This corresponds to 20 percent of the total number of transactions. Only Indonesia (with 38 inbound transactions) had more reported cross-border HE investments. The largest number of transactions was in the halal food sector (16), followed by media and entertainment (10), Muslim-friendly travel (3), halal pharmaceuticals (1), and unspecified (1).

HE enterprises face requirements and challenges beyond those confronting their conventional peers, such as the need to obtain halal certification of their products, inspection

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4 Lim Qian Pink, Anas Afifi Zulkefli and Faqrul Fithri Mohd Nasrudin, Bank Negara Malaysia. Data and analysis provided for this report.

5 Large companies, particularly foreign multinational companies (MNCs) that are involved in Malaysia’s HE could have a higher proportion of their banking transactions conducted through the conventional parent bank.
requirements, and serving more fragmented and dispersed customer markets. These factors can impact the start-up, production, distribution, and marketing costs borne by HE firms. They can also introduce unique barriers to entry that may be daunting to smaller enterprises.

Enhancing Islamic Finance for HE Development

Recommendations were provided on enhancing the use of Islamic finance to develop the HE will entail public and private sector interventions on both the demand and supply-sides. Based on engagement with HDC, businesses involved in the HE, particularly MSMEs, face a combination of access to finance and business-related challenges, which directly impact their financial viability. Therefore, it is important to consider the supply-side elements of the financing gap, such as provision of relevant financing instruments, and to address demand-side elements by supporting the development of halal businesses, who are in effect all potential Islamic finance users, become more financially viable and resilient.

While the contribution of Islamic finance, especially the Islamic banking sector, has increased, further actions can be taken to facilitate funding and the overall growth of HE. Malaysia’s Islamic finance industry currently offers a diverse set of products and services to meet the financing needs of businesses. However, linking Islamic finance more closely with Malaysia’s existing HE development programs can be a major opportunity for expanding the utilization of Islamic finance. Growing the HE in Malaysia requires financing and investment in digitalization, innovation, research and development (R&D), and sustainable practices to enhance productivity and global competitiveness. The role of Islamic finance in the development of the HE in Malaysia could be enhanced further by increasing support for the adoption of digital payments, integrating halal advisory and marketplace, and enhancing current Islamic finance offerings through innovative Islamic finance solutions such as fintech, blended finance, alternative finance, and Islamic social finance. The following table presents a set of recommendations to serve as inputs to key stakeholders in enhancing existing strategies involving the role of Islamic finance in Malaysia’s HE development.

Summary of Recommendations for Stakeholders

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Description</th>
<th>Stakeholders</th>
</tr>
</thead>
</table>
| 1. Enhance policy and strategy coordination across different policy makers and Islamic finance providers to increase the impact of programs. | Various public and private sector initiatives could be streamlined to optimize the impact of such programs.  
• HDC’s Halal Integrated Platform (HIP), an online one-stop center for halal business support, could be leveraged as a central virtual platform that connects relevant government agencies and Islamic finance providers. In addition, financial regulators may advocate for Islamic finance providers to participate in HIP and connect their existing halal systems with the HIP.  
• Linking programs related to financings, such as SME financing and export financing, more closely with halal agencies. | Government agencies, financial regulators, Islamic finance providers, and SMEs. |
2. Establish closer linkages between programs that support innovation and productivity improvements with Islamic finance.

<table>
<thead>
<tr>
<th>HDC, MEDAC, JAKIM, and industry events – WIEF and MIHAS, can provide more comprehensive support to HE enterprises.</th>
</tr>
</thead>
<tbody>
<tr>
<td>• HDC may implement strategies to encourage halal labeling of merchants using services provided by e-commerce and related technology companies.</td>
</tr>
</tbody>
</table>

Closer engagement with the private sector in public programs for innovation and technology adoption could develop an effective pathway to graduate HE enterprises from public funding to private funding.

| • HDC, in collaboration with other relevant government agencies such as Malaysia Digital Economy Corporation (MDEC), could provide technical expertise and technology validation. Like the Green Technology Financing Scheme (GTFS), technology validation can help encourage Islamic finance providers to offer funding for productivity-improving technologies to SMEs, such as AgriTech. |
| • Relevant government agencies, research centers, and Islamic finance providers could collaborate in initiatives that bring public and private actors in creating R&D and capacity-building funds, particularly mobilizing Islamic social finance such as waqf. |
| • Islamic finance providers could provide advisory services and transition finance to transform HE enterprises and halal parks into more sustainable and less carbon-intensive. |

Government agencies, Islamic finance providers, SMEs, and research centers.

3. Encourage Islamic finance providers, particularly Islamic banks to participate in public-private sector collaborations to pilot innovative Islamic finance solutions and scaling up.

<table>
<thead>
<tr>
<th>IFIs should explore the multitude of shari’ah contracts that offer the potential for innovative financing structures beyond conventional debt-based financing.</th>
</tr>
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<tbody>
<tr>
<td>• Equity-based financing, especially for SMEs and funding growth stages, could address funding gaps not currently met by Islamic finance providers. In addition, a public-private sector collaboration could help manage risks and incentivize Islamic finance providers and institutional investors to innovate and participate in more blended finance programs.</td>
</tr>
<tr>
<td>• Government funding programs could be amplified by collaborating with Islamic banks, Islamic fintech and related technology companies to facilitate development of innovative solutions and pilot new funding programs.</td>
</tr>
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</table>

Government agencies, financial regulators and, Islamic finance providers, SMEs.

4. Strengthening collaboration with policy makers in other countries to advance utilization of Islamic finance for HE.

<table>
<thead>
<tr>
<th>Malaysia should take a leadership role in galvanizing global efforts in advancing Islamic finance for HE for the mutual benefit of the OIC countries.</th>
</tr>
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<tbody>
<tr>
<td>• HDC could play an advocacy role in collaboration with financial regulators to further promote the utilization of Islamic finance solutions in funding HE and promoting participation in HDC’s HIP. Partnerships with other key countries to develop an integrated approach to promote global HE could increase the</td>
</tr>
</tbody>
</table>
potential market size of the global HE in strategic sectors such as food and beverages, halal ingredients and agriculture.

- HDC and MATRADE could further support the utilization of Islamic trade finance and explore investment flows between Malaysia and other countries. Collaboration with relevant multilateral development banks (MDBs) that are active in the OIC countries should also be pursued to implement strategies that can advance Islamic finance and the HE.

<table>
<thead>
<tr>
<th>5. Enhancing the role of relevant institutional investors and expanding capital market funding for the HE.</th>
</tr>
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<tbody>
<tr>
<td>There is untapped opportunity to increase Islamic finance utilization amongst corporates and SMEs via capital market instruments.</td>
</tr>
<tr>
<td>- Financial regulators and Islamic capital market participants could collaborate to pilot the issuance of retail bonds for the HE and explore blockchain technology for such issuances.</td>
</tr>
<tr>
<td>- Islamic capital market participants and relevant government agencies could collaborate to develop specific private equity funds for R&amp;D.</td>
</tr>
<tr>
<td>- Relevant government agencies could advocate encouraging the utilization of Islamic finance by institutional investors to invest in mature businesses and drive consolidation and mergers and acquisitions (M&amp;A).</td>
</tr>
<tr>
<td>- Institutional investors and corporates could explore investing overseas in key HE sectors, such as F&amp;B or agriculture, by developing investment strategies specifically for HE sectors.</td>
</tr>
<tr>
<td>Government agencies, financial regulators, Islamic finance providers, and institutional investors.</td>
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<th>6. Enhancing data sharing on Islamic finance and HE.</th>
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<td>Data is an important enabler to advance finance in any segment to determine the gaps and measure the effectiveness of strategies and initiatives. Therefore, HDC, JAKIM, and financial regulators could enhance data sharing between agencies to develop and report key business and financial indicators in HE to better monitor the impact of relevant initiatives, identify further gaps, and improve future strategies.</td>
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<td>Government agencies and financial regulators.</td>
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Chapter 1: Current State of the Halal Economy

1.1. What is the Halal Economy?

The term **halal** refers to anything that is permitted under Islamic Law\(^6\). The halal economy (HE) can therefore be defined as an industry involved in providing halal products and services, including food, clothing and fashion, cosmetics and personal care, travel, financial services, and so forth. Hence, Islamic finance and halal industries are parts of the broader HE (Hassan et al., 2021).

**An important aspect of the HE is the certification of products and services.** The permission to put the halal certification logo on a product conveys that a reliable authority or independent party has confirmed that halal requirements have been met at a sufficient level (Kawata and Salman, 2020). Halal certification is particularly essential when production processes are long and complex, such as in food chains where the development of food technology creates new products and ingredients, and many products are traded internationally. Moreover, composite products may be mixed or contaminated with non-**shari’ah** ingredients. For example, food can be contaminated with pork which is sometimes added in the form of an emulsifier\(^7\). Other non-halal substances such as gelatine, enzymes, glycerine, and lecithin may also be found in processed food. As required, laboratory analysis of specific ingredients and audits of halal production can be used to verify certificates as part of halal assurance systems (van der Spiegel et al., 2012).

**Halal also covers other important aspects of handling animals and food items during production.** Issues such as animal welfare, the ritual slaughter method, treatment and separation of halal animals, cleaning and disinfection, separation of halal and haram food at all stages of the halal food supply chain are key to ensuring that processed items remain compliant with **shari’ah** requirements.

**The HE has expanded in recent years, and food is its largest sector.** Most Muslims prefer certified halal foods and products as a religious obligation, while non-Muslim consumers cite hygiene, sanitation, quality, and safety as the main reasons for purchasing halal products (Rusydiana and As-Salafiyah, 2020). The State of Global Islamic Economy Report (GIER) 2022 estimates that the world’s 1.9 billion Muslims spent the equivalent of US$2 trillion in 2021 across the halal food, pharmaceutical, cosmetics, fashion, travel, and media/recreation sectors. This spending reflects an 8.9 percent year-on-year growth from 2020 despite the continued uncertainty related to the pandemic, and global Muslim spending on the HE sectors is forecast to grow by a further 9.1 percent in 2022 (excluding the Islamic finance sector) as we see a return to pre-pandemic spending levels in all sectors except travel (DinarStandard, 2022). The food sector is the

\(^6\) The opposite of halal is **haram**, which means anything which is not permitted or not allowed by Islamic Law.

\(^7\) For example, pork fat can be used in bread as part of animal-based emulsifiers.
largest component of the HE, with spending on halal food by Muslims valued at US$1.27 trillion in 2021 and projected to reach US$1.67 trillion in 2025 (DinarStandard, 2022 and SESRIC, 2021a) (Figure 1.1).

Figure 1.1 Global Halal Sectors

Source: Global Islamic Economy Report 2022

1.2. Key Drivers of Growth in Global Halal Markets

The growing Muslim population presents an opportunity for expanding the demand for halal products. The 57 member states of the Organization of Islamic Cooperation (OIC) contain approximately 1.8 billion people with a GDP of US$7.2 trillion as of 2019, presenting a massive potential for halal markets (World Bank Group, 2021b). Given the ongoing gradual recovery from the pandemic, it is estimated that the OIC’s GDP will rebound to US$7.7 trillion in 2021, exceeding the 2019 level (US$ 7.2 trillion). With this economic size, OIC member countries accounted for 8.1 percent of global GDP in 2020 (SESRIC, 2021b). Pew Research estimates that by 2050 the number of Muslims worldwide will grow to 2.6 billion, or 29.7 percent of the world’s population.

There are significant numbers of Muslims across all regions of the world. 587 million live in the South Asia region (31.3 percent of the total), 413.1 million in the Middle East and North Africa region (22 percent), 379.3 million in sub-Saharan Africa (20.2 percent), 292 million in East Asia Pacific (15.6 percent), 197.2 million in Europe and Central Asia (10.5 percent). There are also

See https://www.pewresearch.org/fact-tank/2017/01/31/worlds-muslim-population-more-widespread-than-you-might-think/
sizeable Muslim populations in North America (4.5 million) and Latin America and the Caribbean (1.49 million).

**Figure 1.2 Regional Distribution of Muslims**

The consumption patterns of young people will be the main driver for the HE in the coming years. According to 2020 United Nations (UN) estimates, OIC member states are home to 338.3 million youth, representing 17.9 percent of the total OIC population (compared to a global average of 15.5 percent) and 28 percent of the world’s total youth population. It is projected that by 2030 the number of young Muslims will further increase to 396.9 million (30.7 percent of the global youth population) (SESRIC, 2020). This millennial youth is the most globally connected generation, tend to have higher purchasing power and can afford a diverse range of halal goods and services (Charoenchang, 2019).

The linkage between halal and environment, social, and governance (ESG) criteria expands the consumer base and increases the positive perception of non-Muslim consumers toward halal products. According to a 2020 survey of sustainable investing of high net-worth investors carried out by Morgan Stanley Capital International (MSCI), 95 percent of millennials were interested in sustainable investing, especially consumers who demand cruelty-free, organic, natural, and vegan-certified products. These principles are shared with halal-certified products. A study by IBM shows that six in 10 consumers are willing to change their shopping habits to reduce environmental impact (DinarStandard, 2022), consistent with the halal emphasis on purity in substance and the consumption of products closest to their natural state.
The concepts of halal and tayyib are aligned with the ESG values adopted by the top global brands in their end-to-end business operations, including distribution, marketing, and financing. Tayyib means wholesome, pure, healthy, and safe. The growing attention to ESG affects agriculture, food production, and the eating habits of consumers. Pioneering companies such as Saffron Road and Crescent Foods in the United States have incorporated green credentials into the design and packaging of their products and highlight these in their marketing campaigns (DinarStandard, 2021b; Laluddin et al., 2019). Nestle, for example, established the Paddy Club back in 2012 as an initiative to ensure rice used for the company's cereal products is sourced sustainably and responsibly. Another example is the Sustainability Agriculture Code as a pre-requisite for suppliers to enter Unilever's supply chain as part of the group's ambition for sustainable sourcing. This is likely to become a common trend, especially in Muslim minority markets. These qualities and values are generally recognized as an inherent part of halal market values (Ghaffour, 2021).

Many Muslim countries are making conscious efforts to develop their HEs and capture the potential halal market. Malaysia, UAE, and Turkey are among the most active nations and have clear visions of becoming hubs for the global halal trade. Even non-majority Muslim countries like Thailand, Japan, and South Korea aim to position themselves as key players in the halal market. Notably, Australia and Brazil are among the top halal meat and poultry suppliers to countries in the Middle East (Charoenchang, 2019).

Several OIC economies have strengthened certification frameworks for scrutinizing the halal integrity of products imported into their countries. In many OIC countries, designated national bodies, such as the UAE’s Emirates Authority for Standardization and Metrology, Saudi Arabia’s Saudi Food and Drug Authority, Indonesia’s Badan Penyelenggara Jaminan Produk Halal, and Malaysia’s Jabatan Kemajuan Islam Malaysia (JAKIM), monitor and provide halal certification and accreditation to foreign halal certification bodies.

In addition, several OIC countries are working on legal frameworks that will define halal and control the halal integrity of imported products. These efforts are useful in promoting greater general awareness of halal and strengthening the regulations for cross-border trade. Indonesia, with a total halal export value of US$33.8 billion in 2020, is the largest exporter of halal food-related products among the OIC and ASEAN countries, followed by Malaysia (US$20.6 billion) and Turkey (US$19 billion). However, the United States (US$120 billion) and other non-OIC countries such as the Netherlands (US$75.3 billion), Brazil (US$70.8 billion), China (US$64.7 billion), Thailand (US$31 billion), and Vietnam (US$24.4 billion) are dominant in global halal trade⁹.

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⁹ Based on the halal classification for food-related products by the WTO and data available in the UN International Trade Statistics Database.
1.3. Malaysia’s Position in the Global Halal Economy

The GIER 2022 indicated that Malaysia currently leads the overall Global Islamic Economy Indicator (GIEI) rankings for the ninth consecutive year. Malaysia is followed by Saudi Arabia, the UAE, and Indonesia. New entrants to the top 15 include the UK and Kazakhstan. Turkey and Singapore moved up 7 and 8 places to reach the 5th and 7th positions, respectively. Nigeria and Sri Lanka have dropped out of the top 15. In addition, Malaysia obtained the highest score for Islamic finance, halal food, Muslim-friendly travel, and media and recreation sectors. At the same time, the UAE ranked first for modest fashion while Singapore performed better than other countries in pharmaceuticals and cosmetics (DinarStandard, 2022) (Figure 1.3).

Figure 1. 3 Global Islamic Economy Indicator

Source: The State of Global Islamic Economy Report (2022)

According to the 12MP, the halal industry in Malaysia in 2019 was valued at US$27.9 billion (RM115.5 billion), representing 7.6 percent of GDP. Of this, 69.3 percent was from the manufacturing sector and 30.7 percent from the services sector. This halal industry contribution was more significant than the agriculture sector, which contributed 7.1 percent (US$24.5 billion)
to the GDP in the same year\textsuperscript{10}. The industry grew by an average of 5.5 percent per annum during the 2016 to 2019 period. In addition, over the 2016-2019 period, the value of halal exports increased marginally by 0.8 percent per annum, from US$9.5 billion (RM39.4 billion) to US$9.8 billion (RM40.6 billion). However, in 2020, the GDP contribution decreased to US$22.4 billion (RM92.7 billion), and exports declined sharply to US$7.4 billion (RM30.6 billion). Cumulative investments in the 22 existing halal parks amounted to US$0.7 billion (RM2.8 billion) in 2020, and 55 percent were foreign direct investments. A total of 2,225 new companies received halal certification as of 2020, creating an additional 160,337 job opportunities (Economic Planning Unit, 2021).

