

1 Prospects Analysis of an Islamic Capital Market in Bangladesh

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6 **Abstract**

7 Dominant growth of Islamic financial system has ushered in a new era of alternative world
8 economic approach- Islamic Financial System (IFS). It is a well-established fact that Interest
9 (Riba) has negative comportment for an efficient capital market. Greedy intent of making
10 quick buck increases the riskiness of the market. This study ventures deep into full potential
11 of an Islamic Capital Market (ICM) for the flow of funds in Bangladesh. Both the
12 international and domestic challenges are decelerating the opportunities. But, continuous
13 upsurge of Islamic investors and stable market confidence for such market might overcome the
14 snags. The present paper investigates the functioning of Islamic securities and examines the
15 possibilities of their development within the existing regulations and economic determinants in
16 Islamic countries for example Bangladesh.

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18 **Index terms**— capital market, islamic capital market, islamic financial system.

19 **1 Introduction**

20 Islamic Capital Market refers to the market where activities are carried out in ways which do not conflict with
21 the principles of Islam. ICM represents an assertion of religious law in the capital market transactions where
22 the market is free from prohibited activities and elements such as riba (usury), maisir (gambling) and gharar
23 (ambiguity). A hectic effort has been put recently on educating western countries on various types of instruments
24 available in the Islamic Financial System. Books, reports, websites and seminars are flourishing. A great deal of
25 marketing has been done by main financial institutions (DB, Calyon) to advertise for their Islamic window. In
26 this sense, the purpose of this research is, therefore, descriptive. This report aims at investigatating opportunities,
27 needs and challenges of an Islamic capital market in Bangladesh.

28 **2 II.**

29 **3 Islamic Capital Market on the Global Front**

30 Global economy has understood the signifcance of Muslim wealth and their perception of investing in accordance
31 with their own ideology by considering the following statistics highlighted by Darmin [1] ? Muslims of the world
32 today are now estimated at more than 1.5 billion, representing a sizeable 24 percent of total world population of
33 7 billion. ? Latent Islamic funds in global financial institutions is said to be at US\$1.3 trillion while the Islamic
34 financial market is estimated at US\$230 billion in size, with an annual growth rate of 12-15 percent. ? There
35 are over 250 Islamic financial institutions currently operating in about 75 countries worldwide, with more than
36 100 Islamic equity funds managing assets in excess of US\$5.0 billion. Today, the Islamic financial market runs
37 parallel to the conventional financial market and provides investors with an alternative investment philosophy
38 that is rapidly gaining acceptance. In addition, Islamic financial market does not prohibit participation from
39 non-Muslims that creates unlimited upside to the depth and breadth of this market.

9 D) IDB INVESTMENT CERTIFICATES

4 III.

Proposed ICM Products for Bangladesh a) Investment Deposit Certificates (Kuwait Finance House and Sudan Islamic Banks) Kuwait Finance House (Kuwait) has issued three types of Investment Deposit Certificates. Profits are computed annually after deduction of actual maintenance and overhead expenses at the rate of 2.5 percent of annual returns. In this case, investment is made for an unspecified period of time. The investor is free to dispose of the certificates through sale or alienation, on the condition that he enters that in the records of the Kuwait Finance House [2].

In Sudan, Islamic banks, namely, Faisal Islamic Bank of Sudan, Sudan Islamic Bank and the Islamic Cooperative Development Bank, issue "Investment Deposit Certificates" are totally interest-free. The holder of the certificate authorizes the issuing party to utilize the certificates in the way that serves the benefit of both parties (i.e. the holder of the certificate as the fund provider and the Bank as a mudarib: entrepreneur).

5 b) Muqaradah Bonds (Jordan)

These bonds are issued by the Ministry of Endowments and Islamic Affairs and Sanctities in Jordan [3]. A muqaradah bond is an instrument of a fixed value issued in the name of its holder against the amount of money he has contributed towards the Qard Hasan certificates are short-term certificates issued by the Malaysian government by virtue of a parliament decree, in order to obtain interest-free loans from banks, institutions and private individuals. This is the concept of Qard Hasan (interest-free loan) advocated by the Islamic shari'ah [6].

