

Potential Development of Sukuk in Competitive Market

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Abstract: Sukuk is the financial instruments that comply with Islamic rules and since the first establishment of sukuk, it become phenomenon due to its tremendous growth. The development and performance is very encouraging for certain countries in this recent years. However, there are several countries that earn achievements unsatisfactory. One of the cause of unsatisfactory performance is due to the current economic situation that lead to the country pushed for conventional debt. From that, the sukuk issuances become decreasing. Thus, this study highlight the booster elements for sukuk development to boost up the sukuk performance in global competitive market which is consist the standardization of legal standards on sukuk, tax incentive by the government and the latest product innovation on sukuk is green sukuk.

Keywords: *Sukuk Development, Bonds, Financial System, Competitive Market*

INTRODUCTION

Financial system is closely related to developments of instruments in the financial institutions. A wide range and most common that prohibit the charging or payment of interest is sukuk. Sukuk has been used as a financing method for government agencies as well as private companies. Current demand making sukuk indispensable in the market even it has been affected by the global mistrust. Rapid expansion of sukuk in Islamic countries is very encouraging.

Since the first establishment of sukuk, it become phenomenon due to its tremendous growth. According to Abdo [1], the first issuer of sukuk originated form non-Islamic company which is Shell MDS in Malaysia by issued in the principles of Bai' Bithaman Ajil (Deferred payment sale). Thus, sukuk has a big potential to growth in the competitive market globally.

REVIEW ON SUKUK

Sukuk commonly refers to the Islamic equivalent of bonds. Sukuk or Islamic bond, are utilized to the certificate of finance that can be considered in the same Islamic bonds [2]. The most common form of a sukuk is a trust certificate. In other words, based on the National Sharia Board Fatwa, Islamic bond is a long-term securities that issued to the holders of Islamic bonds which obliges issuer to pay income to the holders of Islamic bonds in the form of profit sharing and pay back the funds

as they mature. Sukuk has been tolerating by numerous nations and have more advantages contrasted with customary bonds.

Bey [3] has outlined the benefit of sukuk, which is including sukuk been valued intensely parallel to ordinary bonds; it has a better risk and can be exchanged accordance with Islamic standards. According to Wahdy [4], Islamic bonds or sukuk more competitive in global market compared with conventional bonds. In comparing with the conventional bonds, sukuk has the possibility of getting higher revenue sharing and more secure to fund prospective projects. Sukuk are seen to be less risky than traditional bonds, and can perform better in terms of returns over traditional bonds. Sukuk are regularly issued in light of the standards of Islamic finance. Additionally, if any loss incurred for the funding projects, investor retain their assets and it has been classify as investment letters rather than a debt. Mohammed [5] has outlined five differences between sukuk and conventional bonds (i) sukuk demonstrate ownership of an asset while bonds show an obligation commitment, (ii) the assets under sukuk are compliant with Shariah while assets under bonds may include products or services that are against Islam (iii) sukuk are evaluated by the estimation of the benefits backing them while bonds depends on fixed assets that making them Riba, (iv) sukuk can increase in value when the assets increase in value while profits from bonds correspond to fixed interest, making them Riba, (v) when offering sukuk, it implies offering ownership while the sale of bonds is the sale of debt. Thus, sukuk obviously

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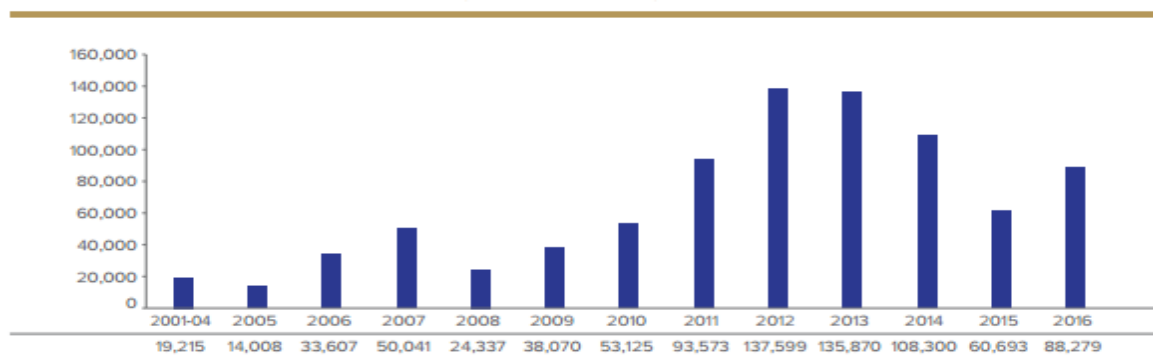
has more benefit compared to conventional bonds. However, in a global market, it is very competitive to compete with conventional bonds.

SUKUK PERFORMANCE

Since the first issued by Malaysia, 2000, sukuk become extremely popular which is followed by Bahrain in 2001. Fast forward, sukuk taking up a large share of the global bond market that are used by Islamic corporations and state-run organizations alike. Pursuant to Alvi et.al [6], the excellent performance of sukuk in global market due to stability in the commodity prices and also the pick up in Corporate Sukuk issuances in certain jurisdiction. The numbers of issuers around the

world is another encouraging development where sukuk act as the financing sources for the certain project includes budgetary requirements, infrastructure development, project financing etc.