The majority of certified HE businesses in Malaysia are MSMEs. According to news reports, 7,204 companies received halal certification from JAKIM in 2019 (Selangor Journal, 2019), and in 2021 the number of halal-certified SMEs was reported to be 7,000 (Jalil, 2021).\textsuperscript{11} However, these numbers represent the lower bound since not all halal-related companies would have obtained halal certification. In addition, according to HDC, SMEs lack knowledge of the halal certification process and face financial constraints in complying with halal certification requirements.\textsuperscript{12}

The largest component of the HE in Malaysia is the food services sector. In 2021, business revenue in the sector was estimated at US$31 billion (RM128.8 billion). It is forecast to reach US$47.6 billion (RM201.02 billion) by 2025, based on a cumulative average growth rate (CAGR) of 11.7 percent growth (Figure 1.4). This industry comprises food services, event catering services, and beverage services. Due to new norms during the Covid-19 pandemic, the online food delivery segment is likely to be the key driver for the food services industry in the coming years.

\textsuperscript{10} DOSM, 2020: Selected Agricultural Indicators of Malaysia
https://www.dosm.gov.my/v1/index.php?r=column/cthemeByCat&cat=72&bul_id=RXVKUVJ5TitHM0cwYWxlOHcxU3dKdz09&menu_id=Z0VTZGU1UHBUT1VJMFlpaXRRROxpdz09

\textsuperscript{11} Latest available statistics on the number of halal-certified businesses were published by DOSM in 2017, which reported the number to be 6,138 as of 2015, up 13 percent from 2010.

\textsuperscript{12} The Star (2021, November 22). Improving SME capacity in halal industry.
The pharmaceutical industry in Malaysia has grown steadily over the last decade and has been identified as a key growth area. The industry plays a significant part in the healthcare sector and contributed 15 percent (US$800 million) to the country’s health expenditure in 2019, which was a 10-fold increase from 1997 (US$78.9 million). Pharmaceutical products manufactured in Malaysia include new drug products, biologics, generics (prescription and over-the-counter (OTC) products), health and food supplements, traditional and complementary medicines (TCM), and veterinary products. (Ministry of Health Malaysia, 2021)

Halal pharmaceuticals in Malaysia are also growing with business revenues of US$4.0 billion in 2021. This industry is expected to grow to US$4.8 billion by 2025 (Figure 1.5), mainly driven by increasing affluence among the middle class and an aging population. In addition, Malaysia is regarded globally as a leader in halal pharmaceuticals due to establishing the world’s first Halal Pharmaceutical Standard, MS2424:2019. In 2019, the total export of halal pharmaceuticals was US$96.6 million (RM401 million).
In 2020, Malaysia’s export of certified halal products totaled US$7.3 billion, a 25 percent decrease from 2019 because of the pandemic. The most significant drop was in the chemical industry and halal ingredients by 44 percent and 31 percent, respectively (Figure 1.6). Top Malaysia's halal export destinations were Singapore (RM4.1 billion), China (RM3.4 billion), the United States (RM1.7 billion), Thailand (RM1.5 billion), and Indonesia (RM1.3 billion). (Figure 1.6). Exports of certified halal food and beverages accounted for 56 percent of halal exports, with most of this going to non-OIC countries (Figure 1.7). However, the total export value of halal food-related products based on WTO assumption13 in 2020 was US$20.6 billion, indicating a massive gap between certified and non-certified halal food markets. This shows the importance of halal certification in avoiding halal washing, reducing asymmetric information, and building trust, especially for international trade.

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13 The WTO assumption of HS code specification for the value of halal product trade also includes unlabeled halal products such as vegetables, fish, fruits, etc.
Based on data from WTO, Malaysia has experienced a trade surplus of halal food-related products since 2016, which has strengthened Malaysia's position as among the key players in the halal markets (Figure 1.8). However, several products, such as cereals and meat, have a significant trade deficit with a heavy reliance on imports.

The top 10 Malaysia export destinations of halal food-related products are China (US$2.9 billion), Singapore (US$1.8 billion), India (US$1.8 billion), Netherlands (US$1.1 billion), the Philippines
(US$822 million), USA (US$786 million), Pakistan ($646 million), Turkey (US$632 million), Japan (US$623 million), and Vietnam (US$578 million).

1.4. Malaysian Halal Regulatory Framework

Malaysia has enacted several regulations to ensure the safety and quality of halal products marketed in Malaysia, particularly halal food. These regulations, in addition, aim to protect the integrity of Malaysia's halal logo as a global brand that aligns with the shari’ah and international best practices. These include the Trade Descriptions Act 2011 (TDA 2011), Animal Act 1953 (revised 2006), Food Act 1983, Food Regulations 1985, Consumer Protection Act 1999, and the Local Government Act 1976. TDA 2011 aims to promote good trade practices by prohibiting false trade descriptions and false or misleading statements, conducts, and practices in relation to the supply of goods and services, thereby protecting the interest of consumers. A fundamental purpose of TDA 2011 is to standardize the issuance of halal certificates. Effective January 1, 2011, only the Jabatan Kemajuan Islam Malaysia (JAKIM) and the respective State Islamic Religious Councils (SIRCs) can issue halal certificates for any food, goods, or related services. Since 2013, JAKIM and SIRCs have coordinated and standardized halal management, including certifications, logos, standards and procedures, and processing fees via online applications. It also includes extending the use of the MYeHALAL system, a comprehensive online halal certification management system throughout Malaysia (Suhaimee et al., 2019). Under sections 28 and 29 of TDA 2011, the Minister issued the Trade Descriptions (Definition of Halal) Order 2011 and Trade Descriptions (Certification and Marking of Halal) Order 2011. The laws offer protection to consumers from unethical trade practices relating to halal products and services (A Rahman et al., 2018).

In addition, a comprehensive halal food guideline is known as Malaysian Standard: Halal Food - General Requirements was launched in 2004 and revised in 2009 and 2019 (Malaysian Standard MS 1500:2019). This was issued by Standards Malaysia, the national standard and accreditation body. The standard prescribes guidelines for preparing and handling halal food, starting from selecting raw materials to distributing and promoting food industry activities. MS1500:2019 provides a more precise understanding among food manufacturers on the application of the halalan tayyiban concept in the halal certification procedures. It also considers appropriate sources of halal food, including animals (both land and aquatic), plants, microorganisms, minerals, chemicals, beverages, and genetically modified organisms. It also

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14 The concept of halālan tayyiban relates to four key elements: i) strict adherence and obligation to halal principles; ii) avoidance of syubhah (status unsure or doubtful) from manufacturing and handling process; iii) demonstration of compliance towards cleanliness; and iv) establishment of good systematic halal management.
states that other factors that should be considered in the processing and manufacturing of halal food products are hygiene, safety, and good sanitation\textsuperscript{15}.

**In general, there are seven conditions of halal food based on MS 1500: 2019** as follows: (a) does not consist of or contain any part of the matter of an animal that is prohibited by \textit{shari’ah} law and fatwa for a Muslim to consume or that has not been slaughtered in accordance with \textit{shari’ah} law and fatwa; (b) does not contain anything which is \textit{najs} (impure) according to \textit{shari’ah} law and fatwa; (c) does not contain any part of a human being or its yield which are not allowed by \textit{shari’ah} law and fatwa; (d) does not intoxicate according to \textit{shari’ah} Law and fatwa; (e) is not poisonous or hazardous to health; (f) has not been prepared, processed or manufactured using any instrument that is contaminated with \textit{najs} (impurity) according to \textit{shari’ah} law and fatwa; and (g) has not in the course of preparation, processing or storage been in contact with, mixed with, or in close proximity to any food that fails to satisfy items (a) and (b). There is no stated requirement in MS 1500 that companies producing halal food use Islamic finance.

**In addition, there are some basic requirements for the preparation of halal food based on MS 1500: 2019:** including (a) sources of halal food and drinks should be animal and plant-based; (b) halal and non-halal animals must never be slaughtered together; (c) product processing, handling, and distribution should comply with halal regulation; (d) product storage, display and serving for instance equipment, machineries, and other materials used must not be made of non-halal materials; (e) hygiene, sanitation, and food safety should comply with the concept of \textit{halalan thoyyiban}; (f) packaging and labeling must be carefully evaluated by JAKIM; and (g) legal requirement which in line with MS 1500:2004 revised in 2009 and 2019. (A Rahman et al., 2018)

**The recognition of the halal standard is also significant in international trade.** Some countries such as Malaysia and Indonesia have implemented the halal accreditation system on food and beverage imports, allowing only products with a list of certified halal logos to be imported into their countries. Countries whose products have a well-recognized halal certification should therefore have some competitive advantage in halal exports. According to Blind \textit{et al.}(2018), the certification of the standard has a significant positive impact on trading. For example, in the case of ISO 9000 standard to trade products from developing countries willing to access markets in developed countries, the certification reduces information asymmetries and transaction costs between trading partners. Hence, the halal certificate can have an essential role in promoting international trade in halal products, especially for the exports coming from non-Muslim countries (Charoenchang, 2019). As a result, the Malaysian halal certification system provides a significant competitive advantage for Malaysian firms in the international arena due to its centralized nature, reliable integrity, and strong support infrastructure for Malaysian halal certificates (Dubé et al., 2016).

\textsuperscript{15} Other standards such as MS1514: 2009 Good Manufacturing Practice (GMP) and MS1480: 2019 Hazard Analysis and Critical Control Point (HACCP) are compulsory requirements in preparing products certified as halal.
JAKIM has recognized 84 foreign halal certification bodies (FHCB) in 46 countries\textsuperscript{16} to ensure the quality and integrity of halal products manufactured in other countries for the Malaysian market. Interestingly, 70 of the FHCBs are in 34 countries that are not members of the OIC, including 7 each in Australia and Japan and 6 in China. The role of an FHCB is to monitor and verify the halal status of the raw materials and products with responsibility and integrity. The recognition is based on compliance and implementation of Halal Standards that meet the requirements set by Malaysia. This recognition aims at meeting procedures set by Malaysia Halal Certification that require imported ingredients to be halal certified by recognized bodies (Suhaimee et al., 2019). The validity of the recognition by JAKIMs is for two (2) years, and FHCBs are required to submit annual reports to JAKIM. In addition, JAKIM’s halal logo is among the most recognized symbols of halal compliance in the world. (Charoenchang, 2019).

1.5. Conclusion

The growth of the market for halal products and services is likely to continue. As the Muslim population grows across the globe and Muslims get improved access to certified halal products that enable them to meet their religious obligations, the demand for these products is expected to strengthen in the coming years. Halal food is the most significant contributor to the HE and has gained the attention of non-Muslim consumers who are showing stronger preferences for natural and organic food items and their concerns for hygiene, quality, and safety of consumed food. In addition, the young will have a central role in the growing halal market given their digital connectivity, affinity with e-commerce, sensitivities to social issues, and higher purchasing power.

The halal certification framework will continue to be critical. The stamp of authenticity on halal products helps to reduce information asymmetries, avoids “halal washing,” and builds trust, especially in international trade. The implementation of halal accreditation systems in countries like Malaysia and Indonesia is welcome and could provide them with a competitive advantage in the international trade of halal products and services. Although Indonesia is the largest exporter of halal food-related products among the OIC and ASEAN countries (with Malaysia in the second place), non-OIC countries are the biggest exporters of halal food products, with Australia, China, Brazil, and the US as key players. In addition, HE’s key stakeholders should be more proactive in addressing the issues and challenges in halal certification, in order to ensure the integrity of halal-certified products. For instance, in 2020, Malaysian media reported a large network has been importing frozen meat bearing fake halal logos for distribution for decades.\textsuperscript{17} This issue sparked a debate on tightening enforcement to ensure the genuineness of certified halal products marketed in Malaysia. For imported halal meat, enforcement will involve the Department of Veterinary


\textsuperscript{17} See https://salaamgateway.com/story/malaysias-scandal-of-imported-frozen-meats-with-fake-halal-logos-whos-in-the-wrong
Services (DVS), JAKIM, Malaysian Quarantine and Inspection Services Department (MAQIS), Customs and the Ministry of Domestic Trade and Consumer Affairs (KPDNHEP). Standardization of the halal logo is also crucial for international trade as it helps create more transparency and avoid halal washing. Member states of the Standards and Metrology Institute for Islamic Countries (SMIIC)\textsuperscript{18} have come together to produce five new halal standards and the SMIIC is also developing Halal Quality Infrastructure standards, which will provide guidelines for strengthening the halal regulatory ecosystem.

\textsuperscript{18} SMIIC, an affiliate body of the Organization of Islamic Cooperation (OIC), was established to prepare OIC/SMIIC halal standards to achieve uniformity in metrology, laboratory, testing, and standardization. A total of 31 member states out of the 56 OIC countries are currently members.
Chapter 2: Financing Malaysia’s Halal Economy

2.1. Modes of Islamic Financing for Halal Enterprises

2.1.1. Introduction

The term Islamic finance refers to financial activities conforming to Islamic law (shari’ah). In addition to the prohibition of *riba* (usury or interest), several other essential provisions may affect financial transactions. These include the ban on *gharar* (uncertainty or asymmetrical information), *maysir* (gambling, speculation), hoarding, as well as trading in prohibited commodities (for example, pork and alcohol). Companies that offer halal products are likely to use Islamic finance to ensure that all business transactions in the entire products and services supply chain align with Islamic principles. Shareholders and business owners who are committed to compliance with religious law may require that HE companies use only Islamic finance. This may also be important to building some customers’ trust and faith in halal products and services. In Malaysia, the agency responsible for the certification of halal products (Jabatan Kemajuan Islam Malaysia, JAKIM), in its 2020 halal certification guidelines, strongly encourages all certified halal companies to use Islamic finance in all their business transactions.

Some key features of HE enterprises affect their financing. In general, HE companies have financing requirements that are similar to the requirements of conventional companies in the same sector (e.g., start-up funding, debt and equity financing, and access to capital markets), whether that be food, travel, pharmaceuticals, fashion, or another industry. A key difference in financing policies, however, is that HE companies are likely to strongly prefer, if not require, Islamic finance solutions rather than conventional ones. At the same time, they may find Islamic financial products and services relatively unfamiliar, complicated, unavailable, or expensive (World Bank Group, 2021b, pp. 67, 78). This is reflected in the fact that, as of 2019, of the 54 percent of HE businesses in Malaysia that received bank financing, a small fraction (22 percent) used Islamic finance. In other words, barely 12 percent of Malaysian HE enterprises were utilizing Islamic bank financing in one of the world's most developed Islamic finance markets.19

Financing the HE may be especially supportive of MSMEs. Across the OIC, there are an average of over 50 micro, small, and medium-sized enterprises (MSMEs)20 for every thousand


20 The definition of MSME used by the Malaysian government is specified by SME Corporation Malaysia, the central body that coordinates official programs for MSMEs throughout the Malaysian federal government. There are varying thresholds for manufacturing and non-manufacturing enterprises, and either revenue or number of employees marks the boundaries between the micro, small, medium, and non-MSME categories. A manufacturer with up to 200
people, double the world average (Malaysia Islamic Financial Centre, 2014). MSMEs often face challenges accessing financing from banks and capital markets, with over half of such businesses in developing countries lacking access to adequate commercial financial services (World Bank Group & Islamic Development Bank, 2015). Despite these challenges, MSMEs account for over one-third of Malaysian GDP and almost two-thirds of employment (World Bank Group, 2020c). In addition, Malay and rural communities, which have historically been underrepresented in the business sector, are active in the HE due to their religious preferences and their rural orientation. These aspects of the financing landscape faced by small businesses in general will affect such HE enterprises. Another indication of the potential for increasing Islamic finance participation in the segment of the HE conducted by small businesses is given by the statistic that in 2019, Islamic banks provided only 28.5 percent of MSME financing in Malaysia (World Bank Group, 2020c). This indicates a gap between MSMEs’ share of GDP and employment. Finally, one Islamic bank noted that as of 2018, 90 percent of small and medium-sized enterprises in Malaysia are not halal-certified. At the same time, over 80 percent of the bank’s financing growth from small and medium-sized enterprises involved HE businesses. Together, these data points indicate a significant untapped potential for creating synergies between Islamic finance and the HE.

Finally, HE enterprises face several requirements and challenges beyond those confronting their conventional peers, such as the need to obtain halal certification of their products, inspection requirements, and serving more fragmented and dispersed customer markets. These factors can impact the start-up, production, distribution, and marketing costs borne by HE firms. They can also introduce unique barriers to entry that may be daunting to smaller enterprises, particularly since halal certification has to be renewed periodically and the related costs may be significant in certain industries. However, there is limited empirical (or anecdotal) evidence that would suggest that the cost of halal certification has a negative impact on financial performance.

