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Problems and Prospects of Islamic Capital Market In Bangladesh

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Abstract

Islamic finance is acquiring a growing respected place in the world financial system and its market share has been growing by more than 15 percent annually for the last ten years. It has been acknowledged by the scholars on the need for this development to cater for the Islamic banking, Takaful and Islamic capital market industries. Among these three streams of the service industry, the Islamic capital market plays a crucial role to support the other two. Since Islamic banks and Takaful operators have to invest to provide the benefits to the investors and policy holders which are compatible with the conventional counterparts, the Islamic capital market is assumed to be the backbone for the two to survive and grow in the Islamic finance industry. It is the objective of this paper to investigate the problems and prospects of Islamic capital market in Bangladesh. Hence, issues related to the ICM such as instruments that is presently used for capital financing, and the background and origin of the Islamic capital market were discussed. Finally, it was concluded that the ICM is rapidly growing and there is a huge potentials waiting to be exploited in the market.

Key words: *Islamic Capital Market, Islamic Financial System, Problem, Prospects, and Shariah.*

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1. Introduction

Islamic Capital Market refers to the market where activities are carried out in ways which do not conflict with the principles of Islam. Islamic Capital Market represents an assertion of religious law in the capital market transactions where the market is free from prohibited activities and elements such as riba (usury), maisir (gambling) and gharar (ambiguity). The justice and fairness is vital for the sustenance of the Islamic financial system and Islamic Capital Market in particular. Hence, all the participants in the Islamic Capital Market are adequately protected and are given their befitting rights and obligations (ISRA, 2011). With this the operations of the market will be smooth and free from human tendency of cheating. The foregoing indicate that for any product to be developed in the ICM such a product should be a Shari'ah-compliant and should pass certain ethical requirements as highlighted earlier on (Al-Bashir & Al-Amine, 2008).

A hectic effort has been put recently on educating western countries on various types of instruments available in the Islamic Financial System. Books, reports, websites and seminars are flourishing. A great deal of marketing has been done by main financial institutions to advertise for their Islamic window. Being an integral component of Islamic financial system, Islamic Capital Market provides opportunities for long-term investments and risk-sharing through diversification. The vast growth and development witnessed in ICM is basically attributed to the variety of products, infrastructures, institutions, and intermediaries available in the system.

2. Islamic Capital Markets: Background and Origins

The point of contention in conventional capital markets from an Islamic point of view arises in some of the underlying structures of products in the equity, debt and derivatives markets that are polluted with elements not in compliance with Shari‟ah (Islamic Law). The Islamic financial system is based on the fundamentals of Shariah that requires gains from investments to be earned in an ethical and socially responsible manner that comply with teachings of Islam (DeLorenzo, 2000). Shariah requires investments to be free from riba (interest rates), gharar (uncertain outcomes), maysir (gambling), and prohibited commodities (liquour, pork, etc.) while further complying with the contractual requirements of investments/trading as required in Islamic Law of Contracts (Rosly, 2005). Shariah also prohibits investments in non-productive and/or potentially harmful activities such as pure games of chance, prostitution, production and/or distribution of non-permissible products such as alcohol, tobacco, pork, pornography and arms (Hassan, 2001).

Hence, the need for Islamic capital markets arises in order to provide the Muslim population of the world access to financing and investment opportunities that are in compliance with their religious beliefs. The process of identifying and producing Shariah compliant alternatives to conventional capital market instruments involves a team of Shariah qualified scholars screening the underlying structures and activities of proposed investments to ensure they comply with Shariah and hence be endorsed with a Shariah compliant label. The emergence of a distinct Islamic capital market, where investment and financing activities and products are structured in accordance with Shariah principles, is therefore the outcome of a natural development in the growth of the Islamic financial services industry. As outlined earlier, the pressing need to address liquidity management for Islamic banks and Takaful operators provoked several countries such as Malaysia, Bahrain, Kuwait, Sudan and Iran – to introduce Islamic bonds to facilitate the management of assets by Islamic financial institutions, whilst there had been earlier efforts by the Governments of Jordan and Pakistan to introduce a legal framework for Islamic bond issuance, the first successful issuance of Islamic bonds was initiated by the Malaysian Government in 1983 with the issuance of the Government Investment Issue or GII (formerly known as the Government Investment Certificate or GIC). Subsequently, the underlying concept of GII was changed to bai al-Inah to allow it to be traded in the secondary market.

