





# **STATE OF ISLAMIC CAPITAL MARKET**

## **Swot Analysis**

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Tehran

March 8th, 2010

# Outline

- **Recap of Basics**
  - What is Shariah
  - Objectives of Shariah
  - Major Prohibitions (Concerning Islamic Finance)
- **Shariah Norms for Investments in Capital Market**
  - AAOIFI
  - US, Europe
  - Middle East
  - Far East
  - Subcontinent
- **SWOT Analysis**

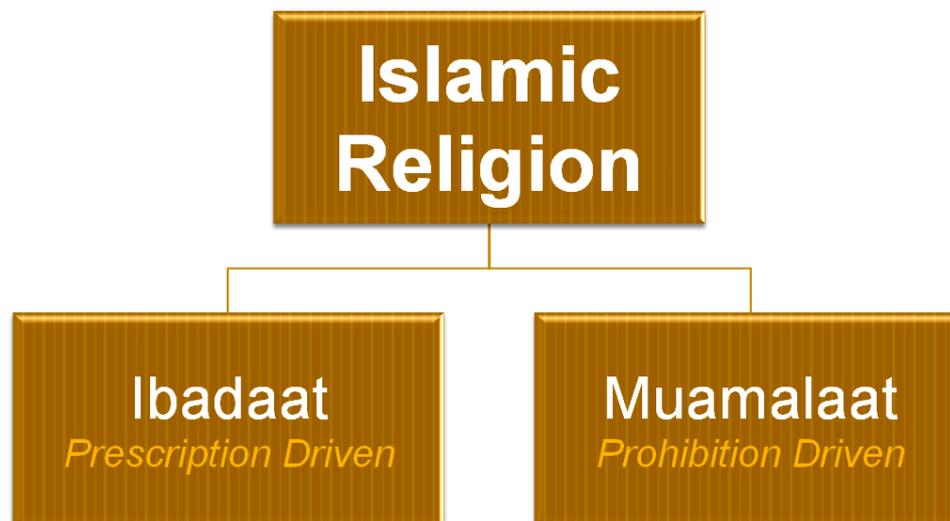
# What is Shariah?

- **The Shariah is an abstract form of law capable of:**
  - Adaptation
  - development and
  - further interpretation.
- **Sources of Shariah**
  - Primary
  - Secondary



# Objectives of Shariah?

- Protecting from Harm (*madarrah*)
- Securing Benefits (*manfa'a*)



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# Ibadaat & Muamalat

- ***Ibadaat***
  - The “principle” is everything except what is prescribed is **“PROHIBITED”**.
- ***Muamalaat***
  - The “principle” is everything except what is prohibited is **“PERMITTED”**.



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## Features of Islamic Market

- Islamic markets are ethical markets governed by norms of Shariah
- Islamic markets can be described as "free and fair" market
- Important Qur'anic Verses
  - Allah has made trade lawful (2:275)
  - Let there be among you traffic and trade by mutual goodwill (4:29)



## 3 Cardinal Principles

### Fairness

- Presence of:
  - Justice
  - Transparency
  - Public welfare

### Freedom

- Absence of:
  - Coercion of either parties.
  - Control or fixation of price'

### Mutual Goodwill

- Absence of:
  - *Riba*
  - *Gharar*
  - *Johal*
  - *Ghabn*
  - *Najash*
  - *Maysir*



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## Fairness

The Prophet (SAW) is reported to have said “No one hoards but the sinner”; and "Do not raise the price when you do not have the intention to buy".

- **JUSTICE**; neither party to a contract may exploit the other.
- **TRANSPARENCY**; those concerned must share all available information. Withholding crucial information bearing on the transaction could render the contract invalid.
- **MASLAHA**; common interest will take precedence over individual or particular interest.