Such certificates will have an expansionary effect without generating inflationary tendencies from which most developing countries are now suffering.

IV.

6 Shari'ah View of Current Islamic Securities

With regard to various Islamic securities viewed earlier-on the basis of mudarabah contracts, we shall now direct our attention to [7]. a) Clarifying certain rules concerning the application of the mudarabah terms in the field of securities, b) Reviewing some of the shari'ah objections faced by the securities currently on the market.

7 Some Rules Relating to the Application of Mudarabah Conditions in the Field of Securities

i. An Islamic security may be issued on the basis of absolute or conditional mudarabah. In the case of absolute mudarabah, security holders grant their unconditional consent to the issuing party to utilise their funds in all fields of investment conforming to the shari'ah. ii. There ought to be a specific date for calculating operating results and distribution of realised profits and specification of profit sharing rates between the issuing party –as a mudarib (responsible for actual management of the project) whether wholly or partially –and the holders of the securities as financiers and project owners. A typical example of these certificates is the securities issued by the Jeddah-based Islamic Development Bank and made available to businessmen in Islamic countries to finance foreign trade and other operations. iii. In case of losses incurred by projects or operations financed through securities, the party in charge of actual management (the mudarib) may be able to meet the loss out of the financial reserves retained from profits realised in earlier periods. The security holders, being the capital owners, would have to meet any loss incurred just as they reap realised profits. iv. Any omission of the conditions relating to profit and loss as well as any ambiguity in prescribing these conditions in the prospectus is considered as a violation of the mudarabah contract. It may profitable investment. The instrument is transferable to a third party under intimation to the issuing party which thus registers the transfer of title.

8 c) Islamic Transactions Certificates (Egypt)

These bonds are issued by the Islamic Transactions branches of Bank Misr (Arab Republic of Egypt) for a nominal value of 1000 Egyptian pounds (or US dollars) and their multiples. The bond is nominal and is issued for a term of five renewable years. The prospectus of these bonds states that they are to be invested in Islamic projects and that the bank is mandated to act on behalf of their holders in determining the appropriate methods of investment, on the basis of unlimited mudarabah rules.

9 d) IDB Investment Certificates

These are investment certificates issued for financing trade among Islamic countries. They may also be used to finance certain other operations for specific purposes including leasing. Each certificate has a nominal value of one thousand US dollars and a term that is linked to the portfolio term, which is 25 years. The liability of the certificate holders including the Bank is limited to the value of the rights of each in the portfolio. e) Participation Term Certificate (Pakistan) These certificates are financial instruments issued by banks and financing institutions in Pakistan. These are negotiable certificates based on the principle of profit and loss sharing and aim at mobilising medium and long-term financial resources in the local currency for industrial and other projects. Ismail [4] explains an issue of Pakistan that issued a statutory law governing all legal matters related to these certificates,

95 Furthermore, the participation certificate holders have the right to transfer a certain part of their certificates
96 into ordinary shares of the issuing company. The regulations also stipulate that the issuing party may grant
97 shareholders the right of purchasing participation term certificates. f) Investment Council Unit Fund Certificates
98 -Bangladesh

99 These certificates are issued by the Investment Council in Bangladesh which is a governmental nonbanking
100 financing institution operating mainly on interest basis. However, the authority also arranges the establishment
101 of unit funds operating on the basis of mudarabah. Each fund is totally independent in terms of assets and
102 liabilities and has its own independent management. The funds' resources are mobilised together through the
103 sale of the above mentioned certificates which are known under the names: ICB Unit Certificates and ICB Mutual
104 Certificates [5]. be noted that the prospectus of the IDB portfolio is very detailed and accurate in this respect,
105 whereas in some other cases no details are given as to what can be expected in case of loss as if this possibility
106 were totally ruled out. This is likely to raise a great deal of suspicion. v. It must be pointed out here that the
107 issuing party is bound by shari'ah to uphold the conditions under which the securities were issued whether it is
108 acting as the end-user or just an agent for these accumulated securities.