During the early development years of the Islamic financial system in Malaysia, the Islamic Capital Markets role was very minimal. Significant developments in the Islamic Capital Market and its contributions towards the development of the Islamic financial system were more obvious from the mid-1990s onward. In Malaysia, the initial efforts to provide a list of Shariah-compliant stocks were undertaken by Bank Islam Malaysia Bhd in 1983. This was later followed by the introduction of a list of Shariah-compliant stocks in June 1997 by the Securities Commission of Malaysia. Malaysia established two Islamic unit trust funds way back in 1993 effectively paving way for the development of the Islamic fund management industry (MIFC, 2011). Malaysia is also noted for its creative leadership in launching the first Islamic Real Estate Trusts (REITs) in the world and the introduction of Asia's first Islamic Exchange Traded Fund (ETF) spearheading efforts in developing Islamic capital market structured products (MIFC, 2011).

Since then, Malaysia has positioned itself as the global leader in sukuk issuances and in provision of liquidity management services for Islamic financial institutions (IFIs) (MIFC, 2012). Lately, research and efforts have been directed towards developing Islamic derivative instruments that could provide effective risk management facilities.

3. Islamic Capital Market: Instruments Sukuk

Sukuk is one of the new issues at the capital market in Bangladesh. It is a financing instrument for the purpose of raising funds by companies or governments and the underlying transaction is structured based on various Shariah principles. Sukuk investors are entitled to the income arising from the underlying transaction. In the Sukuk market different types of Shari'ah compliant products are being structured in line with Islamic financial contracts. These include Sukuk al-Ijarah, Sukuk Bai-bithaman ajil, Sukuk al-Murabahah, Sukuk al-Istisna, Sukuk al-Musharakah, and Sukuk al-Mudharabah. Sukuk is considered to be the most active instrument in the Islamic debt market.

3.1 Shariah-Compliant Securities

A Shariah compliant security is an investment vehicle fund structured in accordance to Shariah rules. Shariah-compliant securities are securities (ordinary shares, warrants and transferable subscription rights) which have been classified as Shariah permissible for investment, based on the company's compliance with Shariah principles in terms of its primary business and investment activities.

3.2 Islamic Unit Trust Funds

Islamic Unit Trust Funds, more commonly referred to as Shariah funds are a group of specialized collective investment funds which offer investors the opportunity to invest in a diversified portfolio of Shariah-compliant securities, fixed income securities and money market instruments that are managed and selected by professional portfolio managers in accordance to Shariah principles.

3.3 Islamic Real Estate Investment Trusts

Islamic real estate investment trusts or I-REITs are collective investment vehicles that pool money from investors and use the pooled capital to buy, manage and sell real estate. I-REITs provide an investment opportunity for those who wish to invest in real estate through Shariah compliant capital market instruments.

4. Islamic capital market: Problems and Challenges

The challenge for Muslim countries like Bangladesh is to overcome its late entry into the market against well-established jurisdictions all over the world. Another subsequent challenge would also be to educate the masses and the other industry stakeholders regarding Islamic financial principles, products and investments. The challenge for them is to motivate authorities to provide favorable platforms and policies to make such initiatives viable.

The Islamic financial operations are subjected to strange rules different from the ones applicable to the conventional operations; there are a number of challenges being faced by ICM. For instance, in many cases, the Islamic capital market has had to comply with the regulatory provisions meant for the conventional system which has an entirely different underlying objective and approach (Cox, 2005; Jobst, et al., 2008). Additionally, it should be noted that the relatively young ICM is operating in the same environment with its long standing conventional counterpart who have been in the arena for centuries (Cox, 2005).

