

INVESTMENT IN STOCK MARKET: A REVIEW ON ISLAMIC PERSPECTIVES

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ABSTRACT

With the evolution of the stock market mindset, many Islamic investors participate in buying and selling shares in the stock exchange. In fact share market plays a vital role in the development of an economy of a nation. This paper aims to review and discuss the investment in stock market status and validity from Shari'ah principles and perspectives. Does it conform or contradict with Islamic value? The basic arguments on gambling, risk and speculation are discussed to clarify the validity from shari'ah point of view. This paper would review the available literature on four areas of discussion; Islamic attitude towards wealth, Shari'ah rulings, Muslim jurists view and speculation in Islam. It is expected that this paper would shed some clear lights on the stock market investment status and validity, and would propose how it should be implemented in line with shari'ah principles.

Keywords: Stock exchange, Islamic value, Shari'ah principles, Gambling, Speculation

1. INTRODUCTION

1.1 Stock Market

The stock market is considered as a significant fragment of the financial sector, which plays a vital role in the process of economic growth by facilitating savings and channeling funds from savers to investors.(Hossain, Hossain, & Sadi, 2013)

Stock represents ownership in a company and stockholders are entitled to all residual income after the fixed income claimants. Such stock is the document that gives the shareholder proof of his right to a stake in the company's wealth comprising its paid-up capital, assets and retained profits. There are several types of stocks: a common stock, which is subject to profit and loss, a preferred stock, which earns part of its share in the profits realized at a known pre-fixed rate and the loan stock, which earns its profit at a fixed rate of interest. (EL-DIN, 2002)

Actually, 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.(Osmani & Abdullah, 2009). The place of the stock market known as the Stock Exchange that is usually located in the capital. This exchange is linked nationally with other exchanges in major cities and internationally with main exchanges in the world. (El-ashkar, n.d.). Its functions complement those of other institutions, such as commercial banks, insurance companies and similar organizations. (M. Ali & Gari, 1993).

Stock exchange performs several important functions as follows:

- Provides a market place to accommodate a large number of buyer and seller.
- Disseminates all relevant information to the potential buyers and sellers.
- As a tool to provide resources for corporation and provide them with sufficient funds.
- Channel for the corporation to raise funds.

By executing all these functions, stock exchange assist in optimizing all possible resources. In order to carry out its economic role, the stock exchange has to have certain kinds of trading opportunities, dealings and contracts, which in totality form a dynamic and lively system of trading. (M. Ali & Gari, 1993). According to Hossain et al., (2013), stock market also contributes the development of a nation.

The stock market is considered as a significant fragment of the financial sector, which plays a vital role in the process of economic growth by facilitating savings and channeling funds from savers to investors. In addition, an active and well-organized stock market contributes to the economy by increasing the liquidity of financial assets, making risk diversification possible, promoting feasible investment decisions, and influencing corporate governance.

Thus, The Muslim faith deems that profit should come as a result of efforts; this is not the case in interest dominated investments.(M.Kabir Hassan, 2010).

1.2 The Islamic Stock Market

By definition, in a Shariā'h compatible stock company, a stock represents a shareholder's share in the company. It is the document that gives the shareholder proof of his right to a stake in the company's wealth comprising its paid-up capital, assets and retained profits.(EL-DIN, 2002).

Like conventional stock market, Islamic stock market must also have a market place for transaction, pricing mechanism, and the commodities. Apparently, the characteristics and implementation for Islamic stock market is totally diverse. Unlike conventional stock market, Islamic stock market has its own features on ensuring the implementation and all contracting parties in stock market are in line with shari'ah principles. The Islamic stock market will be free from interest-based securities. Only shares --ordinary shares--and risk bearing Islamically acceptable financing certificates are permitted in the Islamic stock exchange.(El-ashkar, n.d.). The function of Islamic stock market is not only to the system but also to the whole economy.

