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The Uniqueness of The Sukuk Financial Instrument. Theoretical Analysis of The Similarities and Differences Between Sukuk and Shares

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Abstract: Sukuk financing plays an important role in modern Islamic finance. It is fundamentally different from classic bonds and is designed to play into the changes in Sharia. The uniqueness of sukuk is that it is based on real assets or a basis for them and provides investors with a profit-free income. This aspect makes it partly similar to stocks, since stocks also allow the investor to receive a share of the property and profit. At the same time, sukuk holders share not only the income, but also the risk, ensuring a fair balance in basic finance. In theory, sukuk and shares have similar aspects. For example, both are traded on the capital market, provide ownership rights, and provide for the sharing of profits and losses. However, there are significant differences between them. While sukuk is fixed-term and backed by a real asset, shares are perpetual and dependent on the overall performance of the company. Also, sukuk income is based on rental or partnership profits, while shares are based on dividends and company value growth. The most important difference is the Sharia requirement: sukuk must be Sharia-compliant, while shares are not. Thus, sukuk and stocks complement each other as financial instruments. While sukuk provides a safe and stable option for those seeking Sharia-compliant investments, stocks carry more risk but offer greater potential for returns. This analysis compares sukuk and stocks to reveal their theoretical underpinnings and provides important scientific and practical insights for financial market participants.

Keywords: - Islamic finance, Islamic bank, sukuk, musharakah, mudarabah, bonds, Islamic financial services, trust investment certificates, derivatives, securitization.

Introduction: Sukuk is defined in many international industry institutions and the legislation of various countries as “Islamic term papers” “Securities based on Sharia”. When translated literally, this term means “Halal efficiency paper”. It is considered a tool permitted by Islamic law. Although the sources indicate differences between sukuk and ordinary bonds for some reasons, effective analysis shows that there are scientific research differences between them. Some experts consider sukuk to be equivalent to shares, while others consider sukuk to represent the right to own real assets and, since a fixed income is not guaranteed, it is close to shares. However, a number of researchers argue that the term “Islamic bonds” does not fully reflect the legal and economic activity of the institution. Different views are still active on whether it is classified as a debt-based instrument or as an investment instrument [1, 131-p.].

The term sukuk is widely defined in official documents and regulatory sources adopted by leading international financial institutions, in particular, AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions), IIFM (International Islamic Financial Market), and IFSB (Islamic Financial Services Board) [2, 3-p.].

These are financial instruments with the same nominal value, which represent an undivided ownership interest in tangible assets, rights of use (i.e. usufruct), services, as well as assets related to specific projects or specific investment activities. However, this situation only becomes effective once the sukuk is fully funded, i.e. the subscription process is completed and the funds raised are spent strictly in accordance with the purposes of the sukuk issuance [3, p-51.].

According to this description, sukuk are financial instruments with an investment content. That is, sukuk is not a simple debt obligation, but a method of raising capital based on underlying assets. In this process, the sukuk holder - that is, the investor - acquires the status of a participant in the underlying property, not as a simple lender. Based on these characteristics, AAOIFI calls sukuk not a simple debt instrument, but as a security with an investment nature - that is, investment sukuk.

According to the above explanation, ownership rights under investment sukuk arise only after the following conditions are met:

- the full amount of the sukuk has been paid;
- the subscription process (i.e. registration of investors) has been completed;
- the proceeds have been used in accordance with the purposes of the sukuk issuance [4, p-13].

On this basis, investors cannot acquire ownership rights through sukuk if at least one of the three conditions listed above is not met. It can also be concluded from the definition that, according to AAOIFI standards, any investment sukuk must be issued based on a specific tangible asset or project [5, p-303-323.].

The International Islamic Financial Markets (IIFM) also defined sukuk, stating:

"Sukuk is a commercial paper that provides the investor with ownership rights to the underlying asset."

This interpretation suggests that IIFM, like AAOIFI, interprets sukuk not as a traditional debt obligation, but as a financial instrument that is backed by underlying assets and reflects ownership. Therefore, through this property-based approach, investors have the opportunity to generate stable and Sharia-compliant returns.

Another important aspect of the IIFM definition is that sukuk, unlike conventional bonds, are issued within the following requirements:

On the basis of ownership of the tangible asset;

On the basis of a master lease agreement - in this case, sukuk holders receive a share of the income from leasing the asset.