109 vi. It is also to be noted that in all cases the project or the investment activity financed through securities has
110 its own financial entity as distinct from that of the issuing party. It follows then that the property or assets of the
111 issuing party are totally distinct from those of the project or the investment activity financed through securities
112 [8]. Some Shari'ah Objections against Islamic Securities: Review and Comments a) Shari'ah Objections to the
113 Jordanian Muqaradah Bonds i. Some criticism is raised against the use of the word "bond" to describe these
114 financial instruments. A bond is defined in civil law as a perpetual debt on the issuing party commanding a fixed
115 periodical return agreed upon on the date of issue which is a usurious interest.

116 ii. The law on the basis of which the muqaradah bonds have been issued does not sanction any right to
117 bond holders with regard to the project ownership. Rather, it holds in trust the amounts they have paid which
118 it returns to them at their value at the date of redemption. The Jordanian government guarantees the full
119 settlement of the nominal value of the bonds on maturity.

120 iii. Muqaradah bond holders get their share of any realised profits. However they are not bound, as they
121 should have been according to their status as fund providers in muqaradah contracts, to any commitments in the
122 absence of profits, which mean that they do not incur losses. This is no doubt in conflict with the mudarabah
123 contract which necessitate that fund providers should share profits when realised and should bear losses when
124 incurred, whatever the amount, out of the principal.

125 **10 b) Shari'ah Objections to the Participation**

126 Term Certificates (PTC) of Pakistan: Due to certain similarities between the PTC of Pakistan and bonds
127 transacted in the western markets, doubts have arisen as to the shari'ah permissibility of the PTCs.

128 Mohamed [9] explains the issue of "guarantee" for the certificate's nominal value gives rise to objections on the
129 same grounds mentioned in the previous section on the Jordanian muqaradah bonds. It may be argued that this
130 arrangement was meant to provide a guarantee for the certificate holders in case the project using their funds fails
131 to observe the terms of the mudarabah contract. However, this is not clearly stated in the available prospectus
132 of such certificates. c) Objections to the Investment Fund Certificates -Bangladesh [10] Objections raised in
133 this case are not related to the technique itself or the terms of issue, but rather to actual practices pertinent to
134 utilisation of the resources mobilised through these certificates. Such resources are generally invested in profit
135 generating activities, but any surplus funds are deposited with conventional banks and earn interest. Such
136 a practice, naturally, is not Islamic, and whatever interest is realised through it, and distributed among the
137 certificate holders, is not halal (shari'ah accepted) money. Some would even question the profits realised through
138 investments in certain projects.

139 **11 d) Doubts Surrounding the Certificates of Bank Misr Branch 140 for Islamic Transactions**

141 The Islamic transaction branches of conventional banks have been open to doubts and polemics regarding the
142 seriousness of their Islamic financial transactions. Some hold the view that these branches are nothing more
143 than fictitious windows opened for the sake of attracting savings of Muslims not wishing to deal with interest,
144 and then to use these savings, along with other resources that may be accumulated by the bank, in conventional
145 banking operations. The advocates of this view vindicate it through theoretical proofs based on the nature of
146 banking activities and their methods of mobilising resources [11].

147 V.

148 **12 Islamic Capital Market in Bangladesh**

149 In the context of the present development processes all contemporary Muslim countries combined with the
150 endeavour to revive the application of shari'ah, In fact, these projects depend at the inception of their activities
151 either on private individual financing and subscriptions from relatives and friends or on financing from Islamic
152 banks. It may also be noted that some Islamic banks have already taken this step of getting into the financial

