

The Islamic Capital Markets Versus the Conventional Capital Markets

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Abstract

This short note discusses the differences between the well developed conventional capital market and the newly developed Islamic capital market. One has to bear in mind that both markets are similar because they are there to fulfill the same need, yet they are different because they serve different customers. The need that they fulfill is the need for companies and governments to raise money and for investors to find profitable projects to invest in. The customers that they serve are the companies, governments and the investors. But the later serve the Muslim investors and entrepreneurs, who are trying to do business while following the laws of their religion (Shariah law). That's why they work parallel to one another.

Keywords: *Capital Markets; Islamic Finance; Interest; Islamic laws*

Paper Type: Short Note

Introduction

There are two distinct markets that are the primary markets and secondary markets. In primary markets, new stock or bond issues are sold to investors, often via a mechanism known as underwriting. The main entities seeking to raise long-term funds on the primary capital markets are governments (which may be municipal, local or national) and business enterprises (companies). The existence of secondary markets increases the willingness of investors in primary markets, as they know they are likely to be able to swiftly cash out their investments if the need arises

Also both have another type of division in its markets, which is the stock markets , the market for equity securities, also known as shares, where investors acquire ownership of companies and the share represent his portion in the company he invest in and the bond market, the market that sell bonds that represent the amount of loan that the investor lend the project for, where investors become creditors.

Even though the Islamic Capital market has its unique features like risk sharing, property rights, rights and duties of the individual and society, but unfortunately when developing products it tends to replicate all the conventional capital market products, which interns will hurt its image in the long run.

The researcher will use the tabular format to exhibit her comparison, because from the researcher point of view, table of comparison is not only the clearest way to emphasize the similarities and the difference between the two markets, but also the easiest to follow as presented in Table 1.

Table 1
Comparison of Islamic and Conventional Capital Market

Basis of comparison	Islamic Capital Market	Conventional Capital Market
It's evolution	<p>Islamic banking began in the 1970s and developed erratically until the mid-to-late 1990s, when its focus expanded from deposit-side activities to include investment and finance activities. Investment and finance activities commenced in the mid-1990s and have grown continuously at an accelerated rate ever since. Takaful started in the early 1980s and has been slower to develop. In each case, growth has been somewhat disorganized and sporadic – with the notable exception of Malaysia, which introduced organizational formalities (including laws) in the early 1980s.</p> <p>The Shariah Advisory Council (SAC) was established in May 1996 to advise the Commission on Shariah matters pertaining to the ICM. Members of the SAC are qualified individuals who can present Shariah opinions and have vast experience in the application of Shariah, particularly in the areas of Islamic economics and finance</p> <p>The Islamic capital markets are comprised of an equity side and a “debt” or finance side. The equity side commenced in 1998, after issuance of a fatwa by the shariah board of Dow Jones Islamic Market Indexes (DJIMI fatwa), which set forth parameters</p>	<p>-In the 1300s, The Real Merchants of Venice were the leaders in the field and the first to start trading the securities from other governments.</p> <p>-In 1531, Belgium boosted a stock exchange, in Antwerp. Brokers and moneylenders would meet there to deal in business, government and even individual debt issues.</p> <p>-In the 1600s, investors in Germany, England and France would put up money for the voyage going to East India by outfitting the ship and crew in return for a percentage of the proceeds if the voyage was successful. These early limited liability companies often lasted for only a single voyage. They were then dissolved, and a new one was created for the next voyage</p> <p>Then East India companies were formed, they changed the way business was done. These companies had stocks that would pay dividends on all the proceeds from all the voyages the companies undertook, rather than going voyage by voyage. These were the first modern joint stock companies.</p> <p>-In 1700, In England, most brokers and investors did their business in the various coffee shops around London. Debt issues and shares for sale were written up and posted on the shops' doors or mailed as a newsletter.</p> <p>-In 1773, the first stock exchange in London was</p>