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22 Puspitasari & Urumsah (2021) examined the financial statements of 17 food and beverage corporates listed on the Indonesian Stock Exchange of 2015-2018 period and found that halal certification significantly and positively affects financial performance. Zailani et. al (2020) surveyed 154 halal food firms in Malaysia and found halal materials and halal storage and transportation positively affect financial performance, whereas the halal production process negatively affects financial performance.
2.1.2. Financing Through Islamic Banks

Malaysia has a relatively well-developed Islamic banking industry. According to the 2021 edition of the Islamic Finance Development Report (IFDR), Malaysia has the most highly developed Islamic finance market in the world (Refinitiv, 2021). The metric that the IFDR provides to summarize the state of the Islamic finance industry in each of the 135 countries covered is the Islamic Finance Development Indicator (IFDI). The IFDI is based on five sub-indicators, covering quantitative development (such as the size and performance of Islamic finance institutions), knowledge (education and academic publishing in the field of Islamic finance), governance (regulatory, shari’ah, and corporate), corporate social responsibility, and awareness (events and news items). For several years in a row, Malaysia has taken the top spot among all countries, often by a significant margin, with a 2021 IFDI score of 114 (out of a maximum of 200). Malaysia also ranked first in five of the six sub-indicators that make up the IFDI. The 2021 performance by Malaysia in this regard is typical of Malaysia’s strong IFDI rankings over the past few years.

Malaysia’s Islamic banks offer a diverse set of products and services to meet the financing needs of businesses. The following table shows products and services offered to business customers by Malaysia’s largest IFIs. The offerings are grouped into stages corresponding to a business’s lifecycle and evolving financing needs. The products and services listed span an entire range from working capital and expansion financing, fixed asset financing, trade finance, capital markets, and treasury functions. Some offerings are specifically targeted to MSMEs, and many others are available to businesses of varying sizes. Of the products and services aimed at MSMEs and new entrepreneurs, the financing terms typically involve smaller amounts and require little or no collateral, are sometimes supported by government programs or guarantees, and are available for working capital, capital expenditures, or general business growth.

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23 The IFDR is published by Refinitiv, a subsidiary of the London Stock Exchange Group.

24 The Malaysian IFIs examined for this purpose were AmBank Islamic, Bank Islam Malaysia, Bank Muamalat Malaysia, Bank Rakyat, CIMB Islamic Bank, Hong Leong Islamic Bank, Maybank Islamic Bank, MBSB Bank, Public Islamic Bank, and RHB Islamic Bank.
<table>
<thead>
<tr>
<th>Stage</th>
<th>Products and Services Offered</th>
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<td><strong>MSME stage:</strong>&lt;br&gt;Start-up and early-stage capital</td>
<td>Business term financing for start-ups&lt;br&gt;Working capital financing&lt;br&gt;Capital expenditure financing&lt;br&gt;Targeted COVID-19 working capital relief financing for MSMEs&lt;sup&gt;26&lt;/sup&gt;&lt;br&gt;Separate COVID-19 relief financing for MSMEs in the tourism sector&lt;sup&gt;27&lt;/sup&gt;</td>
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<td><strong>MSME and later stages:</strong>&lt;br&gt;Trade finance</td>
<td>Letters of credit&lt;br&gt;Shipping guarantees&lt;br&gt;Bills for collection (inward and outward)&lt;br&gt;Invoice financing&lt;br&gt;Accepted bills&lt;br&gt;Bills of exchange&lt;br&gt;Trust receipts&lt;br&gt;Export credit refinancing&lt;br&gt;Foreign currency trade financing&lt;br&gt;Factoring</td>
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<tr>
<td><strong>Growth stage:</strong>&lt;br&gt;General business financing</td>
<td>Overdraft financing&lt;br&gt;Project &amp; contract financing&lt;br&gt;Working capital guarantees&lt;br&gt;Factoring&lt;br&gt;Distributor supplier financing&lt;br&gt;Property acquisition financing&lt;br&gt;Hire/purchase financing&lt;br&gt;Project financing&lt;br&gt;Commodity murabaha financing&lt;br&gt;Agricultural enterprise financing&lt;br&gt;Professional services business loans&lt;br&gt;Short-term revolving credit&lt;br&gt;Credit guarantees</td>
</tr>
<tr>
<td><strong>Maturity stage:</strong>&lt;br&gt;Capital markets and treasury services</td>
<td>Capital markets services:&lt;br&gt;• Corporate advisory services&lt;br&gt;• M&amp;A advisory&lt;br&gt;• M&amp;A and bridge financing&lt;br&gt;• Initial public equity offerings (IPOs)&lt;br&gt;• Secondary equity offerings&lt;br&gt;• Sukuk / fixed-income issuances&lt;br&gt;• Syndicated loans&lt;br&gt;Treasury services:</td>
</tr>
</tbody>
</table>

<sup>25</sup> World Bank analysis of publicly available information.

<sup>26</sup> This is part of BNM’s Fund for SMEs. See [https://www.bnm.gov.my/documents/20124/2294076/Brochure_TRRF_EN.pdf](https://www.bnm.gov.my/documents/20124/2294076/Brochure_TRRF_EN.pdf).

<sup>27</sup> This is known as the PENJANA Tourism Financing (PTF) Facility and was instituted under the auspices of BNM. See [https://www.bnm.gov.my/documents/20124/2294076/PTF_FAQ_en.pdf](https://www.bnm.gov.my/documents/20124/2294076/PTF_FAQ_en.pdf)?s=2.
<table>
<thead>
<tr>
<th>Deposit accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Money market (including <em>Wakalah</em>, <em>Mudarabah</em>, <em>Bai Inah</em>, and <em>Tawarruq</em> structures)</td>
</tr>
<tr>
<td>Foreign currency services</td>
</tr>
<tr>
<td>Derivatives and structured products</td>
</tr>
<tr>
<td>Risk management</td>
</tr>
</tbody>
</table>

*Source: World Bank staff’s analysis of publicly available information*

Many Malaysian Islamic banks have initiatives specifically targeting HE companies. Their support for HE enterprises ranges across a full spectrum of business functions: halal certification and training; business development and marketing; distribution, logistics, and warehousing; exports and expansion outside Malaysia; and providing financial services to MSME HE enterprises, including financing and insurance. Some examples of bank initiatives are as follows:

i. Maybank has a “Halal Route to Market Program” that aims to assist MSMEs in expanding their halal businesses outside Malaysia. The bank aids MSMEs in distribution, service advisory, and marketing.\(^{28}\)

ii. CIMB has a “HalalBizReady” program to support halal businesses in multiple areas: logistics and warehousing, halal certification and training, business development, international trade, and financing needs.

iii. Bank Islam Malaysia’s “Go Halal SME Financing Program” similarly provides financing at favorable terms to help Malaysian small and medium-sized enterprises in the halal sector achieve halal certification, afford insurance in the form of *takaful*, fund working capital needs, and purchase plant and equipment.\(^{29}\) Another Bank Islam facility, the Shariah Compliance SME Financing Scheme (SSFS) 3.0, is designed to finance MSME business activity, especially exporting halal products, and is subsidized by the government.\(^ {30}\)

iv. Alliance Islamic Bank’s “Halal in One” likewise helps HE enterprises obtain halal certification, seek out new customers, and secure financing.\(^ {31}\)

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v. AmBank Islamic’s “Halal Quest” is a partnership with the Malaysian government’s halal certification body, JAKIM, that offers halal certification assistance to Malaysian MSMEs.

vi. Standard Chartered Saadiq’s “Halal360” initiative hopes to leverage the bank’s global footprint to serve halal businesses.32

**Outstanding Islamic financing in the banking sector to HE companies exceeded US$ 5 billion and skews heavily towards the food and beverage industry.** As of September 2021, outstanding Islamic financing to halal-certified food and beverage enterprises was US$ 4.0 billion, followed by manufacturing (US$ 718 million), food premises (US$ 239 million), and pharmaceuticals (US$ 109 million). F&B thus represents nearly four times the volume of the next three largest categories combined.33

**The percentage of halal-certified companies using Islamic financing nearly doubled between 2018 and 2021.** In 2018, 21.9 percent of halal-certified companies in Malaysia used Islamic finance (based on approved applications for financing). The figure increased to 41.3 percent by 2021 – an increase of 89% in the adoption rate over a three-year period. The chart below, produced by Bank Negara Malaysia, identifies a series of strategic initiatives over the years that have contributed to the growth in Islamic finance adoption. These include: (1) the inclusion of an Islamic finance pavilion at the Malaysia International Halal Showcase (MIHAS); (2) business engagement programs between HE enterprises and IFIs; (3) partnerships between industry and regulators; and (4) increasingly customized financial solutions for HE enterprises.34

32 See [https://www.sc.com/my/saadiq/halal360/](https://www.sc.com/my/saadiq/halal360/).

33 Lim Qian Pink, Anas Afifi Zulkefli and Faqrul Fithri Mohd Nasrudin, Bank Negara Malaysia. Data and analysis provided for this report.

34 Lim Qian Pink, Anas Afifi Zulkefli and Faqrul Fithri Mohd Nasrudin, Bank Negara Malaysia. Data and analysis provided for this report.
Bank financing, however, has significant limitations and constraints. First, capital offered to start-up enterprises can be limited since large corporate customers are likely to be more profitable for banks to service. The credit review process for small companies may require significant staff time but only generate small revenue for the bank: spending the same amount of time on a larger account would be a more efficient use of human resources. Nonetheless, as noted above, several banks appear to market financial services specifically to MSMEs, and the Malaysian government has several subsidy and guarantee programs to encourage banks to engage with smaller business customers. Second, banks focus on debt rather than equity financing. This focus is a result of their mandate to preserve depositors’ funds and take only a limited risk on their balance sheets. Most of the products and services offered by Malaysian IFIs involve a lending or guarantee component (if the institution puts its capital at risk at all) or involve the provision of services, which often has no downside capital risk for the institution. Third, creditworthiness and collateral are ordinarily essential factors in a bank’s decision to extend financing.

For a start-up enterprise lacking a credit history or limited collateral, obtaining financing can be difficult. Again, some banks have programs catering to MSMEs that recognize these potential hurdles and offer financing with modified terms. Finally, banks’ mandates generally do not necessarily include actively supporting business growth through interventions beyond providing

Lim Qian Pink, Anas Afifi Zulkefli and Faqrul Fithri Mohd Nasrudin, Bank Negara Malaysia. Data and analysis provided for this report.
financing. However, some banks do have programs to assist MSME startup and growth, and the Malaysian government also undertakes several schemes to support MSMEs. These programs make bank-enabled support more broadly relevant to the HE and MSMEs. Bank programs designed to support MSMEs can play an important role in enhancing access to finance – especially debt financing – are encouraging. However, they are likely to remain only part of the solution since banks do not have the mandate to be equity investors in small businesses.

Although micro-sized halal-certified companies have adopted Islamic finance, larger halal-certified businesses primarily use conventional finance (Figure 2.2). Nearly two-thirds (65 percent) of the outstanding bank funding to halal-certified micro-enterprises was Islamic as of September 2021. Non-SME businesses that are halal-certified predominantly used conventional finance; only 25 percent of outstanding bank finance to them was Islamic. Large companies, particularly foreign multinational companies (MNCs) that are involved in Malaysia’s HE, tend to have a higher proportion of their banking transactions conducted through conventional banks associated with their parents. Medium-sized enterprises used 32 percent of Islamic finance; small-sized enterprises used 42 percent. Discussions with halal industry players indicate several reasons for this contrast between heavy use of Islamic finance by halal-certified micro-enterprises when compared to the larger firms. In the first place, larger companies often have less awareness of the benefits of using Islamic finance facilities given long-standing relationships with conventional banks. Also, there is a general misconception that Islamic finance is complex and costly due to the nature of transactions.

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36 See, for example, the large number of BNM SME fund financing products listed at https://www.publicislamicbank.com.my/Business-Banking/Financing/Other-Financing/BNM-SME-Fund-Financing-Products.
Adoption rates of Islamic finance vary greatly by sector (Figure 2.3). Halal-certified companies in the pharmaceutical industry overwhelmingly use Islamic financing (70 percent). In all other sectors of the HE, however, more than two-thirds of outstanding bank financing is conventional. The use of Islamic financing stands at 34 percent for food products, beverages as supplements, 28 percent for slaughterhouses, and 24 percent for the manufacturing and OEM sector. The logistics (19 percent), food premises (13 percent), cosmetics (8 percent), and used goods (8 percent) sectors all have adoption rates of Islamic finance below 20 percent. Figure 2.3 below presents the use of Islamic vs. conventional finance by the HE sector.

Source: BNM analysis (Pink, Zulkefli, and Nasrudin), 2022

Data and analysis provided for this report by Lim Qian Pink, Anas Afifi Zulkefli and Faqrul Fithri Mohd Nasrudin, all at the Bank Negara Malaysia. Please note that the “others” category covers entities such as cooperatives and NGOs.

Lim Qian Pink, Anas Afifi Zulkefli and Faqrul Fithri Mohd Nasrudin, Bank Negara Malaysia. Data and analysis provided for this report.
2.1.3. Financing Through Islamic Non-Bank Financial Institutions (NBFIs) and Capital Markets

Malaysia’s Islamic NBFIs sector is similarly highly developed to its Islamic banking sector. The 2021 IFDR breaks down each country’s quantitative development in Islamic finance (where Malaysia ranks first among all nations) into five further sub-indicators. Other than Islamic banking, the other sub-indicators are sukuk (where Malaysia is in the first place), Islamic funds (first), takaful (fourth), and other IFIs (third). More quantitatively, Malaysia is by far the world leader in sukuk, with Malaysian issuers responsible for over 40 percent of the US$631 billion of sukuk outstanding worldwide in 2020. Malaysia also has approximately 20 percent of the world’s US$62 billion of takaful assets and had one of the three fastest growing takaful markets in 2020. Finally, Malaysia leads all countries in assets held in other IFIs, with over one-third of the world’s US$154 billion markets. This category consists of institutions other than banks and takaful providers such as finance, leasing, mortgage, factoring, and fintech companies (Refinitiv, 2021).

Islamic NBFIs in Malaysia play an essential role in financing and supporting businesses. The table below shows the roles played by various types of NBFIs in this endeavor.

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39 Lim Qian Pink, Anas Afifi Zulkefli and Faqrul Fithri Mohd Nasrudin, Bank Negara Malaysia. Data and analysis provided for this report.

40 IFDR 2021. This category would also include the TH, whose total assets are now close to $20 billion. https://www.malaymail.com/news/malaysia/2021/03/03/tabung-haji-in-the-pink-with-total-assets-outstripping-liabilities-by-rm3.7/1954471.
Table 2.2 Role of NBFI in Financing and Supporting Business

<table>
<thead>
<tr>
<th>Type of NBFI</th>
<th>Illustrative Activities in Financing and Supporting Business</th>
</tr>
</thead>
<tbody>
<tr>
<td><em>Takaful companies</em></td>
<td>• <em>Takaful</em>, a form of shari‘ah-compliant insurance, is an essential service consumed by modern businesses to protect against life, property, casualty, financial, and general business risks. Malaysia has over a dozen <em>takaful</em> operators (Md Husin, 2019).</td>
</tr>
<tr>
<td>Microfinance institutions</td>
<td>• As of 2017 (the latest data available), non-deposit taking microfinance institutions in Malaysia had around $1 billion in loans outstanding to about a million micro enterprises. According to 2016 BNM data, more than one million micro enterprises have received US$1.2 billion of funding from Malaysian microfinance institutions.</td>
</tr>
<tr>
<td>Development finance institutions</td>
<td>• BNM data indicates that as of November 2021, development finance institutions had almost US$4 billion of loans outstanding to SMEs, including over one-quarter of all financing received by SMEs in the primary agriculture sector.</td>
</tr>
<tr>
<td>Leasing companies</td>
<td>• Malaysia has hundreds of leasing companies, which are particularly useful to businesses that must finance the use of expensive fixed assets. Representative industries include energy, aviation, shipping, and construction.</td>
</tr>
</tbody>
</table>
| Government-affiliated entities  | • Tabung Haji has almost US$20 billion of assets invested across a range of equity and fixed income (sukuk), including major industrial, agricultural, and transportation projects in Malaysia. (World Bank Group, 2020c p.69)  
  • PNB (Permodalan Nasional Berhad) is an asset manager with around US$75 billion in AUM at the end of 2020 that includes significant minority or controlling stakes in businesses key to Malaysia’s economic development. (World Bank Group, 2020c p.71) |

Source: World Bank staff’s analysis based on publicly available information

Non-bank financial institutions (NBFI) in Malaysia have several programs that support the HE and MSMEs active in the HE. The programs described below serve MSMEs broadly,

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43 The count of leasing companies is from [https://bizdirectasia.com/list/malaysia/keyword/service+leasing.html](https://bizdirectasia.com/list/malaysia/keyword/service+leasing.html).

44 See also the description of the PNB’s investment strategy at [https://www.pnb.com.my/index_EN.php](https://www.pnb.com.my/index_EN.php).
including companies in the halal economy. In some cases, such as BPMB, there are specific high-profile examples of these NBFIs specifically supporting HE enterprises.

i. The Malaysian Development Bank (known by the acronym BPMB (Bank Pembangunan Malaysia Berhad) is an arm of the Malaysian government that provides financing to industries deemed to be of national importance. Its National Development Scheme initiative is designed to support the 12th Malaysia Plan (2021-2025), which specifically includes the HE under the primary focus category of “high impact industries.” Term financing for capital expenditures and operating expenses is available at subsidized rates to qualifying borrowers.45

ii. BPMB runs several other programs that can support such companies, although not specifically targeted at HE enterprises. For example, one Malaysian halal food producer was the first recipient of financing from BPMB’s “Industry Digitalization Transformation Scheme,” which subsidizes industry adoption of new technologies. BPMB was also the first financial institution to provide financing to this halal food producer 35 years ago.46

iii. Agrobank, another development financial institution in Malaysia owned by the government, focuses on the agricultural sector and related industries. Since 2015, it has been a fully Islamic bank capable of providing Islamic financing solutions to the halal food industry, furthering shari’ah-compliance across the entire value chain.47 Agrobank’s focus on the agricultural sector makes it a natural partner for the halal food sector, which comprises the largest component of Malaysia’s HE.

iv. Tekun Nasional is a government agency whose mission is to make micro-credit financing more accessible to entrepreneurs and, more broadly, provide guidance and advice to entrepreneurs and encourage networks of entrepreneurs to develop.48

v. Malaysia's general takaful providers offer MSME takaful packages that mostly cover P&C claims. However, there are no specific initiatives for HE enterprises at present.