153 market and have issued medium or long term securities in order to establish a new financing source that would
154 enable them to respond to the needs of projects seeking growth. This trend is expected to increase in near
155 future. Among these conditions is the one that requires the shari'ah-based economic activity to attain a degree
156 of maturity to produce a favourable climate for bringing about "external surpluses" required for its sustenance.
157 Muslim countries should have the capability to translate the relevant part of the Islamic shari'ah into the form
158 of essential regulations and systems that would contribute to setting up a secondary stock market capable of
159 meeting the challenges of our modern life [12]. These conditions may be realised in part or full in the foreseeable
160 future in some Muslim countries that have some experience in the activities of stock markets and a strong Islamic
161 economic movement. Based on the above, we find that the establishment of an Islamic secondary stock market
162 will not come about as a natural development at present. In fact, what is required is to make preparations for
163 this market through Islamic studies regarding its laws, regulations, objectives and functions.

164 It may also be noted that the success of establishing an Islamic secondary stock market and ensuring its
165 survival and growth in the long run will not depend only on a good organisational structure to run its affairs and
166 Islamic legislation to safeguard it, but also on the employment of human expertise and know-how that are Islam-
167 oriented to perform its duties and to have peculiar characteristics that would distinguish it from the conventional
168 stock markets [1].

169 13 VI.

170 14 Recommendations

171 The best securities to a Muslim are those issued -a) by ventures serving the objectives of Islamic economic activity,
172 b) projects expected to yield higher returns, c) the Muslim buyer who acquires them will not feel embarrassed
173 to take advantage of price changes through the sale of securities in his possession or repurchasing them later on
174 for the benefit of achieving windfall profits from this transaction.

175 15 Preconditions of an Islamic capital market in Bangladesh -

176 Above critical understanding of available information suggests the following preconditions for ICM in Bangladesh:

177 16 Conclusion

178 In order to underscore the need for an Islamic stock market, let us ask about the alternative in case it is not set up
179 or no efforts are made to establish it. That probable alternative would be nothing but to continue to deal in the
180 Islamic securities in the present stock markets in Muslim countries according to the existing rules and systems.
181 Such a practice will be faced with many obstacles, unbalanced advantages and uncalculated competition with
182 interest-based securities, or securities issued by companies and institutions uncommitted and indifferent to the
183 issues of halal and haram, thus leading to continued weakening of the tide of financing of shari'ah-based investment
184 projects. This can only be achieved when the shari'ah-based investment projects realise actual success and go
185 on expanding. There is a further step that is more ambitious and an advance towards the target. That step
186 is to endeavour to adjust and develop the present rules governing the dealings in stock markets in the Muslim
187 countries.¹

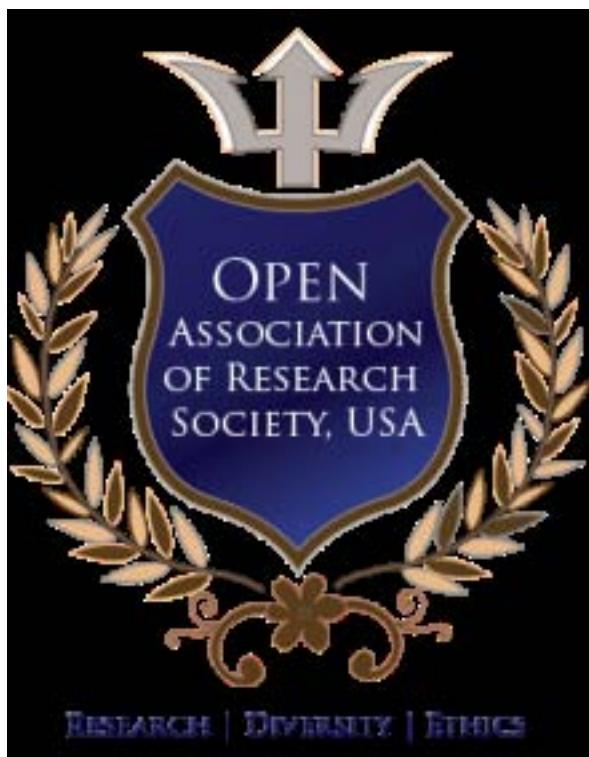


Figure 1:



Figure 2: ear

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