



## **A study on the feasibility of Sukuk in Afghanistan**

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### **Abstract**

Since the advent of Islamic finance, Islamic Capital Market has attained worldwide attention in financing the needs of the public and private sectors. The Sharia compliant bond (Sukuk) has become one of the most dynamic tools for capital mobilization in both the Islamic and Conventional capital markets. This is the certificate representing a proportional and undivided ownership right in tangible asset. It is an interest free financial instrument. As it is not yet launched in Afghanistan. It's going to be introduced soon. So, the purpose of this paper is to gauge the interest of the people in the Sukuk and determine whether people really look for Sukuk as an alternative to Conventional bonds. For this, a feasibility study has been conducted with the sample size of 100 people from Afghanistan. Data from the target audience (investors, bank employees and those having regular income) were collected through a structured questionnaire. According to my survey, it's found that almost all the people are interested in sukuk. The reasons why people are interested in it are: it is based on profit and loss sharing and it brings justice and fairness by avoiding interest.

**Keywords:** Islamic finance, Islamic capital market, financial instrument, mobilization

### **Introduction**

The Sharia compliant Bond best defined as "Sukuk" has become one of the most dynamic tools for capital mobilization in both the Islamic and Conventional capital markets. Long since its inception, sukuk faced number of legal and sharia challenges along with other operational challenges which naturally compelled individual and group efforts by the governments, academic institutions, and corporate bodies to find solution and also to explore the best approach towards dealing with this new product.

However, there were issues of riba free certificates by the Islamic Bank of Malaysia in the 1900s, Sukuk was recognized as an important Islamic capital market instrument in the 2000s and soon started a rapid growth and spread with a widely acceptance not by the Muslim investors but also by the non-Muslim around the world.

Sukuk (plural of 'sakk' the Arabic word for certificate) are defined as certificates representing a proportional and undivided ownership right in tangible asset. These assets must be in a specific project or in investment activities that comply with shariah rules and principles. Sukuk unlike conventional bonds which are debt obligation and its holders are receiving periodic fixed interest, are Islamic financial instruments representing ownership in tangible assets and its holders are receiving profit generated by the underlying assets on a periodic basis. Sukuk are instruments, facilitating the funding of large projects, which would be beyond the capability of either an individual or a small group of investors. Like conventional bond market, sukuk can be bought from the issuer or in the secondary market.

For sukuk to be Shari'a-compliant, however, three requirements must be met: (1) the certificates must represent ownership in tangible assets, usufruct or services of

revenue-generating firms; (2) payments to investors should come from after-tax profits; and (3) the value repaid at maturity should reflect the current market price of the underlying asset not the original amount invested

There are different types of Sukuk like, Al Mudarabah Sukuk, Sukuk al Murabaha, Sukuk al Salam, Sukuk al Ijara, Sukuk al Musharaka, Sukuk al Istisna etc.

According to the Thomson Reuters State of the Global Islamic Economy Report 2015/16, there was \$25bn of sukuk outstanding as of the end of 2014. According to the same report from Thomson Reuters, \$1.814 trillion of assets are being managed in a sharia compliant manner as of 2014, which the report said had the potential to rise to \$3.247 trillion by 2020.

### **Method and materials**

A descriptive research was conducted with the sample size of 100 (out of which 75 respondents have participated) in Afghanistan where investors, employees of the bank, and those having regular income were asked and approached through a structured questionnaire both on line and offline for the purpose of collecting primary data. The secondary data have been collected from many reliable sources including books, Journals, and so on. The questionnaire was based on the parameters of awareness, agreement and preference & choices. For the better understanding and clarification, I have demonstrated the feedback taken from the target audience in both percentage & absolute numbers in tables, graphs and charts. Following are some of the elements for further clarification.

#### **1. Research design**

Descriptive

#### **2. Data type**

**a. Primary data:**

Primary data is collected through a well-structured Questionnaire which was based on the following parameters.

- Awareness
- Agreement
- Choice and preferences

**b. Secondary data:**

The secondary data is collected from many reliable sources including internet, books, and journals.

**3. Sampling Method**

Purposive

**4. Area of research:**

Afghanistan

**5. Target population:**

Employees of banks and investors in Afghanistan.