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## Freedom

- "Prices are fixed by Allah. He contracts and expands the sources of livelihood. And I hope to meet my sustainer in a state that no one may raise a claim of injustice against me in respect of blood and money."  
(Prophet Mohammad SAW)
  - **Absence of coercion** of either party.
  - **Absence of 'control** or fixation of price'



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## Mutual Goodwill Requires

- Absence of *Riba*
- Absence of *Gharar*
  - Absence of *Johal*
  - Absence of *Ghabn*
  - Absence of *Najash*
- Absence of *Maysir*



# Major Prohibitions

- **Riba**; in Islam is **religiously, socially, and economically unjust practice.**
- **Gharar**; Parties to a contract must have actual knowledge of the "**subject matter**" of the contract, **the price** and the **implications of the contract.**
  - **Johal**; refers to absence of value related information.
  - **Ghabn**; refers to the difference between the price at which the transaction is executed and the fair price
  - **Najash**; refers to bidding up the price without intention to take delivery
- **Mysir**; is gambling, bets and wager where whatever one profits is at the cost of others



# Shariah Norms for Investments

## Shariah Scholars' Position

- **Most Conservative:** do not permit investment in the company which is in *haram* business to any extent.
- **Conservative:** allow investment in the company which derives a minor part of its income from *haram* activities.
- **Liberal:** agree to relaxations if the same can be justified on grounds of *masalahah* i.e. public interest.
- **Most Liberal:** allow investments in the company if its engagement in *haram* activities are because of pervasiveness. This in shariah is known as a commonly prevalent evil (very difficult to avoid).



# Issues in Shariah Compliance

- **Business of the Enterprise**

Shariah scholars agree that if the business of the enterprise is shariah repugnant then investments in it is not permitted. There is consensus on it.

- **Structure of the Enterprise**

Three important aspects to be considered:

- Extent of Shariah repugnant debt and investments;
- Extent of impermissible or suspect earnings of the company;
- Extent of cash and receivables with the company.



# Issues in Shariah Compliance

- **Business Screening**
  - All companies whose core or main business is shariah repugnant are excluded from the investment portfolio
- **Financial Screening?**
  - To assess the level of shariah infringement with regard to company's borrowings and investments (indulgence in riba based transaction);
  - To assess the level of impure income company is receiving on account of its involvement in shariah repugnant activities;
  - To assess the level of liquid stocks (cash & debt) the company has vis-à-vis its total assets.



# AAOIFI Shariah Norms

- **What is AAOIFI?**

Established in 1991 AAOIFI stands for Accounting and Auditing Organisation for Islamic Financial Institutions. It is headquartered in Bahrain and today the most widely represented shariah body of Islamic finance institutions in the world. AAOIFI prepares accounting, auditing, governance, ethics and Shariah standards for Islamic financial institutions. AAOIFI's shariah norms are developed by world's 15 top most shariah scholars of finance. Consequently AAOIFI's norms are most respected and widely accepted.

- AAOIFI has 200 members from 45 countries. More details about AAOIFI can be had from [www.aaofii.com](http://www.aaofii.com)



# AAOIFI Shariah Norms

- **Business Screen:**

Investment is permitted if the objectives for which the corporation was established are shariah lawful.

- **Financial Screen:**

Fundamental rule is prohibition of acquiring and trading in shares of corporations undertaking transaction in riba and other prohibited things even when their primary activity is lawful.

- **Exemption to the above:**

- If Memorandum of Association does not mention that one of its objective is shariah repugnant.
- If total borrowings and debt does not exceed over 33% of its market capitalisation.
- If the total income generated from prohibited component does not exceed 5% of the total income of the corporation.



# Dow Jones Screening Norms

Launched in 1999 it currently tracks shariah compliant stocks from about 50 countries

- **Business Screens**

Based on revenue allocation, if any company has business activities in the shariah inconsistent group or sub-group of industries it is excluded from the Islamic index universe. Examples of such business are alcohol, tobacco, pork, conventional finance, weapons, entertainment etc.

- **Financial Screens**

<b>Total borrowings</b>	<b>Less than 33% of Average Market Value (24 months)</b>
<b>Cash plus Interest bearing securities</b>	<b>Less than 33% of Average Market Value (24 months)</b>
<b>Receivables</b>	<b>Less than 33% of Average Market Value (24 months)</b>



# FTSE Screening Norms

Launched in 2000 it currently tracks shariah compliant stocks from about 50 countries

- **Business Screens**

Companies involved in alcohol, tobacco, pork, conventional finance, weapons, entertainment are excluded.