Consequently, for an Islamic economy, a stock exchange may also complement the banking system. Then, it would be possible to consider the investment opportunities offered by Islamic banks, as a basis for measuring the return and risk in other investment portfolios. (M. Ali & Gari, 1993). Islamic stock market adopts a dynamic approach towards the development of just, sound and ethically balanced securities. (Osmani & Abdullah, 2009). Indeed, Islamic alternatives to traditional investment tools have been driven by the fact that such tools do not conform to the Islamic standards. (M.Kabir Hassan, 2010).

In fact, the size of Malaysia's capital market has more than tripled to RM2.5 trillion since 2000, equivalent to 264% of the country's gross domestic product. (www.thestar.com.my). Islamic equities comprise of 853 syariah stocks (86%) represent 64% of market capitalization. (Ranjit Ajit Singh, 2008). The conflicting issue and debates among contemporary scholars is, are Muslim investors allowed to buy and sell shares on the market? Definitely, there will be certain disparities between Islamic market and non- Islamic market. To further the review and discussion, the following components will be explored in this paper:

- (a) Islamic Attitudes towards Wealth,
- (b) Shari'ah Rulings on Investment in Stock,
- (c) Scholars views,
- (d) Speculation and Islam.

2. ISLAMIC ATTITUDES TOWARDS WEALTH

Islamic attitudes toward wealth underpin Islamic economies. Islam does not suggest that wealth possesses any intrinsic ethical qualities, whether good or bad. Unlike some cultures and religions, Islam does not teach that the absence of wealth is a virtue or a vice, nor that its presence implies any particular character.(Ahmed, 2011). In terms of precedent, it is important to note that the Prophet Muhammad and those close to him carried out commercial businesses on a successful basis.(Ahmed, 2011). As mentioned by Zaman, 1986, Muslims are encouraged to seek economic bounties which God has made available to them. They are encouraged to work for a living and have been told to cooperate with each other.

Moreover, Ibn Qayyim urges that the act of Fuduli (i.e. , when a person does something to foster the interest of another person without the latter's prior consent) be compensated and promoted. Then he argues that if Fuduli is not compensated, many just and appropriate voluntary acts simply will not be performed and, as such, potential economic benefits to the society will be wasted.(Zaman, 1986)

Additionally, Islam also prescribes a compulsory financial obligation which is zakah: a financial/wealth obligation to be taken from the rich and given to the poor. Among the many purposes of zakah (and fay) one that is described in Quran is 'so that the wealth does not circulate only among your rich folk. Therefore, if capital markets are not growing to allow for increase in wealth and economic growth or if the growth is skewed resulting in concentration of wealth, then it is an indication of some weakness which needs correction.(S. S. Ali, 2005)

3. SHARI'AH RULINGS ON INVESTMENT IN STOCK

Muslims represent approximately one-fifth of the world's population and are estimated to have more than \$800 billion to invest. This amount is growing by 15 percent annually. Only a small portion of the available funds are invested in Islamic products which is indicative that this market is, for the most part, unexploited.(M.Kabir Hassan, 2010). In spite of the recent credit crunch, inflationary pressures, an increase in commodity prices and widespread economic slowdown, the prospects for growth in Islamic securities markets are likely to be positive.(Al-Masri, 2007)

As for an initial effort towards Shariā'h compliant securities, a very early review and identification of shari'ah-compliant stocks was undertaken in 1983 by Bank Islam Malaysia

Bhd., which led to introduction of a centralized process of such identification under Securities Commission of Malaysia in June 1997.(S. S. Ali, 2005). The first Islamic equity index was launched by RHB Unit Trust Management Berhad. In this case, the role of Shariā'h Advisory Boards cannot be deprived of. The appointed boards will give assurance that the investment in stock market is managed within the Islamic framework.

