Shariah Ethical Investment Products in Indonesian Capital Market: The Debates on Their Integration Process in the Transitional Stage

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Abstract
Islamic investments are a unique form of socially responsible investments because Islam makes no division between the spiritual and the secular. The Shariah ethical investment products do not only provide opportunities for moslem community to apply their religion and belief in business sector, but also provide investment opportunities for universal investors. Investors will not only look at investment performance or Shariah compatibility alone. They will demand both Shariah compliance and good returns. The Shariah ethical investment products in Indonesian capital market as investment instruments play vital role at this sense. However, to realize the ultimate goals of Shariah ethical investment in Indonesian capital market the process will be not easy. In one side, there will be a tendency to bring Shariah ethical investment products in a legal-formal approach and in the other side there will be a tendency to bring Shariah ethical investment products to a more substantive approach in term of realizing the objectives of shariah. This paper argued that the Shariah ethical investment products in Indonesian capital market are still in the transitional stages. The tendency of imitating conventional products will be more dominant. However, the regulator needs to step forward to develop a more substantive investment products based on Islamic true objectives.

Keywords: capital market products, ethical investment, Shariah objectives

Introduction
Many studies have proved that there is a close link between the rate of economic growth and the development of financial institutions. Islamic finance is governed by the law of shariah which basically prohibits the interest rate (riba) as well as a kind of structured uncertainty within financial contracts called gharar. Hence, Islamic capital markets are more relevant in an Islamic economy because prohibition of interest and gharar entail a greater reliance on equity and asset based finance. The Shariah ethical investment foundations such as the prohibition of riba (interest) and gharar (uncertainty/speculation) are believed will bring more stable economic and financial system rather than interest based and more speculative conventional economic and financial system.

However, the Islamic financial system along with its all ethical basics and principles are still in progress. Therefore, it is particularly interesting to see how Shariah ethical investment products are integrated within Indonesian capital market which is still dominated by conventional system in the primary market as well as the secondary market. Bapepam and Shariah National Board as regulator apply two models in developing shariah capital market instruments in Indonesia. First, shari'ah compliant which makes conventional instruments as the model. Second, shari'ah based which make the original Islamic contracts as the basis of the Shariah ethical investment products. This paper will analyze the integration process of Shariah ethical investment products. Then, this paper will compare the regulator's policies with other prominent Islamic scholars in the related issues.

The Shariah Ethical Investment Products in Indonesian Capital Market

Capital market consists of primary and secondary market. The primary market is the fulcrum of capital formation whereby liquid funds are effectively mobilized, pooled and channeled through the financial system to finance the production of goods and services in the economy, and hence, effectively contribute to real economic real. The secondary market provides an element of liquidity, provides pricing and valuation of assets on a continued basis that eliminate arbitrage and inefficiencies.

Touriq argued that the primary market and the secondary market by nature do not conflict with shariah principles. He explained that in the primary market the corporate that intended to expand its business and need more liquidity invites people to invest in the corporate equity (ordinary shares). Hence, the investors who buy the corporate equities become the owner of the corporate. This practice by concept does not conflict with shariah principles as long as the equity is offered by the corporate which the products and the transaction mechanism do not conflict with Islamic principles. The basic idea of stock is called musyarakah or syirkah in Islam. Bapepam LK has set criteria regarding with corporate business activities which do not conflict with shariah principles in the capital market i.e. (a) gambling; (b) trading with non deliverance of goods or service; (c) trading with counterfeite offering/demand; (d) conventional banks; (e) conventional leasing companies; (f) trading of risk that contain uncertainty (gharar) and or gambling (maysir), e.g. conventional insurance; (g) producing, distributing, trading, and or providing products or services that are forbidden because of its contents; products or services that are forbidden not because of its contents but because they are stated forbidden by the National Sharia Board-MUI; (h) and or products or services that can deprave one’s morals and are useless; (i) doing transaction that contains bribe substance. The issues also must fulfil some ratio i.e. (a) Total interest-based debts in comparation with total assets less than 45%; (b) Non-permissible contribution income to revenue less than 10%.