- **Financial Screens**

<b>Total Debt</b>	<b>Less than 33% of Total Asset</b>
<b>Cash plus Interest bearing securities</b>	<b>Less than 33% of Total Asset</b>
<b>Accounts Receivables</b>	<b>Less than 33% of Total Asset</b>
<b>Non-compliant income</b>	<b>&lt;5% of total revenue</b>



# S & P Screening Norms

Launched in 2007 it currently tracks shariah compliant stocks from about 35 countries

- **Business Screen**

Company's annual audited report is screened. Activities screened out are; alcohol, tobacco, pork, financial services, advertising and media, trading of gold & silver, adult entertainment, gambling.

- **Financial Screens**

<b>Total Debt</b>	<b>Less than 33% of Average Market Value (36 months)</b>
<b>Accounts Receivables</b>	<b>Less than 49% of Average Market Value (36 months)</b>
<b>Cash plus Interest bearing securities</b>	<b>Less than 33% of Average Market Value (36 months)</b>
<b>Non-compliant income (other than interest)</b>	<b>&lt;5% of total revenue</b>



# MSCI Screening Norms

Launched in 2007 it currently tracks shariah compliant stocks from about 53 countries

- **Business Screen**  
**Screening is done based on 5% revenue criteria.** Activities screened out are; alcohol, tobacco, pork, conventional finance, weapons, entertainment (hotels, casino, gambling, adult entertainment).
- **Financial Screens**

<b>Total Debt</b>	<b>Less than 33.33% of Total Asset</b>
<b>Cash plus Interest bearing securities</b>	<b>Less than 33.33% of Total Asset</b>
<b>Accounts Receivables</b>	<b>Less than 70% of Total Asset</b>



# NCB Saudi Arabia Screening Norms

- **Business Screens**

Any company whose any of the business objective is shariah repugnant is screened out. Consequently investment is not permitted in any company engaged in alcohol, conventional finance, pork, tobacco etc.

- **Financial Screens**

<b>Total Debt</b>	<b>Less than 33.33% of Market Cap</b>
<b>Interest Income</b>	<b>Less than 5% of Total Income</b>
<b>Debt Plus liquid Fund</b>	<b>Less than 50% of Market Cap</b>



# DFM Screening Norms

- **Business Screens**

Companies are screened based on their business objective and nature of activities. If they fall under prohibited category then they are screened out. Consequently all businesses involving *Riba*, *Gharar*, *Maysir* and other prohibitions are excluded.

- **Financial Screens**

<b>Interest based Borrowing</b>	<b>Less than 30% of Total Assets</b>
<b>Interest based Debts/investments</b>	<b>Less than 30% of Total Assets</b>
<b>Cash Plus Trade Receivables</b>	<b>Less than 90% of Total Assets</b>
<b>Impure Income</b>	<b>Less than 10% of Total Income</b>



# SEC, Malaysia Screening Norms

- **Core Activities:**
- **Mixed Activities:**
  - The public perception or image of the company must be good;
  - The core activities *masalahah*;
  - Non-permissible element very small and involves matters such as *umum balwa* (common plight and difficult to avoid), *uruf* (custom) and the rights of the non- Muslim community.



# SEC, Malaysia Screening Norms

## Benchmarks of Tolerance

- **Five Percent**  
To assess level of mixed contributions from activities that are clearly prohibited. Such as *riba*, gambling, liquor and pork.
- **Ten Percent**  
To assess level of mixed contributions from activities that involve the element of '*umum balwa*' (affecting most people and difficult to avoid).
- **Twenty Percent**  
To assess level of mixed contributions from activities that are Islamically approved but in course of their activities they get some earning which comes from shariah suspect sources.
- **Twenty-five Percent**  
To assess level of mixed contributions from activities that are generally permissible and have an element of *maslahah* (public interest), but there are other elements that may affect the *shariah* status of these activities.