In conclusion, similar to the criteria set by AAOIFI, IIFM also considers sukuk as a financial instrument that is fundamentally different from ordinary interest-bearing debt instruments. That is, sukuk are not structured solely on the basis of debt or interest, but must be directly linked to real economic activity. It is precisely because of these characteristics that they fully comply with the principles of Islamic finance.

Another organization that has provided an official definition of Sukuk is the IFSB (Islamic Financial Services Board). According to its definition:

Sukuk (plural sukk), often referred to as "Islamic bonds", are certificates representing an undivided interest in tangible assets, a pool of assets consisting primarily of tangible assets, or a commercial activity (such as mudaraba). These assets may be related to a specific project or investment activity in accordance with the rules and principles of Sharia [6, p-51.].

If we consider the definitions of sukuk given by AAOIFI, IIFM and IFSB in a general approach, their positions are almost identical. The following main common features are observed in these approaches:

The direction of use of financial resources is clearly defined in advance.

The funds raised through the issuance of sukuk should be directed only as investments in specified and defined projects or assets, and should not be used for general or vague purposes. This means that each sukuk issue must have a clear and existing tangible basis.

Profitability is based only on real assets.

Since sukuk are backed by tangible assets, the income from them should also be generated as a result of activities related to those assets. This means that the income paid to investors through them comes from economic activities that do not contradict the norms of Sharia.

Ownership is limited in terms of time and amount.

Sukuk documents give owners a certain proportional ownership right to the invested assets. This ownership right belongs to the investors for the duration of the sukuk. At the end of the term, this ownership right reverts to the original owner, i.e. the sukuk issuer. Thus, investors participate on a limited and temporary basis for the entire period.

Sukuk and stocks.

A stock is a security that represents ownership of a portion of the issuing corporation. The units of a stock are called shares, and their owners have a claim on the corporation's assets and profits in proportion to their share.

Stocks are bought and sold primarily on stock exchanges and are the backbone of many individual investors' investment portfolios. Stock trading must comply with laws and regulations designed by the government to protect investors from fraudulent practices. Corporations raise money to run their businesses by issuing shares. The person who owns the shares, known as a shareholder, may have a claim to a portion of the company's assets and earnings. A shareholder is considered an owner of the issuing company, depending on how many shares the investor owns and the total number of shares outstanding in the company. For example, if a company has 1,000 shares and an individual owns 100 shares, that individual owns 10 percent of the company's assets and earnings and has a claim to that portion. Shareholders do not own the entire corporation, but corporations are a special type of organization because the law treats them as legal entities. Corporations can pay taxes, borrow money, own property, and be sued. The idea that a corporation is a "person" means that the company owns its own assets. For example, the desks and chairs in a corporation's office belong to the corporation, not the shareholders [7, p-107.].

Shareholders own the shares issued by the corporation, and the corporation owns the assets of the firm. If you own 33% of the company's stock, that doesn't mean you own a third of the company. However, you do own a third of the company's stock. This is called "separation of ownership and control."

Owning a share gives you the following rights:

To vote at a shareholders' meeting;

To receive dividends, if any;

The right to sell your shares to another person.

If you own a majority of the shares, your voting power increases and you gain indirect control over the direction of the corporation, for example by appointing the board of directors[11]. This is especially evident when one company acquires another. The acquiring company buys all of the outstanding shares of the other corporation. The board of directors is responsible for increasing the value of the corporation, and often does this by hiring professional managers in executive positions, such as a chief executive officer (CEO). Ordinary shareholders do not participate in the management of the company.

The importance of being a shareholder is that you have a claim to a portion of the company's profits, which is the basis of the value of the share. The more shares you own, the more of the company's profits you receive. However, many stocks do not pay dividends, but rather reinvest profits into the company's development. These reinvested profits are also reflected in the value of the share.

Source of income

The return on a share depends on the company's overall condition, the success of its projects, and the value of its assets, and the dividends are paid from the company's profits. The share price may increase depending on the company's condition, the value of its assets, and the success of its projects, and shareholders may receive additional income from this. However, if the opposite is true, shareholders may also suffer losses.

In general, in sukuk, the income of sukuk holders, like shareholders, is measured by the value of the asset and the amount of income it generates. Therefore, in both equity securities and sukuk, income depends on the following 2 factors:

- Asset value;

- Project effectiveness.

