

Towards An Islamic Stock Market: A Review of Classical and Modern Literatures

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Share market plays an important role for the economic development of a nation. Companies and individuals purchase shares and bonds, and mostly uncertainties prevail over this market. The scholars, classical and modern, adopted different approach towards the validity or invalidity of such a market as it was not existent in the time of the Prophet or earlier generations. This paper tries to find its origin in Islamic Shari`ah to see its status and validity from Shari`ah perspective. Does stock market comply with the Shari`ah principles such as prohibition of Riba, Gharar, Qimar, and maintaining fairness in price and other rules? Does it contradict with Islamic ethical values such as 'Adl, Amanah, sincerity, truthfulness, mutual cooperation and other values? The paper adopts an inductive and analytical approach to some of the available literatures from the traditional sources and also in modern writings on Islamic trade and finance. It is expected that the paper would shed some clear lights on the validity of the stock market, and if it is valid, how should it be.

Field of Research: Islamic Financial Markets, Stock Exchange, Securities

1. Introduction

The concept of share market was first introduced in France in the thirteenth century. The Dutch East India Company was the first company to issue shares on the Amsterdam stock exchange in 1602 (Al-Barwari, 2002, p. 33). It has been claimed that the concept of *Mudarabah* which in some way resembles to the modern stock market concept was found in the age of Prophet Muhammad (peace be upon him). (Al-Barwari, 2002, p. 31) However, there exist some countries even today, which have no share market of their own. Stock market and its efficient running are considered to be the basis for the development of a country or state.

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Osmani & Abdullah

Islamic *Shari`ah*ⁱⁱ comprehends every single aspect of human life and it preserves all issues of public interest. Since share market is an integral part of the financial transactions, Islamic *Shari`ah* should have clear guidelines about this. As an integral issue of public interest, there is an urge to shed clear lights on share market so that the Islamic financial system would be relevant to modern challenges and realities.

Therefore, it is of utmost importance to analyze the *Shari`ah* appraisals on the existing stock market to see if it is permitted in Islam, or totally prohibited, or allowed with certain modifications of existing share and bond markets. This paper examines the permissibility of conventional stock market, the stock and its classification, buying and selling shares, bonds, brokering and other related issues from Islamic perspective.

2. Literature Review

Indeed, the Qur'an and Sunnah, the primary sources of Islamic jurisprudence, furnished the universal principles for Islamic financial transactions. Allah says in the Qur'an: *O ye who believe! Eat not up your property among yourselves in vanities: but let there be amongst you traffic and trade by mutual good-will: nor kill (or destroy) yourselves: for Verily Allah hath been to you Most Merciful.* (4:29) Likewise, the Prophet says in his Sunnah, *Whosoever cheats is not among us.* (Muslim, vol. 1, p. 267, No. 147)

The classical literatures on Islamic jurisprudence include the basic *Shari`ah* principles for financial transactions like prohibition of *Riba*ⁱⁱⁱ, gambling, *Al-Gharar*^{iv}, coercion, cheating and the *Shari`ah* rulings for partnership business and various types of contracts and the legal maxims for issuing *Fatwa*^v in the new issues. (See Ibn Taymiyah, 1999; As-Sarakhsi, 1978; Al-Kasani, 1983; Ibn Rushd, 1975; Hasani, 1986) Ibn al-Qaiyyim al-Jawziyyah states, the fundamental principle for any transaction is to be valid, unless any proof of its prohibition is clearly stated in the Qur'an or Sunnah. (Ibn Qaiyyim Al-Jawziyyah, 1991, v. 1, p. 334). Some modern literatures describe Islamic financial law in general without an in-depth focus on share market. (Vogel & Samuel, 1998; Rosly, 2005; El-Gamal, 2006)

A detailed discussion on partnership business is adopted by Nyazee in his text. He thoroughly discussed the nature, types and underlying contracts of partnership business. He also mentioned the views of the four schools of jurists and critically analyzed and evaluated their opinions. (Nyazee, 1997) Al-Khaiyyat and Fahd have explained in detail the permissibility of a share market in Islamic *Shari`ah* but the other parts related to the share market are absent in their studies. They argued that the share company is

Osmani & Abdullah

perfectly legal and that there is no prohibition whatsoever for establishing share market in Islam. (Al-Khaiyyat, 1989; Fahd, 2007)

Al-Khalil made a comprehensive discussion on the *Shari`ah* rulings and the views of the scholars on stocks and bonds. He analyzed the nature, types and characteristics of shares and bonds, made a comparison between them and provided *Shari`ah* principles for stocks and bonds and its trading. He also highlighted the Zakat^{vi} of the stocks and alternative paradigm of Halal^{vii} bonds. (Al-Khalil, 2002) Al-Zundi's texts include the *Shari`ah* ruling for the brokers, different types of contracts in the stock trading like forward and future contracts, margin trading and the *Shari`ah* ruling for the issuance of bonds shares and its trading. (Al-Zundi, 1988)