# Meezan, Pakistan, Screening Norms

- **Business Screen**

The basic business of the investee company should be Halal. Accordingly investment in shares of conventional banks, insurance companies, leasing companies, Modaraba companies, companies dealing in alcohol, tobacco, pornography, etc. are not permissible.

- **Finance Screen**

<b>Borrowings</b>	<b>Less than 40% of Total Assets</b>
<b>Illiquid Asset</b>	<b>At least 20% of Total Assets</b>
<b>Investments (Non-compliant business)</b>	<b>Not more than 33 % of Total Assets</b>
<b>Income from Shariah non-compliant</b>	<b>Less than 5% of Gross Revenue</b>
<b>Net Liquid Asset</b>	<b>Less than total Market Cap</b>



# TASIS, INDIA, Screening Norms

Launched in 2007, TASIS tracks shariah complaint stocks listed at India's three prominent stock exchanges i.e. BSE, NSE and CSE. Based on shariah logic and scientific research its norms are most conservative for shariah screening.

- **Business Screen**

Listed companies are first screened on the basis of their business activities. Consequently all non-compliant businesses such as financial services, tobacco, alcohol, pork, vulgar entertainment, manufacturer of explosives etc. are screened out.

- **Finance Screen**

<b>Borrowings/Debts</b>	<b>Less than 25% of Total Assets</b>
<b>Interest Income Plus returns (@8) from all non-compliant investments</b>	<b>Less than 3% of Total Income</b>
<b>Cash Plus Receivables</b>	<b>Less than 90% of Total Assets</b>



# SWOT Analysis

## Strength

- Partnership Approach
- Spans a large fields of venture capital, private equity
- Confluence of views of shariah scholars and finance professionals
- Emergence of various shariah screening institutions and their methodology has led to healthy debate about the theoretical basis of shariah screening vis-à-vis the empirical constructs of the real financial world.



# SWOT Analysis

## Weakness

- Lack of proper understanding of true basis of financial shariah screening.
- Today there is no standardisation of the methodology of financial screening.
- There are a number of different sets of screening norms in use. They differ widely in certain respects from each other.
- As a result a certain degree of confusion exists in the field as to which norms should be applicable.
- There is a tendency on the part of some institutions to make changes in norms merely to suit commercial interests rather in response to a desire for greater compliance with shariah or rectification of past errors.



# SWOT Analysis

## Opportunities

- The stock market occupies a pivotal role in the universe of investment. This is even more so in the case of Islamic Finance, for which the conventional money market is debarred.
- Through this platform Islamic Finance can operate in such major areas of financial activity as mutual funds, pension funds and insurance has to be based on stock market investment.
- Capital market provides liquidity, diversification, scalability, assurance of acceptable levels of governance and availability of expertise
- The growth of Islamic Finance in all these areas is not possible without the development of financial shariah screening. Thus financial screening of stocks opens the door to all these areas for Islamic Finance.



# SWOT Analysis

## Threat

- Slow growth and development of stock markets in Muslim countries.
- Considering the shariah importance of profit-sharing based operations, it is essential for Muslim markets to develop institutions to provide exit routes and thus liquidity to investors in profit based operations.
- Poor representation of Muslim institutions in the field of providing shariah screening norms and their poor credibility among independent users of such norms.
- Till we have institutions whose interest in providing the shariah norms and lists of shariah compliant stocks stems from a genuine independent and Islamic perspective, the screening norms in use will continue to lack credibility and this will act as a drag on the development of equity markets and Islamic investment in Islamic stock markets.



# Critical Appraisal

## Major Issues

- The Rule of One-third
- Suitability of Market Cap for shariah compliance
- Purging of Impure Income
- Application of *Umum Balwa* in Muaamlaat

## Other Difficulties

- Non-availability of Standard shariah Norms
- Non-availability of shariah related information
- Conflict of interest (index service and shariah compliance)
- Is a company merely a bundle of Assets and Liabilities?
- No Research Backup
- Low exposure of shariah scholars in Capital market



THANK YOU  
&  
Wassalam!!

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