Malaysia is consistently ranked as having the world’s most sophisticated Islamic capital market (ICM). As noted earlier, the 2021 edition of the IFDR notes Malaysia’s continued leadership in multiple capital markets metrics, ranking it the world leader in sukuk. Malaysia’s sukuk outstanding stood at US$ 262 billion in December 2020, 42 percent of the global total of US$ 631 billion. Malaysia’s sukuk market volume was equal to nearly the totals of the next three countries combined (Saudi Arabia (US$ 158 billion), Indonesia (US$ 73 billion, and the UAE (US$ 50 billion). Furthermore, the 2021 edition of the Islamic Financial Services Industry Stability Report (IFSISR), which is published by the Islamic Financial Services Board (an international standard-setting organization based in Malaysia), observes that Malaysia has an active domestic sukuk market, citing its depth and liquidity. (Islamic Financial Services Board, 2021 p.21).

Malaysia ranked third amongst all countries in 2020 in terms of Islamic fund assets under management (AUM). Malaysia’s US$ 38 billion in AUM represented 21 percent of the global market of US$ 178 billion. Countries ahead of Malaysia in the rankings are Saudi Arabia (US$ 53 billion) and Iran (US$ 46 billion).

At least 20 percent of Malaysia’s ICM securities are estimated to be issued by HE enterprises. The Securities Commission Malaysia (SC)’s 2021 Annual Report states that 750 securities traded on Bursa Malaysia were shari’ah compliant. This corresponds to 79 percent of all securities available (949) and 67 percent of total market capitalization. Of the 750 Islamic securities, 146 were in the consumer products and services category. Additionally, there were 30 securities in the transportation and logistics sector and 23 in the healthcare sector. (Securities Commission Malaysia, 2021). The consumer companies issuing Islamic securities (19 percent of total ICM issuers) may be assumed to be predominantly halal, as their issuances would not pass the shari’ah filters if their nature of business were impermissible. Some transportation and logistics companies may be halal logistics companies and some healthcare companies may be halal pharmaceuticals. It may thus be safely estimated that at least 20 percent of ICM securities in Malaysia have been raised to fund HE companies.

The ICM in Malaysia provides a diverse set of financing options for large-scale businesses. The SC, which regulates Malaysia’s capital markets, has been important to the development of Malaysia’s ICM. The table below shows the range of Islamic capital market products available to large-scale businesses.

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Table 2. Islamic Capital Markets Products in Malaysia

<table>
<thead>
<tr>
<th>ICM Product</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shares</td>
<td>Both common stock and non-cumulative non-voting preferred stock are considered <em>shari’ah</em>-compliant.</td>
</tr>
<tr>
<td>Sukuk</td>
<td>A form of <em>shari’ah</em>-permissible debt, a sukuk certificate indicates the holder’s ownership or investment interest in certain underlying assets (generally tangible assets) of the sukuk issuer. Malaysia’s sukuk market is the world’s largest.</td>
</tr>
<tr>
<td>Commodity futures contracts</td>
<td>Commodity futures contracts represent an agreement to buy or sell a commodity at a specified price on a specified future date. Futures contracts involving crude palm oil, among other commodities, have been ruled permissible in Malaysia.</td>
</tr>
<tr>
<td>Single stock futures contracts</td>
<td>Malaysia’s ICM includes futures contracts on shares of companies engaged in <em>shari’ah</em>-compliant activities. The shares must be listed on the Malaysian stock market, the futures contract must follow certain standardized terms regarding size and expiration, and the contract must be cash settled.</td>
</tr>
<tr>
<td>Business trusts</td>
<td>The creation of trusts that own business assets and are operated or managed by a trustee are permitted, provided certain <em>shari’ah</em> governance guidelines are followed. A key investor feature of business trusts is that they can pay distributions out of operating cash flow rather than merely accounting profits.</td>
</tr>
<tr>
<td>ETFs based on gold and silver</td>
<td>Islamic exchange-traded funds whose underlying assets are gold or silver are permitted in Malaysia if certain requirements relating to structure, trading, and settlement procedures are met.</td>
</tr>
<tr>
<td>Stapled securities</td>
<td>Stapled securities are “a situation where investors own two or more securities which are generally related to each other and contractually bound together through a single vehicle that cannot be traded separately.” Provided the individual securities that are stapled together are <em>shari’ah</em>-compliant, the overall stapled security will also be permissible.</td>
</tr>
<tr>
<td>Redeemable convertible unsecured Islamic debt</td>
<td>A company may issue such an instrument to obtain financing at a fixed-income rate, with holders of the security being non-voting creditors of the issuer. The instrument may be cheaper to service than a bank loan, and the conversion feature may attract investors looking for additional upside and appeal to current shareholders who prefer equity to debt investing.</td>
</tr>
<tr>
<td>Securities lending</td>
<td>“Islamic Securities Selling and Buying-Negotiated Transaction Model” is permitted as a counterpart to conventional securities lending structures. Such structures permit institutional holders of securities to lend their securities (at a price) to borrowers such as broker-dealers, investment banks, and hedge funds, enabling them to conduct capital markets operations that require possession of the security.</td>
</tr>
<tr>
<td>Islamic REITs</td>
<td>A real estate investment trust, or REIT, is a vehicle that permits large numbers of investors to participate passively in equity ownership of real estate while enjoying professional management of the underlying properties. The SC has published extensive operational guidelines for <em>shari’ah</em>-permissible REITs and guidelines for the conversion of conventional REITs to Islamic REITs.</td>
</tr>
</tbody>
</table>

*Source: Securities Commission Malaysia*
In addition, Malaysia has an incipient market for Islamic derivatives and structured products, particularly certain kinds of forwards and swaps (offered by over a dozen Islamic banks in Malaysia), although Islamic derivatives remain quite limited in scope and scale. Access to these products would strengthen the ability of halal companies to hedge various risks, especially in an uncertain post-pandemic world. Derivatives relevant to HE companies may include (1) forward and futures contracts, by which they can secure prices for the inputs required for producing goods and (2) foreign exchange futures, which help mitigate foreign exchange risk related to either input costs in foreign currency or revenues from customers in foreign currency. Islamic derivative standards produced by the International Islamic Financial Market (IIFM) and the International Swaps and Derivatives Association (ISDA) include templates for both foreign exchange futures and currency swaps (IIFM 2017). HE companies can thus avail of Islamic derivative solutions for key aspects of risk management.

Malaysia’s capital markets have increasingly embraced fintech and other innovative solutions which could help finance halal SMEs. As early as 2016, BNM realized the potential of Islamic fintech solutions, launching a “Financial Technology Regulatory Sandbox Framework” as early as 2016 to enable fintech innovation and experimentation within a supportive regulatory background. BNM specifically noted that innovations eligible for the fintech regulatory sandbox “should have clear potential to improve the accessibility … of financial services … or address gaps in or open up new opportunities for financing.” Likewise, the Malaysian securities regulator has the “aFINity@SC” initiative to support the growth of fintech in the Malaysian capital market and, in 2021, launched the “Fikra Islamic Fintech Accelerator Program” to help fintech startups access capital. Approximately 40 fintech enterprises are currently licensed to do business in various segments of the Malaysian capital market, including digital investment management, equity crowdfunding, peer-to-peer financing, and digital asset exchange. Malaysian Islamic fintech ventures that assist SMEs include those furnishing cross-border payment services to enable

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54 See https://www.sc.com.my/fikra.

payment to non-Malaysian suppliers and a number of Islamic supply chain finance platforms (World Bank Group, 2021b p.70, 72, 87). Several of the most prominent Islamic banks in Malaysia also have online marketplace platforms to support trade and facilitate the provision of financing needs. (World Bank Group, 2021b p.102)

2.1.4. Financing from Malaysian Institutional Investors

Malaysia’s large institutional investors do not appear to have explicit strategies targeting the HE. Although these institutions invest broadly in the Malaysian economy, analysis suggests they have not published strategic plans or investment allocations for the HE.

However, they have mandates that include national development and Islamic investment. Several examples can be given:

i. PNB, with approximately US$75 billion under management, making it one of the largest fund management companies in Malaysia, has as its mission “to enhance the economic wealth of the Bumiputera community and all Malaysians.” Such a goal can incorporate the support of the HE, as this ethnic group generally consists of Muslims. PNB’s portfolio investments include businesses and funds active in HE sectors. If the HE is viewed as a strategic priority for national development, PNB could designate an allocation for HE investments as an application of its overall mandate.

ii. Employees Provident Fund (EPF), Malaysia’s national retirement saving scheme for private-sector workers, manages assets of approximately US$238 billion (as of the end of 2020), of which 40 percent is invested in shari’ah-compliant assets. This includes investments in Islamic private debt securities and shari’ah-compliant financing. (Employees Provident Fund, 2020 p.46, 49, 198). EPF’s commitment to Islamic investment creates a large pool of capital that must be channeled to permissible businesses. As a result, HE enterprises and other businesses that meet EPF’s Islamic screening criteria stand to benefit from the additional capital.

iii. KWAP is the public employee counterpart of the EPF. With total assets of around US$35 billion as of mid-2021, KWAP has avoided investments in certain Islamically

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impermissible activities, such as alcohol and gaming, since its inception in 2007. (KWAP, 2018)57

iv. Malaysia’s national investment fund Khazanah Nasional has set aside US$1.4 billion to be deployed over the next few years into an investment fund aimed at improving national development in addition to providing purely financial returns.58 This is a significant portion of its total assets (as of the end of 2020) of approximately US$20 billion. More generally, Khazanah’s purpose is “to deliver sustainable value for Malaysians” and it is managed internally through two separate funds, one of which, the “Strategic Fund,” aims “to deliver impactful measurable economic and societal returns for the nation and its people.” (Khazanah Nasional, 2021 p.6). To the extent that developing the HE is a priority for Malaysia, Khazanah could potentially allocate from its Strategic Fund in order to catalyze the HE.

2.1.5. Other Institutional Support

Beyond banks and NBFIs, several institutions in Malaysia provide financial and non-financial support for the HE. One of the most prominent is the Halal Development Corporation (HDC), a Malaysian federal government agency that acts as a central promotion body to develop Malaysia’s HE. The HDC offers HE enterprises and the halal industry a broad slate of advisory services, touching upon market research, recruiting, halal certification, logistics, networking, funding, and trade facilitation, governance and auditing practices, and training programs and seminars. The HDC has also designated fourteen locations through Malaysia to serve as “halal parks” hosting industrial facilities populated by HE enterprises, ranging from domestic MSMEs all the way to large multinational corporations such as Kellogg and Coca-Cola’s local bottler.59

The SC, the Malaysian capital markets regulator, has published guidance regarding the shari’ah screening of MSMEs that are seeking to raise funds through crowdfunding and peer-to-peer financing platforms. This is designed to benefit investors seeking to invest in the HE and HE


enterprises to achieve a shari’ah-compliant capital structure. HE companies stand to benefit from these tools, as their ability to pass shari’ah screens can make them eligible for investment from investors who require compliance with Islamic guidelines.

Malaysia’s Entrepreneur and Cooperative Development Ministry (MEDAC) has encouraged awareness of halal certification among MSMEs and supported human and physical capital growth and improved marketing in the HE under the aegis of programs such as the Halal Outreach Program for Entrepreneurs (HOPE), the Product Transformation Program (PuTRA), the Halal Technology Transformation Program (HTTP), the International Product Registration Incentive (PRInce), and the Market Access Incentive (MASSIVE). These programs are implemented by other Malaysian agencies: the Cooperative Commission of Malaysia (SKM), SME Corp. Malaysia, and Tekun Nasional. The SME Corp. Malaysia is notable for being a government agency specifically dedicated to implementing development programs designed to assist MSMEs. It cooperates with other agencies, financial institutions, and entrepreneurs themselves in carrying out this objective.

JAKIM (the Department of Islamic Development Malaysia), a federal government agency, was established in 1974 and maintains the halal certification guidelines that apply in Malaysia. As noted in Chapter 1, the halal certification guidelines JAKIM published in 2020 encouraged certified halal companies to use Islamic finance. Also, under the auspices of JAKIM, Malaysia hosts the International Halal Authority Board, an umbrella organization of halal certification bodies from 45 countries. Therefore, recognizing the validity of halal certification conferred by foreign agencies can remove a roadblock to international trade of HE products.

Additionally, the Ministry of Science, Technology, and Innovation (MOSTI), through the Malaysian Technology Development Corporation (MTDC), provide the Halal Technology Development Fund (HTDF). The HTDF is specifically designed to finance and nurture small and medium enterprises (SMEs) for long-term growth and export through halal-compliant activities. The fund's primary focus is to provide companies with access to the best advisory services and networks. In addition, activities include the halal product development process and

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regulatory compliance services to overcome barriers and hurdles to bringing halal products and services to market.

Finally, Malaysia originated the World Islamic Economic Forum (WIEF), an event attended by business, government, and investor representatives that has fostered intra-OIC business and trade opportunities and encouraged HE activities. The annual event alternates between Malaysia (hosting once every two years) and other countries. The organizers of the Forum have also held events geared toward startups and entrepreneurs.64 Malaysia also hosts a trade fair called the Malaysia International Halal Showcase (MIHAS), which since 2004 has allowed HE enterprises to showcase their wares and network with other industry participants. The MIHAS is hosted by Malaysia’s Ministry of International Trade and Industry and receives assistance from the HDC and JAKIM.65

2.1.6. Cross-Border Investments in the Halal Economy

As mentioned in Chapter 1, Malaysia has captured a large share of global HE cross-border investments. Of 156 cross-border transactions in 2019-20, estimated at US$11.8 billion recorded in the GIER 2021 (DinarStandard, 2021b), 31 were in Malaysia. This corresponds to 20 percent of the total number of transactions. Only Indonesia (with 38 inbound transactions) had more reported cross-border HE investments. The largest number of transactions was in the halal food sector (16), followed by media and entertainment (10), Muslim-friendly travel (3), halal pharmaceuticals (1), and unspecified (1). Although the precise deal value of these transactions is not publicly available, Malaysia’s share could be roughly estimated at US$2.3 billion based on the number of Malaysian transactions (31) and the global average transaction size of US$75.5 million per transaction.

Cross-border investments in the HE may face unique challenges. Total trade by OIC member countries represents 9.2 percent of global trade, although the population of OIC member countries exceeds 20 percent of the global total. Intra-OIC trade is 18.3 percent of OIC member countries' trade, suggesting that intra-OIC trade is 1.7 percent of total global trade (World Bank Group, 2021b). The limited trade volume suggests that investment ties and comfort with cross-border investment may also be limited. In addition, regulatory barriers and foreign exchange risk can contribute to reluctance to invest across borders. In the case of the HE, there may be additional challenges due to halal certification and accreditation requirements varying between countries.

Multilateral development banks (MDBs) can play a supportive role in increasing cross-border investment. Numerous MDBs are active in countries with large halal economy sectors. These include the World Bank Group (WBG), the Islamic Development Bank (IsDB) Group, the

64 See https://wief.org/.

Asian Development Bank (ADB), the African Development Bank (AfDB), and the European Bank for Reconstruction and Development (EBRD), and Asian Infrastructure Investment Bank (AIIB). These institutions can support halal economy sector development through direct financing and non-financing support. The IFC (a member of the WBG) plans to invest up to US$1.2 billion in investments in the Sahel region in sectors including agribusiness between 2022 and 2026.\textsuperscript{66} Political risk insurance and credit enhancement, such as facilities offered by MIGA (a member of the WBG) and credit guarantees like those offered by ICIEC (a member of the IsDB), can mitigate risks associated with cross-border HE investments and enable more such transactions in the future. Additionally, trade finance facilities such as those offered by the ITFC (also a member of the IsDB) can foster greater trade volumes, enhancing the revenues and profits of HE companies and making them more attractive for investment.

Global industry-building efforts by Malaysian institutions may help attract cross-border HE investment. The World Islamic Economic Forum (WIEF), a Malaysia-led initiative, has been held in Malaysia and Pakistan, Kuwait, Kazakhstan, the United Kingdom, the United Arab Emirates, and Indonesia. (WIEF 2022).\textsuperscript{67} Malaysia’s Halal Development Corporation announced a partnership with the Islamic Development Bank to undertake a “Global Halal Ecosystem Assessment” studying best practices and gaps in the halal sectors of 22 countries (IsDB, 2022).\textsuperscript{68} HDC’s Halal Training Institute teaches best practices not only for halal food but also for halal-friendly hospitality, halal pharmaceuticals, and more (HDC, 2022).\textsuperscript{69} Although the direct impact of these initiatives on inbound investment is not known, their role in positioning Malaysia as a HE leader likely helps attract FDI to the country.