Basically, there are four main sources of Islamic law:

- (a) the Qur'an;
- (b) the Sunna of the Prophet, which reflects his way of life and hence sheds light on the Qur'an;
- (c) the consensus (ijmāc) of the great jurists and interpreters of Islamic law; and
- (d) the principle of analogy or precedent (qiyās) by which the rules of Islamic law are extended to similar or analogous situations.

(Ahmed, 2011)

These four sources advocates lawful means of transacting and provide the criteria for judging the validity of the transactions as they also referred as a principle of Islamic equity. To further develop an economy as a whole, Islamic Shariā'h urges and encourages that type of exchange that results in the creation of real utility, whether done directly or indirectly by way of productive mediation or through auxiliary production services in the short or long run.(EL-DIN, 2002). Malaysia has established a sound shariah framework to govern the activities in Islamic Capital Market (ICM) executed by Shariah Advisory Council (SAC). Among of the SAC roles are:-

- (a) Facilitates development and regulation of new products.
- (b) Provides greater clarity and enhances market confidence and integrity through dissemination of shariah rulings.
- (c) Regular interaction with industry and other Shariah experts provide useful feedback for decision making.
- (d) Participation at international conferences and dialogues enhances awareness and Understanding of Malaysia's ICM

The Shariā'h encourages the use of profit-sharing and partnership schemes, and forbids *rib* (interest), *maysir* (gambling and pure games of chance), and *gharar* (selling something that is not owned or that cannot be described in accurate detail in terms of type, size, and amount).(M.Kabir Hassan, 2010)

Generally speaking the key principle in Islamic finance is the need to achieve justice. The aim therefore is to avoid injustice to a party in a transaction. These include prohibitions against *jahala* (ignorance) and *gharar* (speculation). Whilst it is acknowledged that it is impossible to remove all speculation or uncertainty from commerce, the intention is that avoidable elements of speculation should be removed and parties should be clear on the upon which they have agreed to do business. These principles mean that gambling & many types of derivatives contracts, many forms of insurance, unfair advantage & income from objects that are forbidden for a Muslim are not permitted under Shariā'h law.(Mondal, Akter, & Afsar, 2013)

There are three conditions for a security to be Islamic:-

- (a) to be committed to the conditions of profit and loss sharing in a clear, unequivocal stipulation on the legal rules governing the mudarabah and partnership contracts necessarily but not sufficient.
- (b) Resources mobilized through these securities (issued on non interest basis) should not be rechanneled to institutions not functioning in conformity with Shari`ah and to firms dealing with interest in all their activities by using Islamic bank. Without sharing in the risk of this return, such returns are nothing but interest and the term profit is merely a misnomer just for covering it up.
- (c) The funds mobilized through these securities should be utilized in priority projects that clearly fulfill the public interest of the Muslim society and should not invest non Muslim foreign countries.

(Mondal et al., 2013)

Consequently, it is expected that the Islamic stock market will not be fully self- regulated with no government intervention. Instead, a degree of state regulation should be accepted and indeed expected, even with the existence of such a strong religiously established code of conduct. In brief, though the Islamic code of conduct is important, the market still needs the support of law.(M. Ali & Gari, 1993)

4. SCHOLARS VIEWS

Basically, stocks can be broadly divided into two categories, which are common stock and preferred stock. In a corporation, preferred stock has a priority claim over common shareholders, in which, common shareholders only have a residual claim (whatever is left) on income and asset in the case of company's liquidation. Theoretically, the stockholders have a legal control over the firm through the right to elect Board of Directors (BOD), who next will appoint the officers to run the business. In contrast preferred stock provides fixed dividends to the stockholder, which is similar to bond and obviously they cannot participate in the election of the board of directors. Depicted below are the comparisons between these two stocks.