	<p>and principles for the screening of equities for shariah compliance and inclusion in Dow Jones indices. In so doing, it also institutionalized certain principles allowing for “permissible variances” from (or “permissible impurities” regarding) strict interpretations of relevant shariah principles; and methods of “cleansing” or “purifying” impurities.</p> <p>Malaysia is the first Islamic country to have demutualised it’s exchange, Bursa Malaysia Berhad, and list on it’s own bourse. Bursa Malaysia Berhad listed on 18 March 2005, represents a single consolidated group comprising equities, derivatives and offshore markets. The equities market is then subdivided into the Main Board, Second Board and a high growth market called MESDAQ.</p>	<p>officially formed was called the London Stock Exchange , then 19 years later the New York Stock Exchange was established.</p> <p>-In 1970, NASDAQ was established and the introduction of an electronic exchange made trades more efficient and reduced the bid-ask spread , It does not inhabit a physical space, as with 11 Wall Street. Instead, it is a network of computers that execute trades electronically.</p> <p>In conclusion, the conventional capital market was developed long ago, went into phases to fulfill the needs of its customer till it reached to its current status.</p>
<p>Why it exist ?</p>	<p>The Islamic Capital Market exists for Islamic corporations and Muslim countries to raise capital in a Halal way following the laws of the Shariah. They do this in two ways, by selling equity in the form of stocks and debt in the form of Sukuk.</p>	<p>The Conventional Capital market exists mainly channel the wealth of savers to those who can put it to long-term productive use. i.e. for corporations to raise capital. They do this in two ways, by selling equity in the form of stocks and debt in the form of bonds.</p>
<p>Economic background</p>	<p>The Islamic capital market is based on the Islamic economics which is defined as the knowledge of application of injunctions & rules of the Shariah that stop injustice in the acquisition and disposition of material resources in order to provide satisfaction to individual and enable them to perform their obligations to Allah and society, which is a normative economics. It is derived from Quran which is the word of GOD and Sunnah which is the exercise of Prophet Mohamed pbuh as our human example. Where the owner of wealth is Allah the creator of everything and the human are</p>	<p>The conventional capital market is based on the conventional economics which is defined as the social science that studies how individuals, governments, firms and nations make choices on allocating scarce resources to satisfy their unlimited wants, which is a positive economics. It is derived from human thoughts , studies, philosophies, applications. Where the owner of wealth are humans who own it through: finding, extracting, inheriting or working to own it. where the main economic problem is the Scarcity of resources.</p>

	<p>his trustees on wealth, where the main economic problem is building of human being and scarcity is the result of disobedience.</p>	
<p>Market forces & profit motive</p>	<p>Islam does not deny the market forces and market economy. Even the profit motive is acceptable to a reasonable extent.</p> <p>After recognizing private ownership, profit motive and market forces, Islam has put certain divine restrictions on the economic activities. These restrictions being imposed by Allah Almighty, Whose knowledge has no limits, cannot be removed by any human authority. The prohibition of riba (usury or interest), gambling, hoarding, dealing in unlawful goods or services, short sales and speculative transactions are some examples of these divine restrictions. All these prohibitions combined together have a cumulative effect of maintaining balance, distributive justice and equality of opportunities</p>	<p>In the conventional economics , the profit motive or private ownership are given unbridled power to make economic decisions. Their liberty is not controlled by any divine injunctions. If there are some restrictions, they are imposed by human beings and are always subject to change through democratic legislation, which accepts no authority of any superhuman power. Unbridled profit making creates monopolies which paralyze the market forces or, at least, hinder their natural operation. Thus the capitalist economy which claims to be based on market forces, practically stops the natural process of supply and demand, because these forces can properly work only in an atmosphere of free competition, and not in monopolies. It is sometimes appreciated in a secular capitalist economy that a certain economic activity is not in the interest of the society, yet, it is allowed to be continued because it goes against the interest of some influential circles who dominate the legislature on the strength of their majority.</p>
<p>Customers</p>	<p>The Islamic capital market main customers are Muslims profit seekers who are interested to either invest in halal businesses or are interested to establish a halal firm using funds that will be given on the basis of the shariah laws.</p>	<p>The Conventional capital market main customers are profit seekers who are either providers of funds or demanders of funds.</p>
<p>Places</p>	<p>The Islamic capital market is traded in the same places as the conventional ones since no Islamic-only exchanges exist. Islamic capital market products exist mainly in six main places ; Bursa Malaysia (MYX), Labuan International Financial Exchange (LFX), London Stock Exchange (LSE),</p>	<p>Conventional Capital market is available in approximately all the countries, as it is the driving wheel for economic growth.</p>