Zaky adopted a comparative approach towards stock market from both Islamic and Western perspective. He outlined the *Shari`ah* principles for securities transactions and made a comparison between Islamic and Western securities. He explained in detail the formation and organizational structures of Kuala Lumpur Stock Exchange (KLSE) as a case study and suggested avenues to improve from an Islamic perspective. He asserts that the ordinary share is lawful, but the preferred share is not, as he says: "while investment in ordinary shares is perfectly lawful, investment in preferred share is not". (Zaky, 1992, p. 71) This study lacks proofs from the fundamental sources of *Shari`ah* and some new types of contracts in the stock market are also absent. (Zaky, 1992)

Naughton has examined the instruments traded in the stock market and the structure and practices of sock market in accordance with the Islamic *Shari`ah* norms. Nevertheless, some components related to the stock market are missing and the study does not elaborate much on the views and arguments of the scholars on the *Shari`ah* ruling for every aspect of stock market. (Naughton, 2000) Obaidullah has talked about the ethics and efficiency of an Islamic stock market. He argued that a stock market which is full of Islamic ethical principles is not lacking efficiency. (Obaidullah, no date)

Seif has discussed the *Shari`ah* aspects and the economic aspects of stock market and concluded with determining the criteria for an optimal Islamic model of stock market. (Seif I. Tag El-Din, 2002) Al-Barwari and Sabri Harun have described the conventional stock market and then attempted to analyze the *Shari`ah* appraisal for stocks and bonds, *shari`ah* ruling for various types of trading such as short selling, margin trading, forwards, futures and options. They did not explain much on the opinions and arguments of Islamic jurists on this issue. (Al-Barwari, 2002; Sabri Harun, 1999)

Osmani & Abdullah

Mubarak explained in detail the *Shari`ah* ruling for the prevailing securities and its trading in the stock market. He furnished the views and arguments of the modern jurists. He also touched on the issue of *Shari`ah* advisory board for monitoring the progress of the stock market and validity of its different products. Some of his views related to the stock market were debated by the scholars. For instance, he was in favor of the validity of preferred shares even though the juristic scholars were almost unanimous on the invalidity of the preferred share in the *Shari`ah*. (Mubarak, 2005)

Ahmad has adopted a comparative approach where he compares the contemporary trading practices of the stock market with the *Shari`ah* norms. (Ahmad, 2006) Na`im has critically analyzed the *Shari`ah* criteria for the stocks and bonds which are issued by the securities commission of Malaysia and its relation with the objectives of the *Shari`ah*. (Na`im, 2006) The Resolutions of the *Shari`ah* Advisory Council of the Securities Commission of Malaysia included different types of lawful contracts in the capital market and analyzed the different products from Islamic perspective. It also evaluated some issues of the capital market in the light of Islamic jurisprudence and laid down the *Shari`ah* criteria to analyze whether securities of a particular company can be deemed *Shari`ah* compliant or not. (Securities Commission Malaysia, 2007)

Masum Billah's book is a modern comprehensive text which examines important issues on contemporary trade and finance in line with the *Shari`ah* principles. He explained in detail the Malaysian capital market, characteristics of unapproved stocks, investing in the mixed companies, issues pertaining to stocks like gambling and speculation in the stock market, preferred shares, stock hedging and finally illustrated the *Shari`ah* advisory council of the securities commission of Malaysia. (Billah, 2007)

Boni has discussed the *Shari`ah* norms for different aspects of the stock market. He commenced with the meaning of *Shari`ah* norms and its importance, followed by a detailed elaboration on the general *Shari`ah* norms for trading in stock market. He placed the norms for future trading, where he wrote the characteristics of lawful commodities and contracts. He also highlighted the *Shari`ah* aspect of risk taking and the price of stocks. (Boni, 2008) However, this study lacks sufficient analysis on the structures of the stock market based on the *Shari`ah* principles and several issues of the stock market are not discussed.

3. Research Methodology

This study reviews the classical and modern literature on Islamic laws which are related to transactions to find out *Shari`ah* principles and then follows the analytical method to examine every aspect of stock market based on these principles. It also critically evaluates the views of the modern scholars on the stock market by adopting the inductive approach.

Osmani & Abdullah

This study tries to furnish some concrete suggestions and recommendations towards the development of a full-fledged Islamic stock market.

4. Discussion of Findings

To establish an Islamic stock market, it is crucial to comprehend the role of stock market in the economic growth and respond to the demands of the *Shari`ah*. The universal rule of Islam for transactions reveal that trading is not only permitted but also entitled as *Ibadah*^{viii} but with the condition that it is free from all forms of *Riba*, *Al-Maysir*^{ix}, *Al-Gharar*, price controlling, *Al-Ihtikar*^x, misinformation and coercion. The ethical behavior in Islamic market is assured with the quality of *amanah*^{xi}, truthfulness, co-operation, and discarding Jealousy and cheating.