Preferred Stock	Common Stock
<ul style="list-style-type: none"> ▪ Preferred stockholders have a greater claim to a company's assets and earnings and must be paid before common stockholders. 	<ul style="list-style-type: none"> ▪ Common stockholders will not receive any dividend until after the preferred shareholders are paid out.
<ul style="list-style-type: none"> ▪ Dividends of preferred stocks are generally greater than those of common stock and paid at regular intervals. 	<ul style="list-style-type: none"> ▪ The company's board of directors will decide whether or not to pay out a dividend.

Based on the above it can be concluded that a common share is permitted in the Shari`ah, but a preferred share is not allowed as it is not a partnership business because shareholders do not have the right to vote. It means they are not the partners of the company and the extra money that the preferred shareholders get is just like *Riba* as they take it without sharing the risk of profit and loss.(Osmani & Abdullah, 2009).

In relation to the shari'ah rulings, there is no prohibition in Islam to involve in any investment activities. Furthermore, there seems to be a consensus of opinion among contemporary Muslim jurists on the permissibility of exchanging common stocks through buying and selling transactions. This is based on custom (urf), applying the legal maxim "That which is known as custom shall have the force of that which is stipulated as a condition". (M. Ali & Gari, 1993). As mentioned by Dr. al-Khayyat, a Shari'ah compatible partnership in order to be valid should meet the condition of 'niyyah' (intention), which is one of the pillars of a partnership contract. (M. Ali & Gari, 1993). As declared in Islamic Fiqh Academy 1992, investing in ordinary shares is permissible if the main business of the company is in compliant with shariah ruling. Similarly, to purchase, to hold or sell its share is permissible even if the company was to undertake prohibited activities such as borrowing money and/or invest its money on the basis of interest, the company can still be invested provided they fulfill certain criteria.

In relation to the above, the OIC (Organization of Islamic Conference) Fiqh Academy that includes Fiqh Scholars representing the 53 Muslim countries in addition to others experts selected on their scholarly reputation, in several resolutions and recommendations dealt with purchasing stocks. This can be summarized as follows:

- (a) Stocks of companies whose products are not permitted in Shari'ah are prohibited to own, purchase, sell etc. Examples: interest-based banks and insurance companies, entertainment business, etc.
- (b) Stocks of companies that abide by the rules of Shari'ah, such as Islamic banks and Islamic Insurance companies are permissible.
- (c) Stocks of companies whose products are permissible but the company indulges in non-allowed transactions such as getting interest based financing, depositing in banks for interest, making contracts that include prohibited conditions, e.g., selling gold and/or silver and/or currencies in other than spot, or giving donations or selling arms to aggressors such as Israel. Also companies that produce permissible products but also produce non permissible products as a minor line of production, and this category 3 includes most companies in the world such as Microsoft and IBM. All these stocks are not permissible, in principle according to the Fiqh Academy. And this is a decision that actually represents a majority.

However, some group from respected scholars disagrees on these resolution and recommendations. They argued that this resolution is too idealistic and make hardship for Muslim all over.

According to Osmani & Abdullah, 2009, 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. (Osmani & Abdullah, 2009). Conversely, 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. (Osmani & Abdullah, 2009). 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. (Osmani & Abdullah, 2009)

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).

Some Islamic economists with the study of the characteristics of the stock market is by itself indicative not only of the fact that Islamic Sharī`ah recognizes, in principle, such vehicles for investment, but also encourages existing modes of investment that are based on the pooling of large capital resources through floating large numbers of stocks for subscription by the public under specified conditions. (EL-DIN, 2002).

5. SPECULATION AND ISLAMIC STOCK MARKET

Speculation has been defined as "the practice of buying or selling with the motive of then selling and buying and thus making a profit. If prices have changed a speculator will hold only the asset or liability, hoping that at the time the contract matures, events will have moved into his favor. (El-ashkar, n.d.). In fact, speculation is taken in the current literature as a pivotal force in the pricing of modern financial markets, though it is defined differently by different writers. Harrison and Kreps define speculation as follows: 'An investor may buy the stock now, so as to sell it later for more than he thinks it is actually worth, thereby reaping capital gains'. (El-din & Hassan, 1998). Al- Masri 2007, defined speculation is a fake reverse process of selling and buying not aiming at physically exchanging commodities (no actual "commodity" is desired for itself). In reality, it aims at benefiting from natural or artificial price differences and capital gains if the predictions of price changes in the short-term proved to be true.