Sukuk market keep active due to the support and interest from the issuers such as Malaysia, Indonesia, Turkey, Qatar, Governments of Bahrain, UAE, Khazanah Nasional, Malaysian Airlines, Islamic Development Bank, DP World etc. Additionally, the growth of sukuk issuance due to the help form the new issuers such as Oman Telecom, Government of Jordan, Etihad Airways, Government of Togo, Neelum Jhelum (Pakistan) etc.



*Sources: IIFM Sukuk Database

Based on Figure 1, there is volatility in sukuk performance from 2001 to 2016 where the increasing rate is starting 2010 to 2012 then decrease starting 2013 to 2015. However, in 2016, sukuk performance increases with the global sukuk issuance about USD 88279 millions. The expansion in volume amid 2016 was because of relentless issuances from Asia, GCC, Africa and certain different locales while Malaysia keep on dominating the sukuk market, however the nations like Indonesia and Turkey expanded too.

Despite to the performance of sukuk issuance, bond issuances also increase in 2016 after decrease in 2015 for certain countries. Figure 2 illustrates the comparison between sukuk and conventional bonds issuance for Gulf Cooperation Council (GCC)

countries. In GCC countries, bond issuance rapidly rising from 2015 to 2016 while sukuk issuance decrease from 2013 to 2016. It shows that, even GCC is an Islamic countries; the issuance of conventional bonds has beating the issuance of sukuk. According to Barbuscia and Vizcaino [7], the slumping of sukuk performance in 2016 is due to the budget deficits cause by low oil prices. Thus, most of them switched the sukuk to conventional bonds. Additionally, Saudi Arabia debut bond about \$17.5 billions in October 2016, which is entirely conventional. The affected oil price leads to the rise of liquidity in their banking system. Thus, Gulf government had to rely more on foreign investors rather than Islamic banks and funds, which pushed them towards conventional debt.

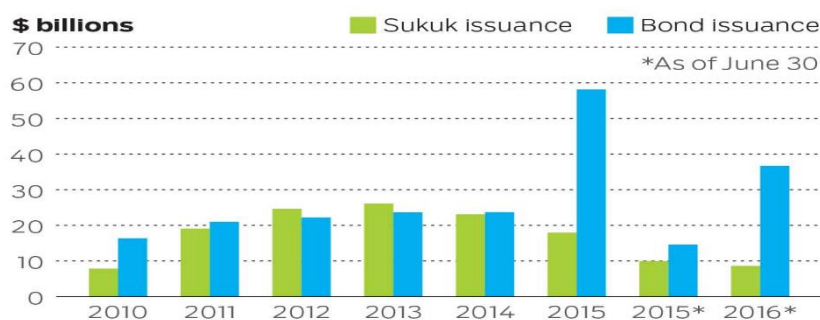


Figure 2: Comparison of Sukuk and Bond Issuance in GCC Countries

* Sources: Standard and Poor's

Apart of GCC countries, Malaysia is one of the biggest sukuk markets. Based on records in 2016, Malaysia shows positive strides. Based on Figure 3, Malaysia dominated the market in 2016 with

USD34.7 billion volume of issuance which commanding a market share about 46.4% of total sukuk issuances then followed by GCC (26.2%), Indonesia (9.9%) and Turkey (5.5%).

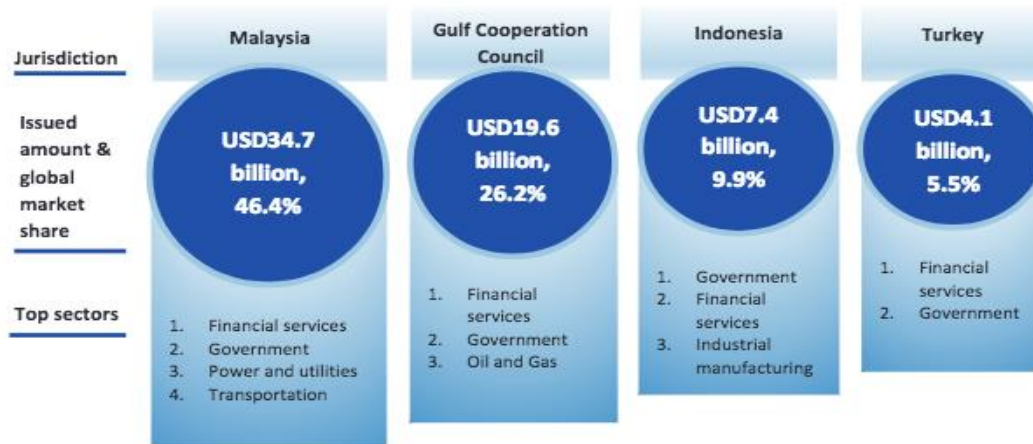


Figure 3: Sukuk Market 2016

*Source: Thompson Reuters, MIFC Estimates

According to Figure 4, sukuk performance in Malaysia shows a rising rate for 2016 although it is not high as 2012. For conventional issuances, the total market issuance is decrease every year. Thus, it seems that sukuk has beat the conventional bond in Malaysia. The outstanding performance of sukuk

issuances is due to various factors in every country. For example, the government of the nation offers for tax incentive for every sukuk issuances to promote the islamic financial product and the latest promotion is about green sukuk.