The risk involved in profit-sharing seems to be so high that almost all of the Islamic banks in Bangladesh have resorted to those techniques of financing, which bring them a fixed assured return. Presently most of the investments of Islamic banks are made on mark-up basis. As a result, the ideal modes of investment (Murabaha, musharaka) are quite absent in their practices. Concentration of Islamic banks investment in short-term trade is a relatable problem in Islamic banking. The badly hit post crisis economy presents another challenge in the form of slight investor confidence in the region. Besides, industries need to collaborate and formulate a joint strategy to develop Islamic capital market policies for the country.

Finally, the highly competitive and rivalrous nature of organization presents another challenge for the sound functioning and growth of the Islamic capital markets. Islamic organizations are in competition with interest-based organization and are therefore anxious to earn at least as much on their investments as will enable them to give a return roughly comparable to prevailing interest rates to their investment account holders.

5. Prospects of Islamic Capital Market in Bangladesh

Bangladesh has developed a sizeable Islamic finance industry but a lack of sharia-compliant instruments is limiting further growth of the sector. With a predominantly Muslim population of 160 million, Bangladesh has developed Islamic finance with only marginal regulatory adjustments; the industry has doubled in size in the past four years.

It may also be noted that some Islamic banks have already taken this step of getting into the financial market and have issued medium or long term securities in order to create a new financing source that would enable them to respond to the needs of projects looking for growth. This trend is expected to increase in near future. One of the sign of the development of an emerging financial market is the creation of a capital market that covers both equity and debt products. This does not happen overnight, but builds slowly until it reaches maturity.

The opportunity for growth in the most populous Muslim nation is simply tremendous. Combined with appropriate support from the authorities, Bangladesh has potential to be the largest Islamic finance hub in the world given its massive population. Bangladesh has several advantages such as a large proportionate Muslim population, gas-induced wealth and general stability. Yet, progress remains uninspiring and Bangladesh is not pacing fast enough compared to other regional players but there is a great opportunity for Islamic capital markets to flourish. Further, effectual studies are required to determine the exact cause of inactiveness in terms of ICM development in Bangladesh.

6. Conclusion

In conclusion, protection of wealth is one of the five overall objectives of Shariah. Without Islamic capital markets, the Muslim population of the world is excluded from various financing and investment opportunities. Islamic capital markets enable Muslims to actively participate in the overall progress of the economy without compromising on their religious beliefs.

Muslim population of Malaysia only 61%, it has achieved feats which nations having 90% and above Muslim populations have failed. In this regards, Having a Muslim population of 90%, Bangladesh progress in the Islamic finance industry has been nothing. In this paper, we comprehensively identified and examined problems and prospects of Islamic capital markets in Bangladesh. Based on results from our analysis, we provided some recommendations that could be used by Muslim leaders for the effective growth and development of Islamic capital markets. Surely, it is now time for Muslim nations to wake up and try hard to develop sound Islamic financial frameworks. Without a well-functioning Islamic financial system, Muslims all over the world are at risk of accumulating sins when dealing in prohibited conventional finance transactions.

7. Recommendations

The ICM across the globe should make an effort to participate actively in the global sukuk market which is presently being led by ICM in Malaysia, Saudi Arabia, United Arab Emirate, Qatar and Turkey among others. In structuring the sukuk and other products in the Islamic capital market, Centralized Shariah bodies can endorse greater confidence amongst the public concerning the Shariah validity of ICM products. At the time of structuring various ICM products some Shariah harm needs to be tolerate in the beginning as long as the benefits to the public (Maslahah) are greater. This is to allow the Islamic capital market to take the basis and consequently the structuring could move towards more falling in line. While benchmarking and learning from the experience of the conventional bond market, rules and procedures should not be blindly adopted because the basic principles of the two markets are not the same. Strong political-backing from management and regulatory support in the form of laws and legislation is vital to the success of ICMs development.

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