Speculators, are therefore left to play with unpredictable residual patterns within the random walks of stock price movements through the adoption of different 'gambling' positions. (El-din & Hassan, 1998). Generally, speculation needs a great deal of knowledge and skills and therefore it cannot be equated with gambling. Similarly, According to Prophetic saying "Islam has strictly admonished any deliberate pushing up of prices whether through monopoly or najash (pushing the prices up without actually intending to buy)". (Mondal et al., 2013).

In particular with the speculation in Islamic stock market, El-ashkar pointed out the following points:-

- (a) All investors, or at least a great part of them, could be said to be speculators. They buy securities on the hope that their prices will move up in the future and they will be able to realize capital gains. They would, rightly, be accused of naiveté if they do not do that. Even for those who do not sell when prices move up, they refrain from selling on the hope that the prices will move up even further. Had they known that prices would fall they would have acted differently. This is quite legitimate. The objective of these

investors is to maximize their holdings even if not to instantly realize capital gains. The difference between speculators and other investors is that while the former buy and sell in a very short time the latter take longer to do so.

- (b) It may be suggested that in the absence of information, speculation comes very near to gambling and the lesser the information available the more speculation becomes close to gambling. This may be true, but it is not necessarily a problem that is confined to speculation. The lack of information becomes a problem for all decision makers. In the absence of information every thing, speculation or otherwise, becomes uncertain and any decision taken in the dark becomes irrational. In such circumstances, many will suffer as a result of lack of reliable information: national planners, entrepreneurs, brokers, jobbers (price makers), investors, and a host of other decision makers. The problem of lack of information is not, and should not be confined to speculation. To say that the absence of information leads speculation to become closer to gambling is to say the same for many other actions taken in the process of decision making. This is only to emphasize the importance of reliable information not only to speculation but to the process of decision making in general.
- (c) Turning our attention to the gharar and speculation, it suffices to say that in speculation the conditions of the deal are clear to both parties with no ambiguity on either. Each party is clear as to the quantity, specification, price, time and place of delivery of the object. Also, the object of the transaction, which is the purchased security, is available in the market at the time of transaction and is bound to be available at the time of delivery.
- (d) Speculation may help activate the market. At times when the market is weak, with very few investors willing to buy or sell, speculators may enter the market buying and selling securities. This can help activate the market. The implications of this can be seen in relation to the ability of firms to raise funds

From the above, it can be concluded that the Islamic securities market should not be envisaged as speculation-free market. A reasonable degree of speculation would be required, and indeed needed, if the market is to be active and operative.(El-ashkar, n.d.).

There are few arguments against speculation. The proponents of speculation differentiate between speculation and gambling on the basis that speculation depends upon information, experience and study unlike gambling that leans merely on fortune and coincidence. Yet, some believe that there are two types of speculation:

- (a) The first type depends upon experience. This type is few in number (speculation of big professionals).
- (b) The second type which is more popular depends upon fortune (speculation of small amateurs).

Despite the differences between them, both types are considered speculation. Likewise, modern gambling could also depend upon information, experience and study.(Al-Masri, 2007).

Nevertheless, the Shariah Advisory Council (SAC) at its tenth meeting on 16-17 October 1997, and at its eleventh meeting on 26 November 1997, on discussing the issue of crude palm oil futures, resolved that speculation is permissible under Islamic jurisprudence.

Several arguments have been used to support the permissibility of the speculation:-

(a) The Principle of Ba' Muzayadah.