Generally, Share Company is legal in Islamic *Shari`ah* in a sense that it is same like partnership business or *Mudarabah* contracts which are permitted in Islam. The Traditional jurists agreed upon the permissibility of partnership business and *Mudarabah* contracts. (Al-Kasani, 1983 v-14, p-331) Furthermore, there is no prohibition in the *Shari`ah* in forming a share company or a partnership company. (Al-Khaiyyat, Abdul Aziz, 1989) While a common share is permitted in the *Shari`ah*, a preferred share is not allowed as it is not a partnership business because share holders do not have the right to vote. It means they are not the partners of the company. Besides, the extra money that the preferred shareholders get is just like *Riba* as they take it without sharing the risk of profit and loss. (Zaky, 1992, pp. 71-72)

Selling a common share is like selling a portion of a capital of the company. So, it is legal according to most of the scholars. They argue that a share is one's own property so he has the right to sell or lend as long as it does not cause harm to other share holders. It does not contain *al-Gharar*, as the price is determined according to the existing market during its purchase. (Mubarak, 2005, p. 184) Short selling is not valid in the *Shari`ah* as it is like gambling and cheating the buyer as the seller sells the product that he borrows but he does not own it. (Al-Barwari, 2002, p. 200) However, if the investor buys the stock from the broker and afterward sells it, then it is allowed in the *Shari`ah*. Though margin trading is not allowed apparently in Islam, as this contract comprises *Riba*, there is room to make this contract valid through giving loans to the investor without interest or if the broker agrees on *Mudarabah* [= profit and loss sharing] contract with the investor.

Scholars disagree on the validity of forwards, futures and options. Some scholars argue that, in these contracts, the sold commodity and the payment of the price are made in future date, so it contains *Al-Gharar* and

Osmani & Abdullah

gambling. The Council of the Islamic *Fiqh* Academy of Makkah decided that the forward contracts with all of its categories which are prevailing in the stock market are invalid in the *Shari`ah* as it contains selling things that a person does not own (Al-Barwari, 2002, p. 210) On the other hand, a number of scholars permit these contracts based on a tradition of Prophet Muhammad (peace be upon him) where he himself got engaged in a forward contract. The Prophet is reported to have purchased a thin, weak camel from Jabir with a price of One Gold coin (*Waqiyyah*), which he paid later and also Jabir handed over the camel at a later time. (Bukhari, 9/233, No. 2517). Taking into Consideration the arguments of both parties, it is observed that forward, futures and options are valid contracts in the *Shari`ah* provided that both parties agree on the stipulated duration and price with no uncertainty in transaction.

The existing bonds of conventional stock market are not allowed in Islam. However there is room to issue Islamic bonds which is similar to *Mudarabah* contracts. Basically, in Islam, brokering for buying and selling is allowed as well as taking salary for that; but it is worth mentioning that Islamic *Shari`ah* requires honesty as an indispensable behavior from the brokers. A company must be free from *Riba*, gambling and manufacturing or selling *Haram*^{xii} products to be listed in the Islamic share market. Islam not only prohibits *Riba* but also forbids any association with *Riba* by any means. The products which are prohibited to consume are also forbidden from business dealings and transactions.

Besides, the shareholders should have the intention of business while buying shares; they need to be moderate in purchasing shares and are not allowed to trade in a non Islamic share market while an Islamic model of stock market is present. Finally, there should exist a reliable *Shari`ah* monitoring council which will monitor the issuance and trading of shares and other stock related activities and products to make sure that the market follows the Islamic regulations and does not violate its limits.

5. Conclusion

Islamic stock market adopts a dynamic approach towards the development of just, sound and ethically balanced securities. It incorporates many products of the conventional stock market and prohibits others. While yet others can be adapted to Islamic stock market after modifying some of its features. Islamic stock market does not allow such products that are totally based on *Riba*, injustice, cheating and lying. The Muslim government, companies, agencies and the intelligentsia should play its due role to establish Islamic stock market as to face the challenges of the conventional *riba* based securities market.

Endnotes:

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- ⁱ *Mudarabah* is a contract of profit and loss sharing, one party provides capital; the other party brings work or effort, the profit is shared according to predetermined mutually agreed upon ratio.
- ⁱⁱ *Shari'ah* is the law of Islam, based upon the Qur'an and Sunnah. It comprehends the whole life of Muslims: individual, familial, social, economic, political, cultural and so on.
- ⁱⁱⁱ *Riba* is Interest, an additional amount charged on a loan or on a capital. Interests earned in conventional banking accounts are also called *riba* in Islam.
- ^{iv} *Al-Gharar* is uncertainty in the contract.
- ^v *Fatwa* is a legal decree by the *Shari'ah* scholars.
- ^{vi} *Zakat* is a fixed proportion of charity (2.5%) given to the poor which is obligatory in the *Shari'ah*.
- ^{vii} *Halal* means permitted in Islamic Law.
- ^{viii} *'Ibadah* means religious duty.
- ^{ix} *Al-Maysir* is every game that is played with a condition that the winner will get something valuable from the loser.
- ^x *Ihtikar* means artificial shortage of supply.
- ^{xi} *Amanah* is trustworthiness.
- ^{xii} *Haram* means prohibited in the *Shari'ah*.

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Osmani & Abdullah

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Osmani & Abdullah

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Osmani & Abdullah

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