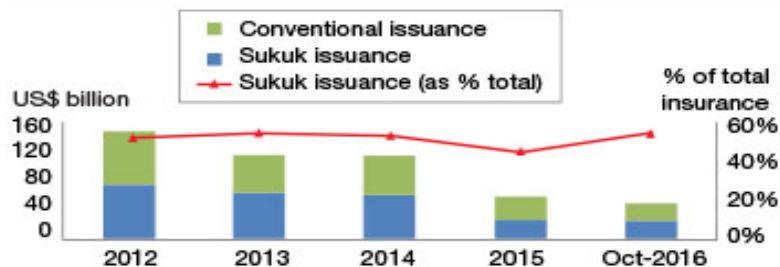


Figure 4: Sukuk Issuance against Total Market Issuance in Malaysia

* Source: Bond Pricing Agency Malaysia (BPAM) and RAM

BOOSTER ELEMENTS OF SUKUK IN COMPETITIVE MARKET

Although sukuk global market is keep rising for certain countries, it still less encouraging for another countries includes Islamic country. Thus, to encourage the sukuk development, it needs some booster elements, which actually has been employ by several countries.

Standardization of Sukuk

There have many challenges for sukuk to survive in global competitive market such as legal challenge of sukuk development in Islamic capital market.

Pursuant to Nazar [8], legal basis for sukuk development is not sufficient because it still relies on convention law and regulations. However, in Malaysia, it has robust regulatory standards that highlighted by Securities Commission. Thus, there are uncertainties for legal enforcement, which lead to the arising of conflict in sukuk transaction especially in legal documentation and Shariah standards. According to Nazar [8], the Shariah standard has been set properly by Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) but the key players in the Islamic financial industry are not binding the standards. Therefore, by standardize the legal documentation on Shariah compliant sukuk in the

global market, it will resolved the conflict arise in Islamic financial industry.

Tax incentive

Malaysia is one of the countries that offer tax incentive to sukuk issuances. It is one of the efforts by the government of Malaysia to promote the financial markets especially Islamic financial instruments. Special purpose vehicles (SPV) are tax exempted on income received by SPV in issuing sukuk (excluding asset-backed securities). According to Razazila, Roudaki and Clark [9], the cost of issuance of the Sukuk incurred by the SPV will be deduct and give to the company that established the SPV. Additionally, stamp duty exemption also applies on instruments used to issue sukuk in any currency. Thus, by introducing the tax incentive, it actually attract more investor especially those non-Muslims to invest in Sukuk in acquiring funds. This efforts lead to the sukuk performance in Malaysia, which is outperformed, compared to conventional bonds.

Green sukuk

In July 2017, Securities Commissions Malaysia has announced the issuance of Malaysia's first green sukuk under Sustainable and Responsible Investment (SRI) Sukuk framework. It is an innovative channel to address global funding gaps in green financing. It is a product innovation that strengthens Malaysia's positions as a leading Islamic finance. Several incentives are in place to promote the green sukuk such as tax deduction on issuances cost, tax incentive for green technology and financing incentive under the Green Technology Financing Scheme (GTFS). The tax deductions are only eligible to the SRI projects in the natural resources, renewable energy and/or energy efficiency sectors. It encourage Malaysia's Islamic finance ecosystem to further contribute towards a sustainable and more inclusive economy. Since Malaysia is one of the largest players in Islamic financing market, it is an advantage for another countries to collaborate with Malaysia to get benefit from a highly conducive business environment of innovation, expertise and deal flow.

CONCLUSION

Sukuk development in global market is seen very competitive especially in compared to the conventional bonds. However, certain countries such as Malaysia, the performance of sukuk is very encouraging. One of the challenges of sukuk to survive in global market is standardization of legal documentation and Shariah standards. Conflict arises when most of the countries not binding the standards that has been highlight by AAOIFI. Thus,

by standardization of Shariah standard for all participated countries, it could contribute to the sukuk development in the competitive market.

As a biggest player in Islamic financial market, Malaysia highlights a new incentive in sukuk. Apart of tax incentive on sukuk, the latest efforts from the government of Malaysia are green sukuk. In a comment piece in the South China Morning Post, Victoria Kwakwa, World Bank regional vice-president for East Asia and Pacific, said Malaysia's innovative "green sukuk" initiative would help close the gap for both infrastructure and green finance. Green sukuk could be a growth driver to Islamic finance which is created to funds project with positive environmentally benefits. It is parallel to the enforcement concept of sustainable development that has been spread around the world. Thus, green sukuk is one of the socially responsible investing that could boost up the Islamic financial industry.

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