**6. Statistical tools:**

- Table
- Graph
- Pie chart
- Percentage

**Difference between Sukuk and Bonds**

Similarities of Sukuk and bonds may be considered as their liquidity in secondary market, their credit being rated by rating agencies and variety in their design and supply. However, Sukuk differ from common bonds of financial markets in seven aspects.

1. Sukuk indicates ownership of an asset. Bonds indicate a debt obligation.
2. The assets that back Sukuk are compliant with Sharia. Assets backing bonds may include products or services that are not Sharia compliant.
3. Sukuk are priced according to the value of the assets backing them. Bond pricing is based on credit rating.
4. Sukuk can increase in value when the assets increase in value. Profit from bonds corresponding to fixed interest, making them Riba.
5. When you sell Sukuk, you are selling ownership in the assets backing them. The sale of bonds is the sale of debt.

Sukuk are backed by tangible assets, rather by debt. Sukuk ownership indicates ownership of an asset that has value. The bond may also indicate this, but the real definition of bond simply indicates a debt obligation. At its root, the relationship between the issuer of a bond and the consumer is very different for the relationship between the issuer of Sukuk and the purchaser of Sukuk. In the case of bond, the consumer is acting as the loaner and the bond issuer as a loan recipient. In this case, the loan has a fixed interest, therefore being Riba. In Sukuk, the purchaser is purchasing an asset that has value rather than participating in an implicit loan agreement.

Another important difference between bonds and sukuk is that the assets involved in sukuk certificates comply with all laws of Sharia. In the case of bonds, the bond certificate may be backed by assets that are not complaint with Sharia, which may be bundled together with other types of assets without the consumer's knowledge. The consumer of Sukuk is assured that the value of the certificate correspondence to assets that are in the public good and not related to activities or products that are against Sharia.

Although some may argue that the difference between

sukuk and bonds are merely technicalities. These differences matter to Muslims. In fact, the practice of profiting from money alone, at the expenses of productivity and real economy has been one of the drivers for many of the economic problems that have plagued the world in the last decade. Interest and artificial inflation of prices based on debt rather than on real value is the main reason why bubbles form, burst, and then lead to recessions and depreciations. Sukuk, unlike bonds, are priced according to the real market value of the assets that are backing the sukuk certificate. Bond pricing is based on the credit rating of the issuer. When you sell a bond on the secondary market, you are actually selling the debt in the underlying loan relationship. The sale of sukuk on the secondary market is simply the sale of ownership in the asset.

The main advantage if sukuk over traditional bonds is that their value increases in relationship to the assets backing the sukuk certificate. If the asset raises in value, then the value of the ownership of that asset, backed by the sukuk, increase. Bonds do not have these characteristics.

This is not to say that bonds and sukuk are not similar in certain ways. Both can be turned into case by selling them on the secondary market. Based on the strength of their backing, both bonds and sukuk can be ranked by ranking institution.

**B. issuing process for sukuk certificates**

The unique nature of sukuk requires a specific issuing process for the financial instruments. The following steps are common in the issuance process:

1. A company that requires capital (referred to as the "originator" establishes a special purpose vehicle). The SPV safeguards the underlying assets from creditors if the originator is in financial trouble.
2. The special purpose vehicle issues sukuk certificates that are sold to the investors.
3. The originator purchases the required asset using the proceeds from the sale of the certificates to the investors.
4. SPV buys the asset from the originator.
5. Then The SPV sets up the lease of the asset to the originator. The originator makes the lease payments to the SPV, which later distribute the payments among the holders as lease income.
6. On the termination date of the lease, the originator purchases the asset back from the SPV at its nominal value. The proceeds will be distributed to the holders by SPV.

**C. Bonds (sukuk) process (securitization) parties**

The main parties participating directly in the bonds (sukuk) process are as follows:

- 1) **Originator:** It is called the issuing entity or the authority owner of the assets intended to be securitized, and can include individuals, groups, or countries. This authority will make an inventory of assets and assemble all the varieties of its financial assets generating cash returns into a pool or one investment account known as a bonds (sukuk) portfolio (portfolio asset).
- 2) **Issuance Agent:** This party undertakes the management of the owned assets for the bonds (sukuk) holders and on their behalf. Usually it is a company of special purpose known as a Special Purpose Vehicle (SPV) undertaking the issuance process. The sukuk will

be bought from the owner company to undertake the issuance process of the bonds (Sukuk), as it carries out all the necessary procedures for the sukuk process against charges or specific commissions. This owner company may have a pool of several functions assigned thereto as an issuance manager or investment trustee, and it is to be legally and financially independent from the authority from which it originated to ensure transparency and protect the rights of the investors of the bonds (sukuk) holders.