National Sharia Board has issued some Guidance concerning with the permissibility of investment in shariah equity based (stocks, sukuk mudharabah/musyarakah) and shariah debt-based securities (sukuk ijarah/istisna'/murabahah) i.e. Number 20/DSN-MUI/IV/2001 regarding Guidelines for investment of shariah mutual funds, Number 32/DSN-MUI/IX/2002 regarding to shariah obligation, Number 33/DSN-MUI/IX/2002 regarding Mudharabah Shariah Obligation (sukuk), and Guidance Number 40/DSN-MUI/X/2003 regarding Capital Market and General Provisions Shariah Principles Implementation in Capital Market.

Touriq further explained that after the primary market activities has been finished, the investors can sell their equities to other investors. This is called the secondary market. Such equities trading is lawful in fiqh muamalah and do not conflict with shariah principles. For equity trading in the

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secondary market Accounting and Auditing Organization for Islamic Financial Institution (AAOFI) headquartered in Bahrain has issued the regulation on the permissibility of equity trading. Moreover in 2011, National Shariah Board issued Guidance Number 80/DSN-MUI/III/2011 regarding The Application of Shariah Principles in Trading Mechanism of Equity Securities at Stock Exchange Regular Market.\(^8\)

Touriq admitted that the shariah capital market practice in the primary market as well as in the secondary market applied in the existing "conventional" system which is based on the Law Number 8 Year 1995 regarding Capital Market. However, he argued that The Law Number 8 Year 1995 does not conflict with shariah principles. The Law also prohibits fraud in article number 90, market and price manipulation in article number 92, insider trading article number 95 to 98. Hence, Touriq concluded that the conventional system based on the Law Number 8 Year 1995 does comply with shariah system even though there is no shariah label on it. However, Bapepam has focused on identifying the capital market products and the transaction mechanism to ensure that shariah principles are applied in the existing conventional capital market.\(^9\)

Recently, the range of shariah compliant products in Indonesian capital market consist of shariah stocks, shariah mutual funds, shariah corporate sukuk, and sovereign sukuk. Touriq\(^10\) and Gunawan Yasni\(^11\) stated that principally Islamic capital market in Indonesia is the capital market which apply shariah principles as basis of its activities. Hence, capital market complies with shariah if the transaction mechanism, the pricing method, and the instruments do not conflict with shariah principles.

1. Shariah Stocks

The number of Shariah ethical investment products increase after List of Shariah Equity Securities (Daftar Efek Syariah – DES) was launched in 2007 with164 Shariah equity securities. The number keep increasing 191 Shariah equity securities in 2008, 198 Shariah equity securities in 2009, 210 Shariah equity securities in 2010, 234 Shariah equity securities in 2011, and 280 Shariah equity securities in 2012.\(^12\) All of the 280 equities issuers do not declares its business activities as well as its business management are conducted based on the shariah principles in the capital market. Therefore, there is no shariah labelled on the company name. They are included in the Shariah Equities List after Bapepam reviewed them and they can be classified as shariah stocks according to Bapepam criteria.

2. Shariah Mutual Funds

Shariah mutual funds was the first shariah capital market instrument in Indonesia that was launched at July 3\(^{rd}\) 1997 by PT. Danareksa Investment Management. The concept of mutual funds is investment and this concept does not conflict with shariah principles. In 2001, National Shariah Board – Indonesian Council of Ulama issued guidance (fatwa) Number 20/DSN-MUI/IV/2001 regarding Guidelines for investment of shariah mutual funds. Until June 15\(^{th}\), 2012 there are 51 shariah mutual funds in Indonesia. All of the 51 shariah mutual funds declare its business activities as well as its

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business management are conducted based on the shariah principles in the capital market as clearly stated on in its article of association and shariah is labeled on their mutual funds name.\textsuperscript{13} 

3. Sukuk

According to Bapepam's data June 15\textsuperscript{th}, 2012 there are 31 series of corporate sukuk that still on the market and 18 series of sovereign sukuk. From 31 series of corporate sukuk, according to the statistic 6 corporate sukuk (19,36\%) apply mudharabah as their underlying contracts, 25 other corporate sukuk applied ijarah as their underlying contracts. According to the data per 28 September 2012, there were 21 corporate sukuk that have been matured. 8 corporate sukuk (38,09\%) applied mudharabah as their underlying contracts, 13 others corporate sukuk (61,90\%) apply ijarah as their underlying contracts. So far, total sukuk that have been issued by Bapepam are 52 series of corporate sukuk, 14 corporate sukuk (26,92\%) applied mudharabah as their underlying contracts, 38 others corporate sukuk (73,08\%) apply ijarah as their underlying contracts. All 18 series of sovereign sukuk (100\%) apply ijarah (sale-lease back) as their underlying contracts.\textsuperscript{14} 