It is clear that in both, the income is tied to the asset. However, there are some differences in the source of income, depending on the degree of dependence, the nature of the sukuk and the share, and the requirements imposed by Sharia. According to Mohd Dawud Bakar, one of the experts in Islamic finance, the main difference between sukuk and shares is the nature of the sources of income, noting that since sukuk is based on real economic activity, it increases economic stability, while shares are highly dependent on market conditions and involve significant speculative risks[12].

Risk.

Shares are significantly more risky than sukuk. This is explained by the large number and complexity of factors affecting shares compared to sukuk. One of them is that if a company experiences negative developments, its profits decrease or it suffers losses, this directly affects the value of the share. In addition, shares are strongly tied to the level of supply and demand in the market, and strong fluctuations in stock markets and economic crises also negatively affect the value of the share. At the same time, the political stability of countries, the reputation of companies, rising interest rates, and inflation also affect the value of the share. In such cases, the share price decreases, and shareholders suffer losses.

An example of this is British Petroleum. In February 2020, British Petroleum's share price was around $37, and by March 2020, after the start of the coronavirus pandemic, the share price had fallen to $15, a decline of about 59%.

Unlike stocks, sukuk has a relatively lower level of risk. This is because sukuk does not have as many types of risks that affect the value of the asset as stocks. Sukuk is based on a real asset, has a clear source of income, and speculative risks in sukuk relations may or may not be very low. Therefore, in sukuk markets, the value of the asset maintains the value of the sukuk. For example, if a leisure center containing various entertainment venues, shops and restaurants is built and rented out under a rental sukuk, the investor receives his benefit from the rental income. Compared to stocks, such income is observed to be more stable.

In addition, in joint-stock companies, frequent changes in management personnel and, as a result, frequent changes in strategies, unsuccessful projects or unexpected expenses reduce the value of shares. Also, the influence of shareholders on the company's activities can lead to the fact that effective and clear decisions in management are not made or take longer. This increases the level of operational risk. In sukuk, sukuk holders (investors) cannot interfere in management processes. This prevents the increase in operational risks, like in stocks.

Speculative risks in stocks are also very high. Usually, investors who trade these stocks buy large amounts of shares of a particular company in order to make a large profit in the short term and resell them at a time and price that suits them. This affects the balance of supply and demand, causing changes in the price of the stock over a period of time. Such sharp drops and rises in the price of the stock can affect the emotions and future expectations and predictions of many buyers, negatively affecting the market price of the stock.

For example, in January 2021, there was a sharp increase in activity around GameStop shares. The stock price was very low, and investors engaged in short sales decided to buy these shares. About 140% of GameStop shares were shorted, which means that more short sales were made than there were shares available in the market. A group of users on the social network Reddit noticed this and began buying shares. This, in turn, led to a sharp increase in the price of GameStop shares. Hedge funds and short sellers suffered huge losses. Some hedge funds lost billions of dollars as the price of GameStop shares increased. As a result, Reddit users and small investors were able to profit, but many people who bought the shares at a high price suffered losses when the price fell [13].

Compliance with Sharia

If we look at the activities of stocks, we see that they are governed by laws regulating the activities of securities and joint-stock companies. Usually, such regulatory laws are adopted based on the management activities of states, economic relations and local views, and religious factors are not taken into account. This leads to the absence of norms that provide for religious restrictions in the activities of stocks [8, p-63.]. For this reason, it is difficult to say that stocks are in accordance with Islamic Sharia. One of the reasons is that the activities of joint-stock companies include the production and sale of alcoholic beverages, gambling (maysir), interest-based financial services (riba), and obtaining interest-based loans from banks. According to Islamic finance, it is forbidden to engage in activities prohibited by Sharia. Gambling, intoxicating products, usury (riba), and pornographic products are among the prohibited activities. Therefore, when analyzing stocks, it is necessary to first determine the company's sources of income and areas of activity. If a company does not engage in activities prohibited by Sharia, it can be considered a Sharia-compliant company. According to Islamic finance expert Taqi Usmani, in order to invest in Sharia-compliant stocks, it is necessary to make sure that the company's income and activities are halal. If a large part of the company's income comes from haram sources, investing in these stocks is prohibited.

Sukuk is different from shares in that it must operate only within the limits of the norms set by Sharia and cannot engage in prohibited activities. It is true that there are various opposing views among Islamic finance experts regarding the purchase of sukuk in secondary markets. However, this does not directly contradict the fundamental principles of Islamic finance.

It is clear from this that some shares comply with Sharia standards. Some do not comply with Sharia standards.

Form and duration of ownership of property.