\textsuperscript{67} See https://wief.org/milestone/


\textsuperscript{69} See https://hdcglobal.com/halal-training-institute/
Special Topic: Financing the Halal Food Industry in Malaysia

2.2. Introduction

The food industry is a complex supply chain network, covering all aspects of food and beverages from production to sale (Figure 2.4). It includes raising crops and livestock, food processing, packaging and labeling, storage, distribution, marketing, retailing, catering, research and development, and education\(^{70}\). There are also supportive activities such as the manufacturing of farm equipment and agrochemicals and the financing of businesses in the food industry. The preparation, handling, and processing of food according to shari’ah principles is the singular distinguishing feature of the halal food industry.

Figure 2.4 Simplified Halal Supply Chain

![Simplified Halal Supply Chain](source: World Bank staff illustration)

Malaysia is the second-largest importer of halal-certified food from the OIC countries behind Saudi Arabia. Globally, the halal food segment has also gained prominence, with Muslims spending approximately US$1.17 trillion on F&B in 2019.\(^{71}\) Awareness of consuming halal food is also growing amongst the non-Muslim population as the definition, and the understanding of halal has evolved from being associated with religious observation to assurance of food safety, hygiene, quality, and wholesome products (Charoenchang, 2019). Indeed, the largest producers and exporters of halal food are countries like Brazil, Australia, the United States, and Argentina.\(^{72}\) Therefore, the sustainable development of the halal food segment is an important objective for the Malaysian authorities, and access to financing at all stages of the supply chain is essential to meeting this objective.


\(^{71}\) Muslim consumer expenditure on food and beverages worldwide from 2018 to 2024 https://www.statista.com/statistics/737151/global-muslim-food-and-beverage-market/

\(^{72}\) Based on the halal classification for food-related products by the WTO and data available in the UN International Trade Statistics Database
2.3. Islamic Banking

Malaysia’s Islamic banking sector is well developed and has numerous traditional and fintech product offerings for the agricultural and food sectors. In addition, several Malaysian Islamic banks, such as Bank Islam, Maybank, CIMB, and Alliance, offer dedicated financing and other forms of support that help expand the halal business, including halal agriculture products. For example, CIMB’s Agrofood Facility Scheme and Maybank’s Primary Agriculture Sector-i provide financing for working capital and/or capital expenditure for the development of agriculture projects, such as purchasing machinery and equipment, or for the renovation cost for owner-occupied business premises. In addition, the Value-Based Intermediation (VBI) initiative, which aims to improve the products and services offered by IFIs towards better facilitation of entrepreneurship, community well-being, sustainable environment, and economic growth, supports commercial banks to continue their offering of loan facilities to the agricultural-related sectors which are usually perceived as higher risk due to low levels of profitability and the lack of assets that can be used as collateral.

2.4. Islamic Capital Markets (ICM)

The capital market plays a complementary role to the banking industry by supporting capital and fund-raising activity. Traditionally, medium to large firms in Malaysia can raise capital through the capital market via equities, bonds, and sukuk. Nearly 80 percent of listed companies in Malaysia are shari’ah-compliant. As of November 2021, the market capitalization of these shari’ah compliance companies stood around US$0.28 trillion (RM1.19 trillion), or around 68 percent of the total Bursa Malaysia market capitalization. Currently, there are approximately 45 agriculture and food-related products firms in the consumer staples group listed in Bursa Malaysia (Figure 2.5 and 2.6). This sector covers food activities from farming, food manufacturing, animal feeds production and fisheries to medication. Listed and planned to be listed firms in the halal food industry can have easy access to raise funds and tap liquidity via sukuk and shari’ah compliant equities. In addition, Halal MSMEs can raise funds via alternative markets such as ECF and P2P lending.
Figure 2. 5 Market Capitalization for Food-related Sector By Size: Shari’ah vs. Non-Shari’ah (as at December 31, 2021)

![Market Capitalization for Food Related Sector: Shariah vs Non-Shariah](image)

Source: Bloomberg

Sukuk, one of the key ICM instruments, dominated the issuance in 2021, representing around 83 percent of capital raised from corporate bonds and sukuk. QSR Brands, which operates KFC and Pizza Hut, issued sukuk *murabahah* of up to US$0.31 billion (RM1.3 billion) in 2017 is a good example of how halal companies could tap the sukuk market. Similarly, FGV Holdings, a plantation-related company producing various halal food-related products, also issued RM 500 million of sukuk *murabahah* in 2021. QSR Brands also listed its assets under the Al-Salam Real Estate Investment Trust (Al-Salam REIT). The proceeds from the sukuk *murabahah* program shall be utilized by FGV to refinance its existing financing or borrowings. Al-Salam REIT was listed on the Main Market of Bursa Malaysia Securities Berhad on 29 September 2015 with an initial asset value of US$215 million (RM903.1 million). Starting with 31 properties in 2015, Al-Salam REIT has expanded its portfolio to 54 properties across Malaysia, comprising three retail malls, an office building, 43 F&B restaurants, and seven F&B non-restaurant assets. The asset value of Al-Salam REIT has since risen to US$0.28 billion (RM1.19 billion) as of 31 December 2020 from its initial investment. As of 31 December 2020, Al-Salam REIT market capitalization stood at US$75.6 million (RM319 million) (Al-Salam REIT, 2020).

### 2.5. Alternative Finance

**ECF** and **P2P** provide additional fund-raising avenues for early-stage businesses and MSMEs. ECF is an innovative form of alternative fundraising that allows small businesses, including those in the halal industry, to raise capital from the public using online platforms registered with the securities market regulator. In the context of the halal industry, ECF allows small halal businesses to offer equity in their companies to investors, who in turn invest in the concept in which they see the potential. Through ECF, investors can diversify their investments beyond traditional asset classes. P2P financing is another innovative form of financing that allows entrepreneurs and small businesses to unlock capital in small amounts from a pool of individual lenders. P2P lets businesses borrow, and investors lend capital through online platforms registered
with the SC, including shari’ah compliant platforms. In addition, the alternative financing market can also help embed financing solutions based on data such as from the agritech platforms or digital marketplaces and support innovative firms in developing credit scoring models that are useful for future lending.

Since their introduction, these alternative market-based fund-raising platforms have benefited close to 3,000 MSMEs. In 2020 and despite economic uncertainties, total amounts raised from these platforms were more than 5.5 times for ECF (Figure 2.7) and 1.2 times for P2P platforms (Figure 2.8) compared to the previous year. The offering of shari’ah-compliant solutions by these platforms has also increased. Currently, there is only one Islamic ECF platform, i.e., Ethis, in contrast to five P2P platform operators that are providing shari’ah-compliant offerings. More than US$0.38 million (RM1.6 million) has also been successfully raised using Islamic investment notes.73

Figure 2.7 Equity Crowdfunding Activities in Malaysia (end-September 2021)

Note: 236 Successful Campaign, RM352.11 A mount Raised, 222 Successful Issuers
Source: Securities Commission, as of end September 2021

Example of ECF registered with Securities Commission Malaysia

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73 See https://www.sc.com.my/resources/speeches/keynote-address-at-sc-hdc-forum-2021-enabling-growth-through-the-islamic-capital-market
However, some private lenders may find it difficult to expose their portfolios to the halal food supply chain base, which is the agricultural sector. The potential reasons are the high entry barrier regarding farming skills and experience, land requirements, and high initial capital investment. On a positive note, growing interest among AgroTech providers such as Kapitani Sdn Bhd provides digital solutions and extends advancements in bookkeeping and agricultural analytics to farmers, which will allow lenders to access real-time farm data and farmers’ credit scores. These digital solution providers can also construct optimal profit-sharing and repayment terms based on individual farmers' financial health and farm operation, connecting farmers with players along the agriculture supply chain.

Figure 2. 8 Peer to Peer Lending Activities in Malaysia (end-September 2021)

Note: 25,259 Successful Campaign, RM1.94 billion Amount Raised, 3,824 Successful Issuers
Source: Capital Market Malaysia, as of end September 2021

Example of P2P registered with Securities Commission Malaysia
Several ongoing initiatives on the ECF front could benefit halal companies. For example, several ECF operators, such as AtaPlus, have included agriculture-related firms in their investment portfolio, including Fefico. This technology-first co-farming company provides traditional smallholder farmers and young agriculture grads with ready-to-farm spaces and technologies to kickstart farming businesses. Also, the Fish Club, an online-to-offline fresh food retail sales platform that reduces market efficiency by buying directly from the source, manages the in-house processing, vacuum-packs and delivers the fresh food directly to consumers, thus providing stable income to fishermen. Shari‘ah-compliant microLEAP, for example, collaborates with BPMB to fund farming digitalization plans aiming to accelerate the use of smart farming systems via the adoption of technology known as a ‘smart fertigation system’ in their farming operations.

In general, opportunities are aplenty for innovative companies along the halal supply chain to receive funding through ECF and P2P platforms. With the introduction of the Halal Integrated Platform by Halal Development Corporation of Malaysia, a data pool of halal products and services that provides industry players with access to global halal players, businesses along the halal supply chain will have greater potential to reach out to global partnership and expand their customer base thus reducing cost and failure risk. This will incentivize potential investors and lenders to engage with halal business operators via the well-regulated ECF and P2P platform.

2.6. Islamic Social Finance

Islamic social finance such as waqf and zakat can play an essential role in supporting the halal food industry. Generally, waqf can be defined as a special kind of philanthropic deed in perpetuity. It involves donating a fixed asset that can produce a financial return or provide a benefit. The revenue or benefit generated then serves specific categories of beneficiaries. Therefore, a waqf focused on the agricultural sector could provide financial support to different market players along the halal food supply chain, including small farmers, small and medium enterprises, and other stakeholders for working capital purposes, land acquisition, technology, etc. In addition, the waqf structure is an effective and administratively convenient mode of investment and finance, particularly for large-scale projects, as waqf has been used successfully to promote the public interest and facilitate investment throughout culturally and geographically diverse countries (Abdelhady, 2012). An example of how waqf can support halal food production is illustrated in Figure 2.9 below.
The *waqf* concept is explained as follows (Wildana & Kafabih, 2021):

i. The asset owner (*waqif*) surrenders his asset (i.e., land) to *waqf* to be managed. The land will be observed by *waqf* whether the land is arable or not. If the land is considered arable, then it can be utilized to plant food crops.

ii. *Waqf*, as the trustees of the land, enter into partnership with farmers.

iii. *Waqf* and farmer choose the most suitable option based on the profile of the farmer. If the said farmer owns no capital, then *mudarabah* (venture capital) contract is chosen. In another case, if the farmer has some capital to cultivate the land, *musharakah* (partnership) contract is chosen.

iv. *Waqf* and the farmer shared profit and loss based on the chosen contract and upon the pre-agreed ratio upfront.

v. *Waqf* share of crops is either deposited in its original form as a reserve or can be sold and converted into cash for either economic, social, or religious purposes.

vi. The reserve held by *waqf* in the form of original staple food crops such as rice, maize, whey, barley, etc., is considered stock to ensure the community's food security in the smallest form.

**The SC has launched a *waqf* framework to broaden the range of innovative Islamic finance products and provide the public access to Islamic funds** that allocate whole or part of the fund's returns towards socially impactful activities via *waqf*. On a bigger scale, *waqf* institutions can opt to explore raising capital to develop their *waqf* projects, such as those related to the halal food industry, through the issuance of sukuk. In addition, the sukuk issuance may be used for various purposes to satisfy the issuer’s commercial needs, such as for financing working capital and capital expenditure requirements, vis-à-vis the investors’ (sukuk holders) investment and risk appetite. Figure 2.10 provides an overall picture of how capital raising from sukuk issuance could be used to develop *waqf* assets.

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74 The concept of *waqf*-syirkah for community food security. Muhammad Dandy Alif Wildana & An’im Kafabih
Zakat (almsgiving) is another Islamic social finance instrument that could be used to provide financing, especially for eligible zakat recipients (asnaf) to participate in the agriculture industry. For example, the Kedah Zakat Agency (LZNK) runs the Paddy Estate Scheme, under which each participant manages a 0.29-hectare paddy field owned by the LZNK. The LZNK has provided them with all the paddy planting inputs, all the way to the harvesting process. In addition, participants would get US$1,190 (RM5,000) worth of interest-free BangKIT micro-financing – twice a year, through a collaboration between LZNK and BIMB. This soft loan will help the participants to support their families throughout the four months prior to harvesting the paddy. LZNK will then deduct proceeds from the paddy sales to repay their loan. LZNK also offers Paddy Estate Cultivation Scheme to existing small farmers. Under this project, LZNK will fund all the costs from cultivation to harvesting, and the loan payment will be deducted from the sales later. Both schemes aim to transform low-income earners into successful paddy farmers.  

Chapter 3: Enhancing Islamic Finance for the Halal Economy in Malaysia

3.1. Introduction

Enhancing the use of Islamic finance for the development of the HE will entail interventions on both the demand and supply-side. According to HDC, businesses involved in the HE, particularly MSMEs in general, face a combination of access to finance and business-related challenges that directly impact their business and financial viability. Therefore, it is not only important to consider the supply-side elements of the financing gap, such as ensuring the availability of relevant financing instruments but also to address the demand-side elements to ensure that halal businesses, who are in effect all potential Islamic finance users, become more financially viable and resilient. This chapter provides an overview of the key elements of the demand and supply-side factors of the financing ecosystem in the HE. Whilst some of these elements appear not just unique to the HE, the chapter endeavours to highlight specificities that may be relevant in the context of the HE.

Facilitating the financing of the HE is a strategic goal of BNM. BNM’s Financial Sector Blueprint 2022-2026, released in January 2022, includes as a goal “greater integration of Islamic finance with the HE, particularly in financing halal trade and investment.” In addition to noting the global opportunity associated with halal trade and supply chain activities, the Blueprint calls on financial institutions to “help nurture local halal businesses into global or regional players” (Bank Negara Malaysia, 2022 p.106).

3.2. Demand-side Factors

Under the Twelfth Malaysia Plan 2021-2025 (12MP), the Malaysian government has outlined a strategy towards fostering the competitiveness of an inclusive HE as part of the government’s priority to accelerate the development of strategic and high-impact industries (Economic Planning Unit, 2021). The key strategies are intended to develop Malaysia’s HE, improve its competitiveness and ultimately position Malaysia as a leading global halal hub. They include halal industrial parks, research, development, innovation, and talent development.

3.2.1. Halal Industrial Parks

Since their introduction in 2011, Halal Malaysia (HALMAS) industrial parks have attracted RM16.1 billion worth of investment, of which RM9.5 billion, or 59 percent, came from

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foreign direct investment (FDI) and RM6.6 billion from domestic direct investment (DDI). There are fourteen (14) strategic HALMAS industrial parks located across Malaysia designated by HDC (Figure 3.1), hosting more than 40 multinational corporations (MNCs) and 200 local SMEs including such brand names as Kellogg, F&N Dairies, Coca-Cola, Ramly Food Industries and Kawan Food Manufacturing. In addition, there are eleven (11) halal parks recognized by state governments or other government agencies. The companies located in the HALMAS industrial parks are involved in various sectors such as food and beverage, cosmetics, logistics, and pharmaceuticals.

Figure 3.1 Location of 14 HALMAS industrial parks

Source: https://hpglobal.com.my/

Halal park operators, manufacturers, and halal logistic operators operating in these locations can also benefit from tax incentives (Table 3.1). For example, manufacturers are eligible to receive a 100 percent income tax exemption on qualifying capital expenditure for as long as ten years or an income tax exemption on export sales for a period of five years. In addition, MNCs located in these parks listed on Malaysia’s stock exchange are mainly shari'ah-compliant, indicating that at least two-thirds of their financing is based on Islamic finance.

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Table 3.1 Tax incentives and grants for halal development in Malaysia

<table>
<thead>
<tr>
<th>Agency</th>
<th>HDC</th>
<th>HDC</th>
<th>MIDA</th>
<th>Malaysian Technology Development Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type of incentives</td>
<td>Tax incentive</td>
<td>Tax incentive</td>
<td>Tax incentive</td>
<td>Grants</td>
</tr>
<tr>
<td>Sector</td>
<td>Services</td>
<td>Services</td>
<td>Manufacturing</td>
<td>Manufacturing and Services</td>
</tr>
<tr>
<td>Incentive description</td>
<td>• Full income tax exemption for a period of 5 years or 100% income tax exemption on capital expenditure for a period of 5 years. • Exemption on import duty and sales tax on equipment, components and machinery used directly in Cold Room Operations in accordance to prevailing policies. • Must be located within one of the the HDC designated HALMAS</td>
<td>• Full income tax exemption for a period of 10 years or 100% income tax exemption on capital expenditure for a period of 5 years. • Exemption from import duty and sales tax on equipment, components and machinery used directly in the Cold Room Operations in accordance to prevailing policies. • Must be located within one of the the HDC designated HALMAS</td>
<td>• Incentives Tax Allowance (ITA) of 100% on qualifying capital expenditure incurred within a period of 5 years. The allowance can be offset against 100% of statutory income in each year of assessment. Unutilized allowance can be carried forward until fully absorbed.</td>
<td>• Halal Technology Development Fund (HTF) is specifically designed to finance and nurture SMEs for long-term growth and export through halal compliant activities. • The primary focus of the fund is to provide companies with access to the best advisory services and networks. Activities include halal product development process and regulatory compliance services, as part of the effort to overcome barriers and hurdles to bring halal products and services to market. • HTF 1 provides flexible funding which includes grant and convertible promissory note up to a maximum of RM2 million. • HTF 2 provides flexible funding which includes grant and convertible promissory note up to a maximum of RM4 million.</td>
</tr>
<tr>
<td>Eligibility</td>
<td>• Services provided by Halal Logistics Operators (HLO) must be integrated which comprises of the 3 principal activities: (i)</td>
<td>• Granted with HALMAS status • Involve the halal industry cluster component in terms of food, non-food products and services</td>
<td>Eligibility activity/product</td>
<td>HTF 1</td>
</tr>
<tr>
<td></td>
<td>(i) New or additional halal food products utilizing modern and state-of-the-art machinery or</td>
<td></td>
<td>(i)</td>
<td>• The company is incorporated under the Companies Act 1965.</td>
</tr>
</tbody>
</table>
Forwarding; (ii) Warehousing; and (iii) Transportation

- And at least one of the following activities: (i) Distribution; (ii) Other related and value-added services/activities (e.g., palletising, product assembly/installation, bulk breaking, consolidation, packaging/re-packaging, procurement, quality control, labelling/re-labelling, testing etc.); (iii) Supply chain management.