\textbf{Regulator's Perception on Shariah Ethical Investment Products Integration into Existing National Capital Market in Indonesia}

In Indonesian capital market master plan 2010-2014, it is stated that the development of the Shariah capital market industries will be done through several programs, two of which are developing Shariah capital market products and service schemes and aligning Shariah-based products with conventional products. The steps taken to deliver these two approaches include composing a standard guidebook for Shariah products, evaluating and transforming conventional capital market products to be Sharia-compliant products, as well as researching and developing new Sharia products.\textsuperscript{15}

Regulator's opinion on the instruments engineering in Indonesian shariah capital market, Touriq\textsuperscript{16} stated that in the eye of regulator all Islamic contracts are equal depends on the market needs. Shariah based approach and shariah compliance approach are permissible according to Islamic law and designed to meet market needs. The instrument structure will vary. For the primary market, the instruments of common shares can be based on equity partnership (musyarakah), while the instruments of sukuk can be based on contracts of ijarah, salam, murabahah, musyarakah, mudarabah, and istisna', and mutual funds can be based on wakalah, musyarakah, and mudarabah.

Touriq\textsuperscript{17} and Yasni\textsuperscript{18} argued that all Islamic contracts are equally important. Profit and loss sharing contract based such as musyarakah and mudarabah as well as fixed based income such as murabahah, istisna', salam and ijarah are equally important. It depends on the nature of the business needed by the market. Nothing is more Islamic or less Islamic among these contracts. They point out that what important is the product is beneficial for the market players as long as be done in a manner that comply with shariah principles and contracts.

Regulator’s opinion on the tendency the issuance of shariah securities which tend to be fixed based income such as sukuk ijarah that dominated the issuance of sukuk rather than


\textsuperscript{15} Bapepam LK, Capital Market and Non Bank Financial Institutions Master Plan 2010-2014, 87.

\textsuperscript{16} Interview with Muhammad Touriq at July 23\textsuperscript{rd}, 2012 in Sumitro Djiejohadikusumo Building, 11\textsuperscript{th} floor Capital Market and Financial Institutions Supervisory Agency. See also Muhammad Touriq, “The Direction of Islamic Capital Market Development.” 17.

\textsuperscript{17} Interview with Muhammad Touriq at July 23\textsuperscript{rd}, 2012 in Sumitro Djiejohadikusumo Building, 11\textsuperscript{th} floor Capital Market and Financial Institutions Supervisory Agency. See also Muhammad Touriq, “The Direction of Islamic Capital Market Development.” 17.

\textsuperscript{18} Interview with Gunawan Yasni at the headquarter office of National Shariah Board Indonesian council of Ulema Jakarta at July 25\textsuperscript{th}, 2012. See also M. Gunawan Yasni, “We Keep on Improving Shariah Securities Criteria.” 16-17.
mudharabah/musyararakah, Touriq and Yasnی argued that as long the underlying transaction is permissible there should be no problem with the sukuk. If the underlying transaction of shariah security is partnership contract such as murabahah and musyararakah there will be profit and loss sharing with variable rate of returns. However, if the underlying transaction of shariah security is exchange contract such as murabahah, ijarah, istisna‘ and salam there will be fixed rate of returns. It has been the nature of the contracts.

Regulator’s opinion on the assumption that shariah products are similar to conventional products, Touriq argued that it is the “selling point” for shariah products because the products have been familiar to investors. It has been a part of Bapepam master plan to encourage the equality of shariah products with its conventional counterpart. As long as shariah products in the process have been through their unique criteria and characteristic according to shariah principles, if then the result shows that shariah products seem similar to its conventional counterpart, Muslim investor should prefer to choose shariah products. Touriq argued that the argument makes sense because shariah products is not only permissible but also competitive for Muslim and non Muslim investors.