Shareholders usually own a share of the company and do not own the income from a specific project or asset managed by the company. This is because the company is a legal entity and can enter into contracts, assume and incur liabilities, and own assets in its own name. Shareholders do not directly own the property owned by the company, but are provided with shares in the company's capital. Since shareholders own shares in the company, they can receive dividends from the company's profits, vote at general meetings of the company, and receive a share of the assets if the company is liquidated (if there are funds left after debts are paid). Shareholders can only share in the company's income, but this income may not be directly related to a single project or asset. Usually, shareholders' income in the form of dividends depends on the company's overall financial results. So it is clear from this that even if a company has many assets, shareholders receive dividends from the income generated by the total assets, not from the income generated by any one specific asset [9, p-4.].

In this regard, there are significant differences between sukuk and shares. Sukuk holders own a specific real asset or project. Therefore, sukuk holders benefit from the income generated by the specific asset. This prevents various uncertainties (gharar) and speculation. Sukuk holders, although they have the right to own the asset, cannot participate in the management of the asset. The management of the asset or project is managed by the sukuk management organization or another similar management body. Sukuk holders only have the right to benefit from the income generated by the asset and project and cannot participate in management activities.

Regarding the tenure, shares are perpetual, and as long as the shares are owned by the shareholder, he has the right to receive dividends from them. Sukuk is usually issued for a specific period, and its term depends on the issuing organization and the investment project. Usually, these terms can be 5-7-10 years, depending on the size of the project, and investors get their investment back after the term expires.

Liquidity

Shares represent ownership rights to corporate property and are more liquid than sukuk. The liquidity of shares compared to sukuk is primarily explained by the wide availability of shares in secondary markets. Shares are widely traded on stock exchanges, and since there is a high demand for shares of large companies and large opportunities are created on stock exchanges, they are easily sold and bought. In addition, the price of shares is dynamic and quickly adjusts to both supply and demand. This, of course, increases the possibility of converting shares into cash. Also, since shares are perpetual, there is an opportunity to sell and buy shares at any time. At the same time, since shareholders receive income in the form of dividends, it increases the number of buyers of shares. This makes shares more liquid [10, p-8.].

Sukuk have lower liquidity than shares, which is one of the factors that makes trading sukuk in secondary markets difficult. In particular, scholars emphasize that only asset-based or project-based types of sukuk are permissible to trade in the secondary market, which implies the transfer of ownership from one party to another. However, scholars prohibit trading debt-based sukuk in secondary markets. They argue that the reason is that since they are based on debt relations, they become similar to riba. Also, since sukuk activities must comply with Sharia requirements, sukuk does not have a wide scope of activities like shares. Sukuk can only operate within the areas permitted by Sharia. This gives shares more liquidity than sukuk. At the same time, regulatory mechanisms for sukuk, like shares, have not been developed in the legislation of many countries. This may limit the activities of sukuk to some extent.

Conclusion

Sukuk is a unique category of financial instruments, as their structural basis is based on traditional instruments of the Islamic financial system. These instruments, in turn, are formed on the basis of various types of assets, including: tangible assets, usufruct rights, debt obligations, cash, services, economic rights, or a combination of the above. Although sukuk may resemble traditional bonds in some external features, they are technically neither debt nor equity. Therefore, it is difficult to clearly define the legal nature of sukuk and their differences from bonds.

Unlike traditional bonds, sukuk are not technically classified as debt instruments, although they are treated as such in some jurisdictions for regulatory purposes. In particular, sukuk instruments do not generate income through interest payments (riba). However, the rental or commercial profit paid to the sukuk investor is often equivalent to the interest rate that would be paid by the issuer if the sukuk were issued in exchange for the bond.

However, none of the above-mentioned instruments should be considered as direct substitutes for interest. It is a mistake to compare them completely or use them in the same way as interest-based financial instruments. The main distinguishing feature of sukuk instruments is that they may not contain elements of riba. In addition, they differ significantly in the structure of the agreement, the legal and economic nature of the investment nature, and the method of generating income.

Sukuk are subject to specific conditions, principles and philosophical foundations for their use as a Sharia-compliant financing instrument. If these criteria are not strictly adhered to, their use as a financial instrument is considered unacceptable from a Sharia perspective. Therefore, insufficient understanding or misinterpretation of the legal and economic nature of sukuk instruments can lead to confusion between the Islamic financial system and the conventional financial system operating on the basis of interest.

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