- 3) **Bonds (sukuk) holders:** The investors buying bonds (sukuk) offered for subscription or the IPO in assets put into bonds (sukuk) in return for recovering the original value of the bonds (sukuk) and the proceeds resulting from the activity of the assets put into bonds (sukuk) at the maturity time. The sukuk holders may be financial institutes, local or international banks, or individuals or governments.
- 4) **Bonds (sukuk) portfolio (portfolio asset):** It is an investment bowl, including various assets put into bonds (sukuk) in favor of the originator, with the aim of obtaining liquidity or cash for either the financing establishment of a new investment project or expanding and developing the base of an existing project in accordance with the Islamic financing formulas. The proceeds from such bonds (sukuk) portfolios (portfolio asset) will be collected and deposited in a special account used for the settlement of the dues of the bonds (sukuk) holders on their maturity dates.

Bonds (sukuk) securitization process auxiliary parties are those who agreed to carry out special services for the bonds (sukuk) processes. The most important parties are as follows:

**Investment Trustee:** The mediator financial institute undertaking the protection of the interests of the bonds (sukuk) holders in addition to the supervising and monitoring of the issuance manager to ensure their compliance with the organization's conditions on the investment process mentioned in the prospectus. Furthermore, it will maintain the documents and guarantees on the basis of an agency contract, with fixed charges specifying the prospectus with clear and express instructions.

**Underwriters:** It is the authority undertaking to subscribe the rest of the bonds (sukuk) that are not subscribed. Underwriters can undertake to pay the rights of the bonds (sukuk) holders after collection, provided that such obligation is made free of charges by the applicant, and is announced in the prospectus.

**Shari'a Supervisory Body:** It is the authority studying the issuance structure from Shari'a in terms of legitimacy, and the authority that decides whether or not the bonds (sukuk) process is sound in terms of legitimacy and integrity. In addition, the Supervisory Body will set the Shari'a standards that control the bonds (sukuk) process (securitization) and the contracts organizing the relations between their parties. In some cases, it will be obliged to have the authority to monitor the issuance authority and the issuance manager using Shari'a controls. Usually the Shari'a Supervisory Body consists of clerics and jurists in the Islamic religion in addition to the Research and Shari'a Fatwa centers in that country.

**Credit Rating Agency:** These represent specialized agencies, like the Malaysian Credit Rating Agency based in Malaysia, which assess the extent of the credit and financial worthiness of the offered securities with guarantees and the fixing of a fair price, along with the proportion of the risks involved in the issued securities. Also, in the case of the Islamic bonds (sukuk), they will assess the efficiency of the client in the al-Musharakha activity and his integrity and honesty to protect the bonds (sukuk) holders. It is worth mentioning here of the necessity to develop a working system for the credit rating authorities that take care of the bonds (sukuk), and to have an umbrella for all the countries dealing with bonds (sukuk) in its financial system, especially in the emerging Asian and Arab countries, and then followed by other countries.

Construction of the house. The cost of correcting any discrepancy would have to be borne by him.