Regulator’s opinion on people argument that secondary market instrument do not have direct impact to economic growth and tend to be closer to speculative transaction (gambling) which is prohibited in Islam. Touriq and Yasnی argued that the practice of sale and buy equity securities is lawful because it represents a lawful certificate of ownership on a corporate which its core business is lawful. Gunawan argued that Bapepam and National Shariah Board through Guidance Number 80/DSN-MUI/III/2011 regarding The Application of Shariah Principles in Trading Mechanism of Equity Securities at Stock Exchange Regular Market has tried to ensure the trading mechanism is fair and transparent. In the trading mechanism that is called continous auction the price can be up and down. If we check the Law Number 8 Year 1995 and other Bapepam’s rule and regulation always mentioned that the objective of the regulation is to maintain fair and transparent price in the market. In fiqh terminologi the creation of fair and transparent price is called bay‘ al-musawamah. Therefore, to make sure the price is fair and transparent Shariah National Board and Bapepam regulate 14 prohibited activities in the Guidance.

Finding and Discussion

There are two options for Muslim society towards contemporary financial system in the Islamization process i.e., integration or separation. It seems that most of Muslim countries choose integration of Islam in their mainstream financial system rather than separation. M. Umer Chapra,


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17 Second Inter-view with Gunawan Yasni at the headquarter office of National Shariah Board Indonesian council of Ulama Jakarta at July 25th, 2012. See also M. Gunawan Yasni, “We Keep on Improving Shariah Securities Criteria.”


21 Second Interview with Gunawan Yasni at the headquarter office of National Shariah Board Indonesian council of Ulama Jakarta at July 25th, 2012. See also M. Gunawan Yasni, “We Keep on Improving Shariah Securities Criteria.”


14 Interview with Gunawan Yasni at the headquarter office of National Shariah Board Indonesian council of Ulama Jakarta at July 25th, 2012. See also M. Gunawan Yasni, “We Keep on Improving Shariah Securities Criteria.”


M.A. Mannan, M. Nejatullah Siddiqi, Monzer Kahf, Syed Nawab Haider Naqvi, Abdullah Saeed, Muhammad Akram Khan, Muhammad Arif, Muhammad Anwar, Muhammad Anas Zarqa, Zubair Hasan, and M. Aslam Haneef are proponents of the Islamization of banks and other financial institutions as an effort to integrate mainstream financial system into Islamic finance. They emphasized the need for building economic and its institutions consistent with Islamic values and norms.

The integration approach opens the door to interact with conventional system and practices as long as they do not conflict with shariah principles. This approach put emphasized on “step by step” approach to modify modern socio-economic order to be more ideal with Islamic principles. The integration approach now become the mainstream in developing Islamic financial institutions, including shariah capital market in the world. The integration of shariah finance into existing national as well international financial system take place in various Shariah ethical investment products introduced and developed in the existing “conventional” system.


31 Zubair Hasan, Islamic Banking and Interest, 140.


However, the integration process which apply step by step approach in applying shariah principles in Islamic finance and shariah capital market and open the door to interact with conventional system through shariah compliant process has been criticized. According to some prominent Islamic scholars such as Monzer Kahf41, M. Fahim Khan,42 M. Nejatullah Siddiqi,43 Nazim Zaman and Mehmet Asutay,44 M. Aslam Haneef,45 Volker Nienhaus,46 Mohammad Obaidullah,47 M. Amin El-Ghamal48 and Abdullah Saeed,49 Salman Syed Ali50 Asyraf Wajdi Dusuki,51 Sudin Haron and Wan Nursofiza, Al-Amine,52 Wafica Ali al-Ghoul,53 and Ali Adnan Ibrahim54 the integration has resulted a paradox. According to their opinions there is no significant distinction between shariah model compared with conventional model. Islamic economics and finance are presently no more than the result of applying the Islamic rules and injunctions, i.e. Islamic fiqh, to secular economics. The recent reality shariah application which dominated by taking conventional finance as the model is just duplicative efforts which overemphasis to the "form" rather than to the shariah "substance" (maqasid shariah).55

Ghamal and Dusuki\textsuperscript{56} mentioned that the paradox emerge for a reason. There are two different opinions between the shariah experts in understanding the structure and the objectives of Islamic financial institutions. On one hand, the shariah jurists and academicians demand that Islamic finance should place greater social economic welfare responsibilities and religious commitment in order to achieve the Islamic economic objectives including social justice, equitable distribution of income and wealth, and promoting economic development. They argued that Islamic finance is demanded not only to comply with shariah contracts, avoiding prohibited business, but should also play important role as a means to realize the shariah objectives in economy.