A HLO must own the minimum infrastructure as follows: (i) Commercial vehicles – 20 units; (ii) Warehousing facilities – 5000 sq. meters.

- Employing substantial number of knowledge workers in the halal industry.
- Having certified halal slaughter from respective authority for companies involved in the slaughtering of animals.
- Provide technology/transfer and or contribute towards the development of halal industry.
- Establish a separate legal entity for the HALMAS status.
- Comply with the environmental guidelines.
- Activities NOT ELIGIBLE for HALMAS: (i) Business Trading – business trading activities only is not allowed to apply for the halal industry incentives. (ii) Producers – Those are not operating in the HDC designated halal parks. (iii) Consultancy – consultation activity that is primarily providing professional advice and to any halal status application develop in-house by the applicant.

Note: Having met the eligibility criteria, all the applications must comply with HDC standards and guidelines for halal parks. Any new halal parks proposed by the state government will

- Technology. (ii) Expansion with upgrading of existing plant by investing in additional machinery and utilizing modern technology. (iii) Products not listed in the promoted list with modern and state-of-the-art machinery and technology would also be eligible for consideration.

Eligible applicant:
(i) New companies undertaking production of halal foods. (ii) Existing companies undertaking diversification project in the production of halal food. (iii) existing halal food companies undertaking upgrading/expansion of existing plan.

Eligibility criteria and conditions:
(i) Fulfill the level of value-added percentage and level of technology as measured by the Managerial, Technical and Supervisory (MTS) index; (ii) The company shall obtain JAKIM halal certification in compliance with MS1500:2019.

- The company must be at least 60% owned by Malaysian(s).
- The company qualifies as an SME according to the guidelines on new SME definition 2013 by SME Corp. Malaysia.
- The company has already obtained halal certification from JAKIM.
- The company must not be a subsidiary of a GLC/MNC.

HTF 2
- All the criteria listed above (HTF 1); and the products or services have already been exported.
HALMAS industrial parks provide access to an integrated HE ecosystem to improve the efficiency of HE business operations. The establishment of industrial parks and economic zones has primarily been associated with providing functional infrastructures in a more effective manner and creating spillover effects both inside and outside of the parks (Saleman & Jordan, 2013). According to research, key criteria of the HALMAS industrial parks that tenants highly value include their accessibility to the nearest port and highways, customs and cargo inspection services, traceability services, and packaging facilities (Islam & El Madkouri, 2018). In addition, HALMAS industrial parks are equipped to facilitate logistics to comply with international and Malaysia Halal Certification (MHC) standards. More than 50 international bodies mutually recognize MHC standards, and the global reputation of the MHC has created a demand for these certifications from firms outside Malaysia. As a result, an overseas manufacturing manual has been introduced.

Under the 12MP, underperforming HALMAS industrial parks will be revived through coordination involving state authorities, investment promotion agencies, and regional economic corridors authorities. Based on engagement with HDC, there is no periodic performance evaluation conducted for monitoring HALMAS industrial parks. However, a research conducted to evaluate the performance of the HALMAS industrial parks indicated a higher score for more established locations such as the PKFZ National Halal park and Selangor Halal hub. In contrast, the less urban locations such as the Pedas Halal Park and POIC Lahad Datu fared poorer on the scale (Islam & El Madkouri, 2018). The key areas of improvement include accessibility to infrastructure, facilities, logistics, local support authorities, and the role of the HDC. With coordinated support from the relevant government agencies, state authorities, and the private sector, challenges faced by these underperforming locations may be overcome, which can help to attract fresh financing and investment prospects.

HALMAS industrial parks could be transformed into halal eco-industrial parks (EIPs) that implement circular economy practices to enhance the value of the HE and increase competitiveness (see section 3.2.6 on sustainability)). EIP is defined as a dedicated area for industrial use at a suitable site that supports sustainability through the integration of social, economic, and environmental quality aspects into its siting, planning, management, and operations (United Nations Industrial Development Organization et al., 2021, p.13) (Figure 3.2). Benefits such as access to finance, technical support, and policy, economic, and community gains were frequently cited in EIP case studies by UNIDO in 2016 (ibid, p. 21). Circular economy interventions are not just environmentally beneficial but also economically viable and hence, can
improve the competitiveness of industrial parks and tenant firms (World Bank Group, 2021a). The World Bank report suggests mainstreaming circular economy principles in industrial park operations by improving the circularity of energy, water, materials, and by-products during production processes, such as adopting renewable energy sources and water efficiency technologies (ibid) (Figure 3.3). According to HDC, currently none of the HALMAS industrial parks are recognized EIPs but efforts are underway by some of the EIPs to incorporate renewable energy options in their energy supply mix.

Figure 3. 2 Sustainable Development Goals (SDGs) applicable to EIPs

Source: UNIDO; World Bank Group & GIZ (2021)

Figure 3. 3 Circular economy principles in industrial parks

Source: (World Bank Group, 2021a)
3.2.2. Innovation and Research and Development (R&D)

Malaysia’s HE is concentrated in the F&B sector and lacks diversification in high productivity sectors. According to HDC, one of the challenges faced by HE manufacturers in Malaysia is the lack of diversification beyond the F&B sector. Based on data from HDC, US$2.1 billion (RM8.8 billion) or 28.9 percent of Malaysia’s halal export value for 2020 was attributed to halal ingredients, where 95.5 percent of these exports were produced by MNCs. The 12MP intends to promote initiatives that will encourage Malaysia’s halal entrepreneurs to venture into the production of high value-added products, such as halal ingredients, pharmaceuticals, cosmetics, and medical devices.

Supporting relevant R&D activities is essential to developing high-value-added innovation in Malaysia’s HE. A World Bank report has shown that Malaysia’s quality of research has remained low compared to high-income countries. Thus strengthening support for Malaysia’s public research organizations and universities is crucial to accelerating the transition to an innovation-driven growth toward becoming a high-income nation (World Bank Group, 2020a). Total R&D spending as percentage of GDP lags behind high income countries (Figure 3.4) and most of the R&D funding is sourced by businesses themselves (56.5 percent) and they typically focus more on applied research (Figure 3.5).

Figure 3. 4 R&D indicators (2018)

<table>
<thead>
<tr>
<th>R&amp;D indicators</th>
<th>High income countries</th>
<th>Malaysia</th>
<th>East Asia and the Pacific</th>
<th>Middle income countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Researchers per million population</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R&amp;D spending as percentage of GDP</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: UNESCO Institute for Statistics

Figure 3. 5 Research orientation - R&D Expenditure RM Millions (2016)

<table>
<thead>
<tr>
<th>Business Enterprises</th>
<th>Government Research Institutes</th>
<th>Higher Education Institutes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Research</td>
<td>Applied Research</td>
<td>Experimental Research</td>
</tr>
</tbody>
</table>

Source: National Survey of R&D in Malaysia 2017

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The 12MP has identified the need to support HE-focused incubators and R&D commercialization. After the Ninth Malaysia Plan 2006-2010, where the development of the HE was identified as a key strategy, several institutions of higher learning in Malaysia have established dedicated research centers for halal encompassing various fields, including shari’ah and law, detection systems for non-halal products, pharmaceutical and vaccine, logistic, consumerism and products and others. In addition to research, these centers also provide services such as providing analytical testing services and training and consultancy for halal certification (Table 3.2)

Table 3.2 List of research centers at Malaysian universities and services provided

<table>
<thead>
<tr>
<th>Research center/ Center of Excellence</th>
<th>Laboratory testing</th>
<th>Training and consultancy</th>
<th>Product commercialization</th>
</tr>
</thead>
<tbody>
<tr>
<td>Halal Research Centre (UMHRC), University of Malaya</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>International Institute for Halal Research and Training (INHART), International Islamic University Malaysia</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Institute of Fatwa and Halal (IFFAH), Universiti Sains Islam Malaysia (USIM)</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Halal Products Research Institute, Universiti Putra Malaysia</td>
<td>Yes</td>
<td>Yes</td>
<td>Unknown</td>
</tr>
<tr>
<td>Unipeq, University Kebangsaan Malaysia</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Asian Halal Institute, University Utara Malaysia</td>
<td>Unknown</td>
<td>Yes</td>
<td>Unknown</td>
</tr>
</tbody>
</table>

Source: World Bank staff’s illustration

However, there is limited data on commercialized research and registered patents that may suggest the potential impact of relevant R&D has not been optimized by the HE. Whilst this challenge is common in all economic sectors in Malaysia, it is imperative for the HE to invest in R&D in order to promote innovation and higher productivity. In one of its studies, HDC found that there is a lack of product creation and innovation by Malaysia’s HE players.80 Hence, HDC has initiated further efforts to promote research and knowledge generation by introducing the Halal Knowledge Center at the end of 2021 as a knowledge resource platform to promote the global sharing of information on HE. In addition, HDC is also collaborating with a government agency, the Academy of Sciences Malaysia, under its ‘i-Connect’ initiative, which intends to facilitate the R&D of innovative solutions through collaborative networks. The halal supply chain is one of the four strategic industry sectors that have been included as an area of focus under the i-Connect initiative. Since supply chains are specific and unique by industry, greater focus should be given to priority halal sectors such as food sector or pharmaceuticals.

Enhancing the business development and brand value of halal businesses can positively impact business performance. According to HDC, most certified halal businesses in Malaysia are MSMEs. These businesses generally focus on a small local market and lack the capacity to

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develop their products for the export market.81 However, HDC noted that 61 percent of the businesses surveyed indicated an interest in diversifying into the future export market82. Branding and promotion by SMEs are mainly poor, and brand investment is a key challenge for SMEs.83 Halal branding is becoming a key priority for halal businesses, and brand recognition can help to elevate the presence of these brands domestically and globally (Figure 3.6). HDC and SME Corp have initiated several programs to assist SMEs with branding development, such as the Product Transformation Program (PuTRA) and the Market Access Incentive (MASSIVE). PuTRA is specifically designed to assist SMEs in improving the commercial value of their halal products through improved branding, packaging, and labeling. MASSIVE will help SMEs to market their halal products to potential international markets.

Figure 3. 6 Winners of the Brand Laurette Halal Most Valuable Brand Award 2021

![Image of winners](https://www.thebrandlaureate.com/world-halal-bestbrands/the-world-halal-bestbrands-2021)

3.2.3. Talent Development

Developing a comprehensive halal talent framework is important to ensure an adequate supply of quality professionals to provide high-quality service. One of the strategies under the Halal Industry Master Plan 2030 (HIMP 2030) is to produce more ‘Halal Champions’ among local industry players. To this end, the Ministry of Entrepreneur Development and Cooperative (MEDAC) has appointed government agencies such as the Cooperative Commission of Malaysia (SKM), SME Corp, and Tekun Nasional to implement Halal Professional training. In addition, the Malaysian Qualification Agency (MQA) and HDC have developed a program standard for halal studies from certificate level to doctoral degree. However, funding for professional development

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82 Ibid.

training and tertiary education outside of existing government schemes would require private sources. Currently, Islamic finance providers have a minimal offering of education financing beyond crowdfunding solutions. Islamic social finance and Islamic fintech solutions are ideal for providing funding options to complement available public funding. For example, Google-incubated fintech player Financepeer, based in India, offers interest-free tuition fees to parents of the school and college-going students. Similarly, Pintek, an Indonesian fintech for education, has successfully provided access to funds for students or parents for study fees.

3.2.4. Digitalization

The potential of digitalization as a catalyst to unlock new economic opportunities has been **embedded in the 12MP**. The 12MP has identified technology adoption and innovation as a key policy enabler and targets to grow the contribution of e-commerce to GDP to 10.5 percent by 2025 (Q3 2021: 8.4 percent). Similarly, the HIMP 2030 intends to leverage technology and digitalization to improve the competitiveness of Malaysia’s halal businesses. According to a World Bank report (World Bank Group, 2020d), digitalization is a key enabler in (i) developing financial products that provide access to finance, (ii) driving transformation that enhances efficiency, reduces the cost of production, and increases profitability, ultimately attracting more financing, and (iii) creating market enablers such as e-commerce and open banking.

While the pandemic has accelerated the adoption of digital solutions by firms, the percentage of SMEs investing in digital solutions lags those of large firms, indicating a potential for **significant funding opportunities** (World Bank Group, 2021c). According to the World Bank’s Business Pulse Survey (BPS), 54 percent of the small firms surveyed made investments in digital solutions compared to 81 percent and 83 percent of the medium and large firms surveyed. (Kuriakose & Tran, 2020). In another study conducted by the SME Association of Malaysia, only 26 percent of SMEs were revealed to have chosen digital technologies as their main post-pandemic growth strategy. The majority of SMEs (57 percent) have not even started efforts toward digitalization. The digitalization of the ASEAN economy during the pandemic has largely favored individual consumers, with SMEs facing significant barriers related to access and use of digital technologies that prevent them from optimizing their business potential. In terms of digital

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84 Malaysia e-commerce income soared 17.1 percent to RM279 billion in the third quarter 2021. (2021, November 10). DOSM


presence, fewer Malaysian businesses have websites than per capita income would predict compared to other countries (World Bank Group, 2018). National statistics suggest that as of 2019, 53.9 percent of business establishments in Malaysia have a web presence, up from 37.8 percent in 2017. Limited access to finance remains the most significant constraint for firms’ investing in digital solutions, followed by a lack of information and lack of certainty regarding the benefits to be derived (World Bank Group, 2021c) (Figure 3.7).

Firms (including halal companies) have identified the need for funding support to expand digital business capabilities, which can be offered through innovative financial products and services. The cost of digitalization is a major challenge for businesses, especially SMEs. Relevant government agencies such as Malaysia Digital Economy Corporation (MDEC) offer funding programs to support digitalization by firms, such as SME Business Digitalization Grant, SMART Automation Grant, 100 Go Digital, and SME Digital Accelerator. Cognizant of the gap in digital access in rural East Malaysia, the 12MP has identified several initiatives such as the eRezeki and eUsahawan programs to increase the skills and opportunities of the rakyat in Sabah and Sarawak. Digital financial education is also critical to ensure that MSMEs can fully optimize the benefits of fintech products and services. However, these programs, such as the SME Business Digitalization Grant, are limited to 100,000 SMEs, which leaves a significant funding gap for the remaining Malaysian SMEs. According to the BPS survey, firms indicated sales and marketing support as the most popular choice for government support (Figure 3.8). Funding for improvements in payment methods and supply chain management capabilities can also be supported by relevant financial products and services offered by IFIs.

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87 Income of e-Commerce transactions surged 30 percent in the first quarter 2021, DOSM, Jul. 6, 2021.

88 See https://mdec.my/digital-economy-initiatives/for-the-industry/SME
Box 1: Leveraging Digital Connectivity to Expand the HE

OIC countries with an estimated youth population of 338.3 million would be a key driver of the HE, especially in the borderless society connected through a digital platform. The number is projected to reach 396.9 million youth by 2030. According to the Global Innovation Index (GII) 2021, among the OIC countries, only UAE, Malaysia and Turkey ranked in the top 50. The GII captures the innovation ecosystem performance of 132 economies and tracks the most recent global innovation trends.

The (ITU, 2021) data show that young people are more connected than the rest (Figure 3.9). In 2020, 71 percent of the world’s youth (between 15 and 24 years) were using the Internet, compared with 57 percent of the other age groups. On the global scale, young people were thus 1.24 times more likely to connect than the rest of the population. The ratio was small in developed countries, where 90 percent of the population is already online (1.14). In developing countries, the difference stood at 1.32, and in the LDCs, it reached 1.53, as 34 percent of young people were connected compared with only 22 percent of the rest of the population. For Asia and the Pacific region, it was 1.35. The greater uptake among young people bodes well for connectivity in areas where the demographic profile is skewed towards youth, such as the LDCs, where half of the population is less than 20 years old. The workforce will become more connected and technology savvy as the young generation joins its ranks.
The OIC countries should leverage digital technologies to expand the HE. Digital technologies may eventually lower trade costs behind the border, at the border, and between borders, including improving transparency and price discovery and the information flow between exporters, shippers, and country authorities. This may support global supply chains. For example, robotics can help accelerate port procedures. Artificial intelligence can help lower logistics costs by optimizing route planning, storage, and inventory and improving tracking and monitoring. 3D printing, in addition, can help shorten supply chains and localize supply chains, thus reducing the environmental footprint of trade. Blockchain technology can help reduce time spent in customs, especially for time-sensitive goods, facilitate cross-border payments by increasing transparency and credibility, and enhance information sharing within supply chains (Fan et al., 2019; WTO, 2018). Such technologies may disproportionately benefit small and medium-sized enterprises facing larger trade costs than large enterprises. Rapid digitalization resulting from the pandemic has fundamentally transformed economies by permanently changing the way companies do business, individuals work, and consumers consume. (AMRO, 2021)

The COVID-19 pandemic inadvertently accelerated the “flight to digital,” and this behavior change is unlikely to be reversed. Many technology platforms that are being used widely during the pandemic—such as e-commerce, videoconferencing, cloud services, remote working, and others that were critical in maintaining business continuity—have been available for some time but were not widely used and diffused, especially in non-urban areas or with
businesses that operate more traditionally. A well-known example of technology adoption is evident in the unprecedented growth of e-commerce and other online businesses in the past year. Global digital sales of various items jumped by 71 and 55 percent year over year in the second and third quarters of 2020 (Shim, 2020). Online sales worldwide of food and beverage increased the fastest with an impressive growth of 153 percent, an upsurge never seen before. (Figure 3.10).