	Luxembourg Stock Exchange, NASDAQ Dubai, Tadawul (the Saudi Arabian stock exchange).	
Asset backing Finance	Asset-backed Financing is one of the most important characteristics of Islamic financing. Islam, on the other hand, does not recognize money as a subject-matter of trade, except in some special cases. Money has no intrinsic utility; it is only a medium of exchange; Each unit of money is 100% equal to another unit of the same denomination, therefore, there is no room for making profit through the exchange of these units inter se. Profit is generated when something having intrinsic utility is sold for money or when different currencies are exchanged, one for another. The profit earned through dealing in money (of the same currency) or the papers representing them is interest, hence prohibited. Therefore, unlike conventional financial institutions, financing in Islam is always based on illiquid assets which creates real assets and inventories.	The conventional / capitalist concept of financing is that the banks and financial institutions deal in money and monetary papers only. That is why they are forbidden, in most countries, from trading in goods and making inventories
Basis of activity financed	The Islamic Capital Market are only allowed to offer investment instruments for projects that are useful and add a value to the society. But are not allowed by any means to offer investment instruments in casinos, alcohol manufacturing, pornography and interest bearing businesses that are harmful to the moral health of the society.	The conventional Capital market offer investment instruments for any profitable project whether it is beneficent to the society or not, the only important factor is how profitable and how risky is it . So a gambling casino can offer its bonds to develop its gambling business. A pornographic magazine or a company making nude films are as good customers of a conventional capital market as a house-builder. Thus, conventional financing is not bound by any restrictions.
Risk and Return	In Islamic capital market risk sharing is essential. So there is no instrument that is considered shariah complaint except when the return is associated with the risk.	In conventional capital market, risk is better be avoided. Most derivatives are developed to hedge against risk. And speculation activities are allowed for risk takers to gain money like in gambling .

Real versus Artificial products	Since financing in an Islamic system is backed by assets, it is always matched with corresponding goods and services	In conventional market interest-based financing does not necessarily create real assets, therefore, the supply of money through the loans advanced by the financial institutions does not normally match with the real goods and services produced in the society, because the loans create artificial money through which the amount of money supply is increased, and sometimes multiplied without creating real assets in the same quantity. This gap between the supply of money and production of real assets creates or fuels inflation.
Products	Islamic capital market products are a wide range which include :Sukuk, sharia-compliant equities, Islamic funds, equity funds Islamic exchange-traded funds (IETFs), Islamic real estate investment trusts (IREITs)	Conventional capital market products are equities, derivatives (swaps ,options, futures , forward) and bonds.
Product development	Islamic product development is slow compared to conventional product development because Islamic investments must comply with shariah, which requires screening processes and debate among scholars that can be quite time-consuming	Product development is quick and efficient
Accessibility of the products	Investors sometimes lack access to the Islamic capital market. For example, because of a lack of financial infrastructure, a customer in Canada may not be able to access the U.S. Islamic asset market	Products are highly accessible via broad range of conventional markets available in most countries.
Liquidity	Because its products are not as accessible to the customers are the conventional counterpart the lacks the ability to turn the investments into cash is no as quickly .	Due to the high accessibility of the market and the vast no of customers, the conventional market in most cases highly liquid in comparison to the Islamic Capital market products
Size of the market	The market share for Islamic investments is still small compared to the conventional capital markets	Huge