This view even goes further to argue that "Profit and Loss sharing" with equity based contracts is the only principle representing a true spirit of Islamic financial system which departs significantly from the interest based system. M. Umer Chapra\textsuperscript{57} and many other scholars subscribe to this view including Sadr,\textsuperscript{58} M.N. Siddiqi,\textsuperscript{59} Khursid Ahmad,\textsuperscript{60} Khursid Ahmad,\textsuperscript{61} Siddiqi,\textsuperscript{62} Haron,\textsuperscript{63} Rosly and Bakar,\textsuperscript{64} Haron and Hisham,\textsuperscript{65} Naqv,\textsuperscript{66} Choudhury,\textsuperscript{67} Wahbah al-Zuhali,\textsuperscript{68} Waled Hegazy\textsuperscript{69} and Taqi Usmani.\textsuperscript{70}

On the other hand, the practitioners view that Islamic finance should act as a normal commercial entity aims at maximizing profits as long as it is done in a manner consistent with Islamic law. This second view also stresses the equal importance of profit and loss (equity-based) contracts and other debt-based contracts which have a clear indicative of permissibility based on shariah rulings in the Quran and Hadis. The debt-based contracts encompass murabahah (cost-plus sale), bay` bitsaman ajil (deferred payment sale), bay` al-salam (purchase with deferred delivery), bay` al-Istisna’ (commissioned manufacturing), and ijarah (leasing). Hence, overemphasis placed on Profit and Loss sharing modes of financing is believed to be inappropriate and unfounded to any Quranic text and


\textsuperscript{59} M. Baqir al-Sadr, \textit{An Introduction to Principle of Islamic Banking}, terj. Bazban-Rad (Tehran: Bunyad Be’heet, 1982).

\textsuperscript{60} M.N. Shiddiqi, \textit{Issues in Islamic Banking} (Leicester: The Islamic Foundation, 1993).


\textsuperscript{69} Waled Hegazy, “Fatwas and the Fate of Islamic Finance: A Critique of the Practice of Fatwa in Contemporary Islamic Financial Market” in \textit{Islamic Finance: Current Legal and Regulatory Issues}, 141

\textsuperscript{70} Muhmmad Taqi Usmani, \textit{An Introduction to Islamic Finance} (Karachi: Maktabah Ma’arif Qur’an, 2005), 24.
even incompatible with the methodology of shariah. The main Islamic financial institutions responsibilities are towards the shareholders or investor and not to be burdened with other responsibilities. The social welfare responsibilities of Islamic financial institutions should be fulfilled by other bodies such as the government. Islamic financial institutions pay zakat as part of their social contribution while complying with the shariah requirements. The use of Islamic financial institutions funds for other social activities which are not required by the law may jeopardize the viability of Islamic financial institutions.71

Indonesian shariah capital market instruments seem to face the same dilemma. It seems that Islamic economics and finance are presently no more than the result of applying the Islamic rules and injunctions, i.e. Islamic fiqh, to conventional economics. Islamic economics is not yet, contrary to what some scholars would want Muslim to believe, a discipline that replaces conventional economics. Instead, Islamic economic and finance complement and converge with existing mainstream conventional economics and finance.72 It can be traced from the regulator policies that try to integrate shariah products into mainstream national conventional capital market under the Law Number 8 Year 1995. In Capital Market Master Plan 2010-2014, the steps taken to increase the number of shariah products are by evaluating and transforming conventional capital market products to be Sharia-compliant products as well as researching and developing new Sharia products.73

The phenomena applying shariah principles in conventional practices can also be traced in primary market when Bapepam review existing stocks according to certain criteria. All of shariah stocks in the Equity Securities List came from the issuers that do not declares its business activities as well as its business management are conducted based on the shariah principles in the capital market. In the issuance of sukuk, total sukuk that have been issued by Bapepam are 52 series of corporate sukuk and the majority i.e. 38 corporate sukuk (73,08%) apply ijara as their underlying contracts. All of 18 series of sovereign sukuk (100%) apply ijarah (sale-lease back) as their underlying contracts. It showed that majority of sukuk issuance are fixed based returns under ijarah contract. These are some indicators that show shariah instrument converge into Indonesian existing conventional capital market.