In the ASEAN regions, along with the boom in e-commerce, the number of Internet users doubled compared to the average annual growth in users between 2015 and 2019 (Google et al., 2020). New users appear to be coming from smaller, non-metropolitan cities in the region’s economies. The pandemic undoubtedly prompts the increase in internet usage—as some businesses shifted to online meetings, conferences, and seminars; students to virtual education; shoppers to online shopping, and the increased use of digital banking and other services (Figure 3.11). Post-pandemic, the outlook for digital service consumption is highly positive, especially as more consumers and businesses become increasingly comfortable using digital services. Inadvertently, the social distancing measures and other restrictions have reduced barriers to technology use and provided a tremendous boost to the digital industry. More importantly, the pandemic has forced a change in businesses’ and consumers’ mindsets regarding the utility of technology.

3.2.5. E-commerce

HE businesses, particularly SMEs, could benefit from expanding their businesses on e-commerce and sharing/gig economy platforms. These business models have been a key factor in the growth of digital financial products and the digitalization of SMEs, helping to expand SMEs’ reach into domestic and global markets (World Bank Group, 2020d). According to a recent report, the pandemic has resulted in continued shifts in consumer and merchant behaviors, leading to the rise of digital consumers and merchants, with the gross merchandise value (GMV) in the ASEAN
region expected to grow to US$1 trillion by 2030 (Google et al., 2021) (Figure 3.12). The report noted that Malaysian businesses, especially, expressed the importance of digital platforms to ensure business continuity during the pandemic period (Figure 3.13). ASEAN’s e-commerce market is quite fragmented, with the presence of several regional players such as Lazada and Shopee and many local business-to-consumer (B2C) platforms. National statistics recorded an increase in Malaysia’s e-commerce income by 23.1 percent annually to US$190.8 billion (RM801.2 billion) in the first nine months of 2021 compared to US$155 billion (RM651 billion) in 2020. Cross-border e-commerce is already important and established part of the Malaysian online shopping experience accounting for 44 percent of overall e-commerce sales, with more than half (52 percent) of Malaysian online shoppers spending cross-border. Leading cross-border shopping origin markets are China, Singapore, and Japan. These non-Muslim markets create the necessity for halal certification and present an opportunity for Islamic finance to facilitate businesses in these countries to obtain the certificate. In contrast, an HDC study suggests that Malaysia’s halal businesses face challenges penetrating Muslim consumer markets in the Middle East.

Figure 3. 12 Breakdown of digital consumers in ASEAN countries

Figure 3. 13 Merchant sentiment on benefits of operating online

Source: Google, Temasek & Bain, e-Conomy SEA 2021


90 Malaysia e-commerce income soared 17.1 percent to RM279 billion in the third quarter 2021. (2021, November 10). DOSM


92 See https://www.ppro.com/countries/malaysia/

Malaysia’s HE benefits from better integration between halal-focused and generic e-commerce/e-marketplaces, which has the potential to generate more meaningful data and further enable embedded finance solutions to be developed for halal SMEs. More than 80 percent of Malaysian consumers are engaged in various forms of e-commerce activities, such as using shopping applications and making purchases online. Malaysia’s top-three e-commerce sites by traffic are Shopee, Lazada, and PG Mall. In addition, halal-focused marketplaces that engage in business-to-business (B2B) and B2C transactions, such as Daganghalal.com, Muslimbrands.com.my, halalmall.online, and myhalmart.com are also present, but their market reach is limited compared to major sites like Shopee that are also used by halal businesses. In 2021, HDC launched the Halal Integrated Platform (HIP) – an online networking platform that connects local HE players to global HE players and acts as a one-stop center for business support tools such as consultancy, training, and funding facilitation, e-marketplace, and online marketing. While the development of HIP is more targeted, exploring potential collaboration with other major e-marketplaces may help to expand the reach of targeted businesses. Currently, major e-commerce sites do not distinguish halal businesses, which is a missed opportunity to better showcase halal businesses to customers who prefer halal products and services. Halal labelling of products within these e-commerce sites would provide greater accessibility and offer product differentiation to customers who are looking for halal products and services.

**Box 2: Supporting the growth of Halal SMEs through an e-commerce platform**

Major e-commerce sites used by Malaysian businesses, such as Shopee and Lazada have been instrumental in supporting digital business growth by MSMEs throughout Malaysia, including those from less urban areas. 80 local sellers, who joined Shopee in 2021, achieved more than RM1 million in sales in just their first year on the platform.

Shopee has introduced various campaigns regionally and locally, such as the #ShopeeSapotLokal initiative in Malaysia to give more exposure to local sellers. Under its #ShopeeGivesBack program, it has partnered with 12 non-government organizations (NGOs) and social enterprises, including Budimas Charitable Foundation, Hopes Malaysia Welfare Association, Islamic Aid Malaysia, and the MyKasih Foundation, on a donation drive. Shopee has also collaborated with Mydin, Nestlé, RB Home, Thong Guan Trading and Unilever to offer users the option to donate essential bundle packs between US$7.14 (RM30) and US$23.8 (RM100) towards providing necessities such as clean water, food, and other basic amenities to rural and underprivileged communities in Malaysia.

Source: [https://www.malaysiakini.com/announcement/602352](https://www.malaysiakini.com/announcement/602352)

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95 Müller, J. (2021, September 29). Top 10 e-commerce sites in Malaysia as of second quarter 2021, by monthly traffic. Statista
3.2.6. Global Value Chain and Sustainability

Malaysia has experienced limited gains from global value chain (GVC) participation, necessitating a shift towards higher value-added activities to be more competitive (Economic Planning Unit, 2021). Mainstreaming an economic growth strategy that incorporates green and environmental sustainability may positively improve competitiveness (World Bank Group, 2021c p.71). Malaysia’s industries need to make more significant investments to improve resilience post-pandemic, which can also support higher levels of connectivity with GVCs, requiring all chain participants to engage in green and sustainable practices (World Bank Group, 2020e). In the Asia Pacific region, efforts to mainstream sustainability measures in global trade facilitation for SMEs, agriculture, and women’s engagement are currently underway (Asian Development Bank, 2019).

The HE contributes significantly to Malaysia’s GDP but lacks the capacity to produce high-value-added products and services that can increase its competitiveness in the global HE market (Economic Planning Unit, 2021). HDC has stated its intention to further strengthen Malaysia's HE by broadening the industry's end-to-end presence in the global halal supply chain, such as developing local supply chains to source raw materials. SME Corp has also introduced several initiatives to increase the productivity of halal SMEs, such as PuTRA, MASSIVE, and the Halal Technology Transformation Program (HTTP). The HTTP program is designed to assist SMEs in managing and improving their manufacturing processes through the adoption of system automation.

The halal market’s concentration on the F&B sector creates an opportunity to develop a halal green and sustainable supply chain. The food industry is one of the major contributors to greenhouse gas (GHG) emissions from crops and livestock farming and waste generated from the F&B sector. Promoting sustainability in the halal supply chain can reduce the environmental footprint and benefit Malaysia. Other countries can recognize Malaysian halal standards for hygiene and safety as a symbol of sustainable practices (Abdullah et al., 2018). A research paper found that while evidence suggests halal food production can achieve sustainable production, not all halal standards adopted by Malaysian SMEs demonstrated a connection with sustainable production principles (Ali & Suleiman, 2016).

The modest fashion industry, which also forms part of the broader HE, is also exposed to sustainability issues related to fast fashion waste, non-sustainable raw materials usage, and poor labor practices. Adopting sustainable standards can broaden the modest fashion market

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beyond existing Muslim clientele, including customers who specifically target sustainable products (DinarStandard, 2021b). In 2021, Malaysia’s online fashion retailer, Zalora introduced a sustainable modest wear range made using 100 percent sustainable fabrics such as Tencel, Ecovero, and Organic Cotton.97

Malaysia’s IFIs are well-placed to facilitate investments in Malaysia’s HE to expand their presence in GVCs and transform their businesses towards more sustainable practices in line with the Value-based Intermediation (VBI) initiative. The VBI is an initiative introduced by BNM in collaboration with the IFIs and aims to deliver the intended outcomes of shari’ah through practices, conduct, and offerings that generate a positive and sustainable impact on the economy, community, and environment and is consistent with the shareholders’ sustainable returns and long-term interests (Bank Negara Malaysia, 2017 p.6).

The recently published Financial Sector Blueprint 2022-2026 notes that BNM intends to leverage VBI to further support sustainable finance and funding halal trade and supply chain activities (Bank Negara Malaysia, 2022). In addition, BNM intends to collaborate with the relevant agencies to create stronger links between Islamic financial services and Malaysia’s economic propositions as a leading halal hub, particularly in supporting high value-added sectors and initiatives under the National Investment Aspiration (NIA) (ibid, p.107). To this end, IFIs may play a leading role in providing advisory services, financing, and market access solutions to support local halal businesses to become global and regional players and more sustainable. For example, CIMB Islamic has combined MATRADE’s Sustainable Exporter Program with its own Halal Biz Ready solution to help develop a “sustainable halal” ecosystem of companies and trading partners.

3.3. Supply-side Factors

As articulated in Chapter 2, Malaysia’s Islamic finance providers have been actively facilitating the financing needs of the HE. This section examines ways that Islamic finance can further support the HE through digital services and innovative activities beyond traditional financing.

3.3.1. Digital Payments

Cashless and digital payments are expected to continue to grow significantly in the next decade, and facilitating cross-border transactions is an important development in the market. According to a report by PricewaterhouseCoopers, global cashless payment volumes are set to increase by more than 80 percent from 2020 to 2025, from about US$1 trillion transactions

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to almost US$1.9 trillion, and to almost triple by 2030, with the fastest growth expected to be seen in the Asia Pacific region, with cashless transaction volume growing by 109 percent until 2025 and then by 76 percent from 2025 to 2030, followed by Africa (78 percent, 64 percent) and Europe (64 percent, 39 percent). In ASEAN, member countries have taken steps to advance cross-border interoperability of standardized quick response (QR) code for payments and introduce innovative real-time remittances to achieve cross-border real-time retail payments in the region by 2025.  

Beginning April 2021, Singapore and Thailand have linked their respective real-time retail payments platform (RRP), PayNow and PromptPay, allowing customers of participating banks in Singapore and Thailand to transfer up to S$1,000 or more THB25,000 daily across the two countries, using just a mobile number.

**Cashless and digital payments can potentially improve HE enterprises’ financial performance and the opportunity to access various financial solutions.** Digital payments can increase an entrepreneur’s profitability by making financial transactions with customers, suppliers, and the government more convenient, safer, and cheaper (Klapper, 2017). Digital payments automatically provide users with data points to develop a credit history that can help improve a firm’s access to credit (ibid). The use of alternative data such as mobile phone call records, utility and bill payments, digital payment transactions, social media, psychometric tests, industry/sector data, and many others have become essential in the development of credit risk models to assess the willingness and ability of SME borrowers to pay (World Bank Group, 2020d).

**The introduction of cross-border payment linkages can help expand HE enterprises’ reach to the wider domestic and global markets.** Based on the MasterCard Impact Study 2020, Malaysia leads Southeast Asia in e-wallet use, at 40 percent take-up, compared with the Philippines (36 percent), Thailand (27 percent), and Singapore (26 percent). Malaysia’s e-wallet coverage is dominated by Touch’n Go, Boost, and GrabPay.

In the period of one year to June 2021, e-wallet volume has increased 89 percent to 468 million transactions, merchant participation for QR payments jumped 57 percent to one million

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registrations; and online banking volume improved 36 percent to 12.1 billion transactions.\textsuperscript{102} In June 2021, BNM and Bank of Thailand announced the completion of the first phase in linking Malaysia’s DuitNow QR and Thailand’s PromptPay, which allows users in Thailand to use their mobile payment applications to scan DuitNow QR codes to make payment to merchants in Malaysia including for online cross-border e-commerce transactions.\textsuperscript{103} In January 2022, a foreign bank launched Malaysia’s first multi-currency digital wallet that will allow SMEs to make and receive international payments from a single global account.

\begin{boxedtext}
\textbf{Box 3: Supporting the growth of Halal SMEs through digital payment solutions}

SME Corporation Malaysia (SME Corp) has been promoting cashless initiatives among SMEs, targeting 100,000 SMEs utilizing cashless or digital payment methods by 2018. The push toward cashless payments is expected to improve operational efficiency, reduce administrative costs, and improve payment collections. Currently, e-wallet providers only distinguish HE enterprises that are involved in the food delivery business.

A new player in the digital payment market is jomSETTLE™ which was introduced in 2021. jomSETTLE™ is a fintech solution that provides businesses, especially micro-businesses, the ability to pay and receive credit card payments virtually from customers without needing a website, payment gateway, or credit card terminal. jomSETTLE™ facilitates better management of accounts payables and accounts receivables, thus improving MSMEs' cash flow management and capital turnover. jomSETTLE™ provides two payment solutions which are jomSETTLE™ Make Payment and jomSETTLE™ Request Payment.

With the jomSETTLE™ Make Payment solution, underserved halal MSMEs can leverage on credit available to them via their Credit Card as working capital to pay for business expenses to a payee who does not have a credit card receiving facilities. This includes rent, staff salary, suppliers’ invoices, legal fees, machinery purchases, business loans, and more. Halal MSMEs will now have immediate access to new working capital through their credit card without the hassle of going through the conventional route of applying for business loans or high-interest cash advances. On the other hand, many businesses can still not accept credit card payments due to low credit card payment volumes, high costs, and lack of technical skills.

With this in mind, jomSETTLE™ has introduced the jomSETTLE™ Request Payment solution: Malaysia's 1st Virtual Credit Card Platform. Through the jomSETTLE™ Request Payment solution, Users can request credit card payments by sending a secure payment link via SMS or
\begin{footnotes}
\item[102] Ikram, I. (2021, September 21). \textit{e-wallet, QR payments and online banking surged exponentially in one year up to June 2021, says Tengku Zafrul}. The Edge Markets

\end{footnotes}
email to their customers. In addition, customers can pay businesses from anywhere at any time via the payment link issued. This has broadened the payment receiving methods for many halal businesses. Eventually, businesses can secure their payments faster and gain a competitive advantage over their competitors solely dependent on cash terms.

Over the last quarter of 2021, jomSETTLE™ has facilitated close to 1 million Ringgit in transactions, where 46 percent of the transactions are accorded to halal businesses. The company partners with Bank Islam and collaborates with HDC in their outreach programs across Malaysia to raise awareness on the various financial facilities available to the halal businesses in Malaysia. jomSETTLE is the first Fintech startup approved under the Malaysia National Technology and Innovation Sandbox (NTIS).

Source: jomSETTLE™

3.3.2. Islamic Fintech

Innovative fintech solutions can benefit from rapid digitalization to expand access to finance to the underbanked and underserved. As stated above, digital payments can provide alternative data sets to enhance SMEs' credit analysis with a limited credit history. For instance, Kopo Kopo, a Kenyan fintech, applies big data analytics to merchant payment transaction data to offer SMEs a range of value-added services, such as unsecured, short-term loans (World Bank Group, 2020d). In addition, China’s Ant Financial has developed a private credit scoring system, Zhima Credit, based on various factors, including transactions performed through its Alipay mobile wallet. Islamic fintech companies could collaborate with mobile network operators (MNOs) to utilize mobile payments solution to develop financing products for halal businesses. Distributed ledger technology (DLT) or blockchain can be utilized to modernize trade finance and collateral management. At the same time, potential open banking applications such as account aggregation can further facilitate access to finance for SMEs. (Nemoto & Yoshino, 2019). However, in order for SMEs in the halal economy to become active participants in mobile money wallets, there is a need to enhance their awareness of the potential benefits of this new financial technology.

The HE can benefit from Islamic fintech innovations that can expand the reach of Islamic finance, particularly Islamic social finance. Islamic fintech has significant potential by optimizing opportunities presented by the growing digital demographic, advancements in big data analytics, and increasing interest in alternative finance markets (World Bank Group, 2020b). According to the Global Islamic Fintech Report 2021, payments are a relatively crowded segment with a high number of Islamic fintech players, but Islamic social finance remains relatively untapped, suggesting potential for growth (DinarStandard, 2021a). Another report also identified the growing demand for Islamic social finance and its application in providing access to finance for SMEs (DinarStandard, 2021b). In addition, DLT or blockchain adoption can modernize and improve the pricing competitiveness of Islamic trade finance and supply chain finance solutions.
This would be a critical development to facilitate cross-border trade amongst halal businesses along the global halal value chain.