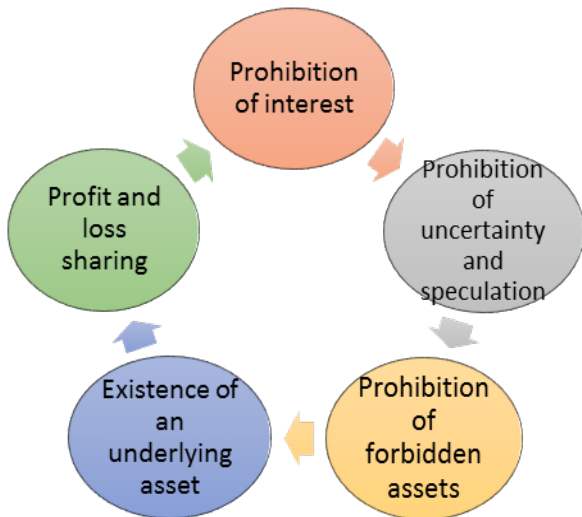
#### Benefits of Islamic bonds

- Bringing financial self-sustainability to finance the budget deficit particularly development budget.
- Financing government priority medium- and long-term economic projects
- Financing the infrastructure projects including Dams, Irrigation systems, Power Generation, Railways, Highways, Airports, Gas Pipelines, Electricity supply Oil Refineries, Oil Extraction etc.
- Islamic bonds provide the guaranteed and government back millions of investment opportunities for public.
- It pays the way for opening shares and stock markets in a country with no shares and stock markets.
- Islamic bonds raise money from internal sources and substitutes the Donors funding.
- Islamic bonds enhance and strengthen the public trust in economy and attract public funds investment in national economic projects.
- Islamic bonds have positive effects on balance payments and brings more cash to government to support its national payment
- Islamic bonds have significant effects on national monetary policy by collecting local currencies against financial instruments
- It helps rapid growth of GDP

#### Islamic bonds worldwide

- Malaysia, Saudi Arabia, USE, Qatar, Belgium and UK are the global Sukuk issuers and up to 60 countries issue Islamic bonds.
- Government issues Sovereign Sukuk and private sector may issue corporate Sukuk worldwide.
- Sukuk contribution in Global Islamic Finance Market is 30%, which is almost 767 billion US\$ as per Global Sukuk Report 2016.
- Ijara and Istisna are most favorite models to finance infrastructure economic projects worldwide.
- Beside Muslim countries non-Muslims most developed countries like UK, France, USA, Japan, China and Germany also issue Islamic bonds.

**Principles of Islamic Finance:**



**How will sukuk effect the overall economy of Afghanistan?**

Sukuk is an efficient long-term financial instrument to the tool. It plays a vital role in the economy of the country. The policy of the Sukuk will restore public confidence on the government of Afghanistan and its other economic policies if it's implemented successfully. This will paw the way for raising billions amount of money to finance the infrastructure projects which creates thousands of jobs opportunities and increase the per capita income which will lead to raise in GDP. It will also directly or indirectly benefit all those who have money but has no investment opportunities. By the issuing Sukuk, we would establish secondary market for marketable securities and boost up the security market in our country. For supervising the security market, there will be security Exchange Commission established which would be supervising its activities. This will reduce the burden on National Reserved Assets from which Government of Afghanistan spent billions of US\$ and on average Central Bank of Afghanistan auctions 25 millions of US\$ each week in order to stabilize the national currency against Forex. This will take Afghanistan's financial industry in to international secondary markets to earn more and more money, by this the Afghanistan's economic rattoo will hike which will encourage international big companies to come and invest. FDI or Foreign Direct Investment plays a positive role in the economy of any country. Increase in FDI in a country particularly a country like Afghanistan is a sign of positive and good economy. It means people are showing their interest to invest, with the investment, there would be job opportunities, unemployment which is a great concern for a country, will be reduced, income of the people will increase, it will lead to increase in demand, once demand is increased, there will be increase in production, increase in GDP and eventually there will be economic stability and economic growth & development. (Dr. Alam Khan Ahmadzai Founder of Islamic Banking in Afghanistan, July 1, 2017).

**Result and discussion**

1. According to this survey, it is found that almost all the respondents are interested about the Sukuk and they have shown their interest in investing in it.

2. The reasons for their interest in Sukuk are
  - a. It is based on the principle of profit and loss sharing
  - b. It brings fairness and justice by avoiding interest
3. As per the result of my study, 82.66% of the people are willing to invest.
4. The major obstacle/challenges for investment as per the respondents are:
  - a. Economic instability
  - b. Current financial system which is based on interest
5. 38% of the people strongly agree and 45% agreed that Sukuk will directly benefit all those who have money but do not have investment opportunities.

Study has also revealed that only 33.33% of the people have invested in saving accounts and 6% in fixed deposits rest have either invested in current accounts or don't have any bank accounts at all.