In the secondary market, Bapepam also has the task to ensure that speculative behaviour that close to gambling ruled out from the market. Bapepam should provide secondary capital market as an element of liquidity and as fair and transparent pricing and valuation of assets on a continued basis that eliminating arbitrage and inefficiencies. The price of the stock should be fair and transparent all the time to make sure that the trading mechanism of shariah securities are in the right direction in accordance with the Guidance Number 80/DSN-MUI/III/2011 regarding The Application of Shariah Principles in Trading Mechanism of Equity Securities at Stock Exchange Regular Market.

This paper argued that principally under the "step by step" approach in integrating Shariah ethical investment products into existing national conventional capital market in Indonesia, the policies have been taken by Bapepam and National Shariah Board can be accepted as long as all the processes have been through in a manner consistent with shariah principles. The integration and convergence are needed to put Shariah ethical investment products develop and fulfil the national and international standards while applying shariah principles. The reality now should be understood as transitional stages to go forward to a more ideal application of shariah principles in economics and finance.74

As a part of step by step approach in integration process, Bapepam need to step forward to maximize the Shariah ethical investment products contribution towards Indonesian economy. Bapepam LK need to develop their regulation regarding shariah capital market instruments in

72 Waleed J. Ajdass, Methodology of Economics: Secular vs Islam, 126.
Indonesia within five objectives. The shariah objectives in islamic capital market must follow the three IOSCO objectives of securities market i.e. (i) investor protection, (ii) transparency and disclosure, (iii) avoidance of sistemic risk.\textsuperscript{75} The objectives should also be completed with specific shariah objectives i.e. (iv) keeping a constant link of financial asset with real economy activity, and (v) ensuring the key prohibitions such as riba and gharar are implemented.\textsuperscript{76}

Therefore, Bapepam LK need to consider Iqbal and Mirakhor's opinion. They argued that shariah based or innovative approch requires a deep understanding of the Islamic economic and fnancial system as well as the risk/return characteristics of each basis building block, it is a long term-solution and requires extensive research and commitment. Many writes argued that shariah based is better aligned with the essence of the shariah. Pioneering new frontiers in a different paradigm always poses new challenges and takes time. Therefore, it is conceivable that due to the pressing need for innovation, the imitative (shariah compliant) approach will dominate in the short time, and an adoption of some combination of reverse engineering and innovation will take place in the medium term. However, the full potential of the system will only be achieved if serious efforts are made to introduce new instruments (shariah based), which provide unique risk/return characteristics that are equally desirable for Islamic and non Islamic capital market.\textsuperscript{77}

**Conclusion**

The recent reality has shown that the imitative model has become the majority in issuing Islamic capital market instruments. The tendency to generate fixed based income has become common phenomena in Islamic capital market instruments such as the popularlity of sukuk based on *ijarah* at most compared to sukuk based on *mudharabah* or *musyarakah*. Besides, Islamic capital market instruments in secondary market are still debatable in spite of there has been fatwa from Shariah National Board regulating trading stocks in secondary market. Many people argued that these instrument did not have direct impact to economic growth and tend to be closer to speculative transaction (gambling) which is prohibited in Islam.

Pioneering new frontiers in a different paradigm always poses new challenges and takes time. This paper argued that principally under the "step by step" approach in integrating Shariah ethical investment products into existing national conventional capital market in Indonesia, the policies have been taken by Bapepam and National Shariah Board can be accepted as long as all the processes have been through in a manner consistent with shariah principles. The integration and convergence are needed to put Shariah ethical investment products fulfil the national and international standards while applying shariah principles. The reality now shold be understood as "transitional stages" to go forward to a more ideal application of shariah principles in economics and finance. As a part of step by step approach in integration process, Bapepam need to step forward to maximize the Shariah ethical investment products contribution towards Indonesian economy.

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\textsuperscript{75} IOSCO, "Islamic Capital Market Fact Finding Report" 10.

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\textsuperscript{77} Zamir Iqbal and Abbas Mirakhor, *An Introduction to Islamic Finance: Theory and Practice*, 208.