To accelerate fintech innovations, partnerships between traditional Islamic banks and Islamic fintech should be encouraged where they can lower costs, strengthen financial inclusion and/or improve the quality of financial products and services for SMEs (World Bank Group, 2020d). Islamic banks can partner with Islamic fintech to create credit scoring models that combine data from digital payments and e-commerce platforms to facilitate lending to SMEs. For example, in 2021, a local Islamic bank has partnered with a technology company to expand the capability of its existing halal digital finance platform by utilizing big data analytics and artificial intelligence (AI) to help their halal business customers to better predict market trends, meet their customer demand, automate operational processes, and scale-up their business.\(^\text{104}\) Whilst the use of big data analytics by Islamic fintech is still at the nascent stages, examples from their conventional counterparts can be adapted to develop shari’ah compliant alternatives. In addition, as described in Chapter 2, Islamic financial providers can also collaborate with AgroTech providers to offer financial solutions based on improved bookkeeping and agricultural analytics.

### 3.3.3. Blended Finance and Alternative Finance

Blended finance incorporating debt-based and non-debt-based instruments (such as Islamic social finance and equity-based instruments) can offer innovative funding alternatives for halal businesses. The role of blended finance is becoming increasingly important in improving access to finance. During the pandemic, iTEKAD was a blended social finance program that offered seed capital and microfinancing to micro-entrepreneurs and partly funded by zakat (tithe) funds. More recently, in January 2022, BNM announced the establishment of a new financing facility that utilizes blended finance (debt and equity financing) as an innovative solution to fund SMEs.

Alternative financing such as equity crowdfunding (ECF) and waqf (endowment) have been identified as a source of funding to support halal business start-ups under the 12MP. In the Capital Market Masterplan 2021-2025, the Securities Commission Malaysia (SC) intends to further collaborate with relevant stakeholders to establish and develop an ecosystem conducive to facilitating shari’ah-compliant funding models and mechanisms such as PE, VC, ECF, and P2P to support halal MSMEs. In 2020, the SC launched a new framework to facilitate the offering of Islamic funds with waqf features to enable the growth of the Islamic social finance segment. In 2021, SC launched a shari’ah Screening Assessment Toolkit for unlisted MSMEs as an industry reference to identify potential halal asset class. In the 2022 budget, the government has committed to channel a start-up fund of RM10 million using the waqf concept to start the SME Halal

Endowment, Agriculture Endowment, and Disaster Endowment to produce more farmers, entrepreneurs, and halal industry traders and to aid them in the event of a disaster.

Currently, there is limited research on the application of waqf for the development of the HE. Several studies have outlined different conceptual frameworks for mobilizing cash waqf to fund human capital development programs for MSMEs (Mohd Thas Thaker et al., 2021) (see also Chapter 3). Ismail et al., (2021) explored the potential use of waqf building to resolve issues related to the availability of proper premises faced by SMEs when applying for halal certification. In 2017, in collaboration with BNM and the State Islamic Religious Council, six Islamic banks developed the ‘myWakaf’ platform to mobilize waqf collection from the public towards projects that provide impact to the underserved communities. The Islamic banks provide financial and investment expertise, effective governance mechanisms, and access to their wide banking channels for cash waqf collection that can optimize the development of waqf. A similar collaboration between IFIs and relevant government agencies could be explored to create opportunities for halal businesses to connect with potential waqf fund providers.

Box 4: Supporting the growth of Halal SMEs through alternative funding solutions

One of Malaysia’s registered P2P providers is microLEAP, which provides Islamic and conventional invoice financing to MSMEs in all sectors, including those involved in the HE. To date, more than RM16 million in financing has been disbursed, and 98 percent of the transactions executed are based on shari’ah compliant financing due to the high supply of retail investors seeking competitive shari’ah investment opportunities. Aside from funding, microLEAP also offers value-added services such as access to personal insurance products for borrowers and basic debt management and accounting training. The additional services help to improve the borrower’s financial acumen and thus, to a certain extent, mitigate the financial risk to investors.

Several e-wallet providers have started offering financial products such as deferred payment schemes (buy now pay later solutions) and investment products. However, currently only Touch’n Go has a full shari’ah compliant set up including its investment solution GO+, making it Malaysia’s first shari’ah-compliant e-wallet product.

3.3.4. Integrated Halal Advisory and Marketplace

Several Islamic finance providers have expanded their services offering to include halal advisory and marketplace. As this report has articulated, the HE enterprises face requirements, such as the need to obtain halal certification of their products, inspection requirements, and serving more fragmented and dispersed customer markets that can introduce unique access to finance challenges. As such, the need to offer effective halal advisory services is more urgent in the HE. The Halal Integrated Platform (HIP), launched by HDC in 2021, is intended to become a one-stop center for business support tools such as consultancy, training, funding facilitation, e-marketplace, and online marketing for local and global HE enterprises (Figure 3.17). Islamic finance providers
can leverage the comprehensive technical support provided to HE enterprises by HDC and other government agencies to expand their financial product offering to the HE enterprises registered with the HIP. To date, three Islamic banks, which have developed their halal marketplaces, have also enrolled as strategic partners in the platform.

Figure 3.14 Range of services provided under the Halal Integrated Platform

### 3.3.5. Enhancing Current Islamic Finance Offerings

**Islamic finance providers may explore the usage of unique shari’ah contracts such as bai’ salam to finance the agriculture sector.** As described in Chapter 2, conventional bank financing has significant limitations and constraints. Currently, Islamic finance providers in Malaysia offer debt financing based on murabahah and tawarruq contracts and a very limited number of equity financing. Several studies have posited potential Islamic finance instruments using the bai’ salam contract (Atah et al., 2019; Muneeza et al., 2011). *Bai’ salam* is a contract where two parties enter into a contract of sale of goods that would be delivered in the future for which the price for the goods would be paid in cash on the spot at the time of the signing of the contract. Because the risk of non-delivery is borne by the financier alone, *bai’ salam* has not been successfully adopted in Malaysia. However, the risk of *bai’ salam* could be mitigated by combining *takaful* (insurance) and collaborating with relevant government agencies to monitor the performance of the agriculture producers effectively, as proposed by Atah, et al. (2019). Under this proposal, the agriculture producers will contribute towards the *takaful*, which could provide mutual protection against potential loss. The Ministry of Agriculture and Food (MAFI) announced that an Agrofood Takaful for the paddy and rice sector would be launched in 2022 to assist industry players, especially during
natural disasters such as floods. This provides an opportunity for Islamic finance providers to explore the hybrid *bai’ salam* and *takaful* model. Islamic social finance, such as *waqf* and *zakat*, could also be incorporated into the model (see Chapter 2, Special Topic).

Additionally, financial regulators and Islamic finance providers should explore initiatives to encourage the participation of retail investors in funding the HE. As described, many HE enterprises are MSMEs, which require a relatively smaller funding size compared to corporations, which limits the opportunity for them to tap potential funding from the capital markets except for in alternative funding platforms such as ECF and P2P. According to SC, retail investors have been increasing their investment significantly in ECF and P2P platforms from approximately US$6.9 billion in 2017 to US$93.1 billion in 2021. To increase the options of capital market instruments and encourage retail investors’ participation in the bond market, Malaysia could explore strategies to allow smaller bond issuances by medium-sized enterprises. For example, in 2021, SHUAA Capital led a first of its kind US$ 50 million structured sukuk for Pure Harvest Smart Farms, the world-leading, sustainable technology-enabled agribusiness based in the UAE. Financial regulators, relevant government agencies and HE industry players could collaborate to further explore the potential of issuing such instruments for the sophisticated retail investors. Nonetheless, since Sukuk and bonds are not really retail instruments, the use of themed debt funds to provide SME financing (possibly co-lending with Fintech companies) may hold more potential. At the same time, there is a need to explore more sustainable bank funding for P2P providers since they cannot rely on funding from financial markets.

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107 *Shuua leads $50m sukuk for Pure Harvest.* (n.d.). The Arabian Post. [https://thearabianpost.com/shuua-leads-50m-sukuk-for-pure-harvest/](https://thearabianpost.com/shuua-leads-50m-sukuk-for-pure-harvest/)
Chapter 4: Conclusions and Recommendations for Stakeholders

The HE plays an important role in Malaysia’s economic growth, contributing 7.5 percent to the GDP as of 2020. Malaysia continues to be a leading player in the global HE and is recognized as a leader in halal accreditation systems. The penetration of HE in the global markets and the growing Muslim population present an opportunity for growth in the demand for halal products and services. Malaysia’s HE is largely concentrated in the halal food-related sector, with 28.9 percent of Malaysia’s halal export value in 2020 attributed to halal ingredients.

Malaysia has a well-developed Islamic finance market, which has provided additional funding support for HE. Malaysia’s Islamic finance providers (banks, NBFIs, and capital market players, including fintech) offer a diverse range of financial products and services and have been recognized as one of the five key enablers for implementing the strategies outlined in the HIMP 2030. The percentage of halal-certified companies using Islamic finance nearly doubled between 2018 and 2021, growing from 21.9 percent to 41.3 percent. The growth in Islamic finance usage by the HE enterprises could be attributed to the targeted awareness and capacity-building initiatives driven by BNM in collaboration with key agencies such as HDC and JAKIM through the years.

While the contribution of Islamic finance, especially the Islamic banking sector, has increased, further actions can be taken to facilitate funding and the overall growth of HE. This report has explored the current Islamic finance ecosystem supporting HE enterprises in Malaysia and globally and considered both the demand and supply-side factors to explore further avenues to enhance Islamic finance for HE development. As a result, this report has identified the following gaps where the contribution of Islamic finance can be further advanced:

(i) enhancing capacity and funding for innovation and productivity improvements;
(ii) increasing access to finance for SMEs through innovative solutions, including fintech and social finance; and
(iii) supporting cross-border trade and investment at the growth stage.

A major opportunity is linking Islamic finance more closely with Malaysia’s existing HE development programs. The HE requires critical financing and investment in technology adoption, digitalization, innovation and R&D, and sustainable practices to enhance productivity and global competitiveness. Islamic fintech innovations also have the potential to expand the reach of Islamic finance, particularly Islamic social finance for HE. This chapter offers a set of recommendations to serve as inputs to key stakeholders in enhancing existing strategies involving the role of Islamic finance in Malaysia’s HE development.
Recommendation 1: Enhance policy and strategy coordination across different policymakers and Islamic finance providers to increase the impact of programs.

Various public and private sector stakeholders are actively developing and implementing strategies to support the HE. However, the report observes that these strategies could be streamlined to avoid duplication of resources and thus optimize such programs’ impact.

- HDC’s Halal Integrated Platform (HIP), an online one-stop center for halal business support, could be leveraged as a central virtual platform connecting relevant government agencies and Islamic finance providers. Financial regulators may advocate for Islamic finance providers to participate in HIP and connect their existing halal systems with the HIP. In addition, Islamic finance providers may expand their financial advisory service to facilitate business development and leverage HDC’s expertise in the halal certification process.

- Linking programs related to financings, such as SME financing and export financing, more closely with halal agencies – HDC, MEDAC, JAKIM, and industry events – WIEF and MIHAS, can provide more comprehensive support to HE enterprises.

- HDC may implement strategies to encourage halal labeling of merchants using services provided by e-commerce and related technology companies.

Recommendation 2: Establish closer linkages between programs that support innovation and productivity improvements with Islamic finance.

Currently, government agencies are leading efforts to implement innovation and technology adoption programs. While the support of the public sector is critical, involving the private sector could develop an effective pathway to graduate HE enterprises from public funding to private funding. A closer engagement at the early stages will also help inform Islamic finance providers of innovation and technological advancements that can help them to mitigate financial risks.

- HDC, in collaboration with other relevant government agencies such as MDEC, could provide technical expertise and technology validation, similar to the approach under the Green Technology Financing Scheme (GTFS). The technology validation can help encourage Islamic finance providers to offer funding for productivity-improving technologies to SMEs, such as AgriTech.

- Relevant government agencies, research centers, and Islamic finance providers could collaborate in initiatives that bring both public and private actors to creating R&D and capacity-building funds, particularly mobilizing Islamic social finance such as waqf.

Islamic finance providers could provide advisory services and transition finance to transform HE enterprises and halal parks into more sustainable and less carbon-intensive.

**Recommendation 3: Encourage Islamic finance providers, particularly Islamic banks to participate in public-private sector collaborations to pilot innovative Islamic finance solutions and scaling up**

IFIs should explore Islamic finance solutions beyond conventional debt-based financing. Islamic finance has a multitude of shari’ah contracts that offer the potential for innovative financing structures.

- Equity-based financing, especially for SME and funding growth stages, could address funding gaps that Islamic finance providers do not meet. In addition, a public-private sector collaboration could help manage risks and incentivize Islamic finance providers and institutional investors to innovate and participate in more blended finance programs.
- Government funding programs in support of the HE could be further amplified by collaborating with Islamic banks, Islamic fintech and related technology companies to pilot new funding programs. Relevant government agencies and financial regulators could facilitate data sharing and product ideation to develop innovative solutions.
- Islamic banks could also do more to securitize loans to halal SMEs, since this will enable them to maximize the use of their capital in support of these enterprises, in addition to facilitating access to larger pools of funding from the capital markets.

**Recommendation 4: Strengthening collaboration with policymakers in other countries to advance the utilization of Islamic finance for HE**

Malaysia should continue developing its leadership role in Islamic finance and HE to galvanize global efforts in developing the global HE for the mutual benefit of the OIC countries.

- HDC could play an advocacy role in collaboration with financial regulators to further promote the utilization of Islamic finance solutions in funding HE and promoting participation in HDC’s HIP. In addition, partnerships with HE initiatives in other key countries – especially in ASEAN, the GCC, and Turkey – would provide market access opportunities for Malaysia’s IFIs to provide Islamic finance support to other economies pursuing the HE opportunity. An integrated approach to optimize the comparative advantages of individual countries could increase the potential market size of the global HE in strategic sectors such food and beverages, halal ingredients and agriculture.
- HDC and MATRADE could further support the utilization of Islamic trade finance and explore investment flows between Malaysia and other countries. Islamic trade finance has been

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identified as a meaningful opportunity for Malaysia (World Bank, 2021). Both agencies could also collaborate with relevant multilateral development banks (MDBs) that are active in the OIC countries to implement strategies that can advance Islamic finance and the HE.

**Recommendation 5: Enhancing the role of relevant institutional investors and expanding capital market funding for the HE**

An untapped opportunity exists to increase Islamic finance utilization amongst corporates and SMEs via capital market instruments.

- Financial regulators and Islamic capital market participants could collaborate to pilot the issuance of retail bonds for the HE and explore DLT for blockchain bonds. The issuers could be IFIs or government-linked companies (GLCs). The proceeds would be used solely for financing HE companies. Over time, financial regulators could develop mechanisms to facilitate access capital markets by medium-sized enterprises through micro-issuances.
- Islamic capital market participants and relevant government agencies could collaborate to develop specific private equity funds for R&D.
- Relevant government agencies could advocate for the utilization of Islamic finance by institutional investors to invest in mature businesses, and drive consolidation and M&A.
- Institutional investors and corporate could explore investing overseas in key HE sectors, such as F&B or agriculture. In addition, institutional investors could develop investment strategies specifically for HE sectors, such as consolidating halal meat producers or packaged food companies to raise capital from HE-oriented investors from other countries.

**Recommendation 6: Enhancing data sharing on Islamic finance and HE**

In preparation for this report, a key challenge evident is the lack of data on HE and Islamic funding of HE. Data is a critical enabler to advance finance in any segment to determine the gaps and measure the effectiveness of strategies and initiatives. Whilst there has been collaboration between HDC and the Department of Statistics Malaysia (DOSM) to compile halal data, analysis and intelligence reports covering various halal activities, these outputs are not published regularly. Therefore, HDC, JAKIM, DOSM, and financial regulators could enhance data sharing between agencies to develop and report key business and financial indicators in HE to better monitor the impact of relevant initiatives, identify further gaps, and improve future strategies.
**Recommendation-stakeholder matrix:**

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Stakeholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Enhance policy and strategy coordination across different policymakers and Islamic finance providers to increase the impact of programs.</td>
<td>Government agencies, financial regulators, Islamic finance providers, and SMEs.</td>
</tr>
<tr>
<td>2. Establish closer linkages between programs that support innovation and productivity improvements with Islamic finance.</td>
<td>Government agencies, Islamic finance providers, SMEs, and research centers.</td>
</tr>
<tr>
<td>3. Encourage Islamic finance providers, particularly Islamic banks, to participate in public-private sector collaborations to pilot innovative Islamic finance solutions and scale-up.</td>
<td>Government agencies, financial regulators and, Islamic finance providers, SMEs.</td>
</tr>
<tr>
<td>4. Strengthening collaboration with policymakers in other countries to advance the utilization of Islamic finance for HE.</td>
<td>Government agencies and financial regulators.</td>
</tr>
<tr>
<td>5. Enhancing the role of relevant institutional investors and expanding capital market funding for the HE</td>
<td>Government agencies, financial regulators, Islamic finance providers, and institutional investors.</td>
</tr>
<tr>
<td>6. Enhancing data sharing on Islamic finance and HE.</td>
<td>Government agencies and financial regulators.</td>
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