**Table 1**

This table describes the level of interest of the participants about Sukuk

Options	Response	
	Number	%
Extremely interested	37	49.3
Interested	32	42.6
Moderately interested	4.0	5.4
Not at all interested	2.0	2.7
<b>Total</b>	<b>75</b>	<b>100</b>

**Interpretation:** As it is shown in the above table, most of the people are interested in Sukuk and they are willing to invest in it.

**Table 2**

This table describes the reasons why the participants are interested in Sukuk.

Options	Responses	
	N	%
Bringing fairness and justice by avoiding Riba (Interest)	16	21.4
It is based on the profit and loss sharing principle	6.0	8.0
It is an asset based/backed investment	2.0	2.6
All	51	68
<b>Total</b>	<b>75</b>	<b>100</b>

**Interpretation:** The above table shows that out of all respondents, 68% of the people chosen all, because it brings fairness and justice by Avoiding interest and it is based on the principle of profit and loss sharing



This figure describes the willingness of the participants for investment in Sukuk

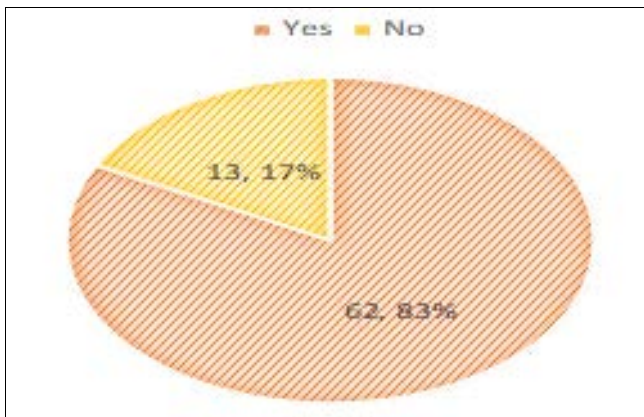


Fig 1

The above figure depicts that majority of the people (83%) are willing to invest.

Table 3

Options	Responses	
	Number	%
Current financial system which is based on interest	15	20
Economic instability	25	33.33
Under-developed distribution channel	6	8.0
All of the above	29	38.66
<b>Total</b>	<b>75</b>	<b>100</b>

The above table indicates the major challenges that investors face. That is why sukuk will provide investment opportunities for all those who have money but do not have opportunities.

**Conclusion**

Since financial crisis in 2008, Sukuk has been growing rapidly not only in Islamic countries but in Non-Islamic countries too, and it has been recognized as an alternative investment tool for bonds. Since conventional bond represents debt obligations and must be repaid over time with a fixed rate of interest, which is not permissible according to Islam hence Islamic countries looked for an alternative which is both acceptable from Sharia prospects and as well as meets the need of modern economic system. Sukuk is an investment instrument where Muslims and Non-Muslims both can invest in it. Sukuk (plural of sak, which is the Arabic word for certificate) is defined as certificates representing a proportional and undivided ownership right in tangible asset, a pool of predominantly tangible assets, or a business venture. These assets must be in a specific project or in investment activities that comply with shariah rules and principles.

Afghanistan is a country where 99.6% of its population are Muslims. According to a report, only 10% of the people deal with banks. There are many reasons for not dealing with banks like economic instability, under-developed distributional channel but the major reason is the current

financial system which is based on interest. That is why there is a great need of Islamic Finance generally and Sukuk particularly. Fortunately, it is going to be launched soon, its policy is made and approved. Although, we have Islamic banking in our country and it is growing rapidly but its size of operation is very limited, government needs to pay more attention and support Islamic finance as a whole so that people could deal with banks, financial institutions and eventually the ratio of financial inclusion increases. In current scenario, the issuance of sukuk in Afghanistan will play a vital role, since there are some projects and economic activities which could not be carried out by companies, even by government alone, hence Sukuk is the best and appropriate way to finance such large projects or activities. This will be an effective tool to boost the economy of Afghanistan and restore public confidence on the government of Afghanistan. This will directly benefit millions of Afghans who have money but has no investment opportunities to invest.

After conducting a survey, I can conclude that most of the people are happy for the decision taken by the government and they have shown their positive interest in investing in Sukuk.

**AUTHOR PROFILE**

Mr. Ehsanullah Mohammadi was born in 1993 Paktia city, Afghanistan. He received his B.B.A (Hons) from SHUATS University, Allahabad, UP, India in 2019.

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