As a result of the studies undertaken, the SAC found that speculation is present in whatever form of trade and is not confined to the share market. The question is whether such an act is forbidden entirely in Islam. Generally, making a profit from a price difference is not a hindrance in Islamic jurisprudence. Should this activity be forbidden, then surely sale and purchase principles like bai' muzayadah and murabahah would also be forbidden because both involve making a profit from the difference in the original price. Hence, this particular principle is allowed in Islam.

(b) The Non-interference Practice of the Prophet s.a.w. in Determining the Market Price.

What are clearly forbidden in Islam are fraud and manipulation. These practices have to be monitored and supervised to ensure fairness for market players, and to minimise forbidden practices. A situation whereby a trader makes bountiful gains as a result of a price increase following an increased demand is acceptable in Islam. It represents a blessing and an opportunity for the trader. Rasulullah s.a.w. himself said:

دعوا الناس يرزق الله بعضهم من بعض

Meaning: "Let the people seek their own livelihood provided by Allah for them".

What needs to be done is monitoring to ensure that fraud and manipulation do not occur in the market. The aim is to create a healthy market in line with the principles outlined in the Shariah. The Prophet s.a.w. himself was loth to interfere in the fixing of prices in the market after finding that the prices were being determined by market forces and not by any act of manipulation. This view was supported by a prophetic tradition which told of how the Prophet s.a.w. responded to a request made of him to arrest the prevalent rise in prices by fixing the prices in the market. He said:

إن الله هو المسعر القابض الباسط الرازق وإنى لأرجو أن ألقى ربي وليس أحد يطالبني بمظلمة في دم ولا مال

Which means: "Verily, Allah S.W.T. determines the climate of economic affluence and gloom. I do not want to take any action to fix the prices because I do not want, later in the hereafter, any among you to demand for the return of your property and blood from me because of my tyranny (in fixing the prices)." The Prophet s.a.w. described the act of fixing prices as tyranny towards the seller if price fluctuations in the market were due to normal market forces. An increase in price due to increasing demand should be seen as an opportunity for the seller to make more profit from the prevalent market climate. Fixing the price would mean forcing the seller to sell at the fixed price and stopping him from enjoying the bounties provided by Allah S.W.T. Thus, it will not be against Syara' if market players take advantage of the rise and fall in prices following the forces of supply and demand of the goods offered.

(c) Difference Between Speculation and Gambling.

At a glance, speculation and gambling appear to be similar in practice. As such, we do hear, for example, the exhortation not to treat the share market as a casino. This perception arises because speculators enter the market depending solely on luck, similar to gambling.

The share market is not a place for gambling. The share market is a place which allows shareholders to dispose ownership of shares to other investors in order to gain liquidity.

Whether it is gambling or not depends on the conduct of the investors who enter and leave the market, as well as their motives. There are those who are well-informed when they enter the market. This is good because they enter with careful consideration. There are, however, those who enter the market depending solely on luck. This not only exposes them to risk, but is also not in line with what is required in Islam.
(www.sc.gov.my)

6. CONCLUSION AND RECOMMENDATION

There has been a growing desire to have funds in which profits are not based on *riba*, or interest, which is rejected in Islam. Nevertheless, there are few ambiguities among investors and scholars that need to be further clarified. Thus, 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 reveals that trading is not only permitted but also entitled as Ibadah but with the condition that it is free from all forms of Riba, Al-Maysir, Al-Gharar, price controlling, Al-Ihtikar, misinformation and coercion.

The ethical behavior in Islamic market is assured with the quality of amanah, truthfulness, cooperation, and discarding jealousy and cheating. (Osmani & Abdullah, 2009). In Malaysia the authorities must strengthen the shariah framework as it works as a fundamental for Islamic Capital Market development. In view of Islamic investors' perception, that investors want to get separate Islamic stock market not to transfer existing stock market. Islamic securities can be the opportunities to issue, purchase and for trading benefit to the economy. (Mondal et al., 2013)

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