What Factors are Affecting the Underdevelopment of the Debt Capital Market in the GCC Region

AL-TAWARI, ISSAM,ZAID

“***What Factors are Affecting the Underdevelopment of the Debt Capital Market in the GCC Region***”

By

Issam Zaid Al-Tawari

Supervised by

Professor **Pólos Laszlo**

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Abstract

For decades, the GCC countries have been dependent on an oil rentier economic model that supported its growth plans. Moreover, the region has enjoyed budget surpluses during that time and considered a net exporter of capital with its petrodollars. However, as the importance of oil as a source of energy diminishes, so does its value. After oil prices dropped over 75% within 20 months in 2014, the GCC countries faced substantial deficits. Consequently, the majority of GCC regions had to learn how to import capital and tap into the debt capital markets both conventional and Islamic. The present research has focused on academic and practical issues relating to the underdevelopment of the GCC debt capital market to establish itself as a viable source of funding both for sovereign and corporates borrowers. The study has adopted action research design to locate a model through which GCC can develop their debt capital market by examining market ecology, the process of persuasion and legitimation exploring organisational ecology and Institutional theory for sharper understanding of the motives. The impact and benefit on various debt capital market stakeholders in the GCC region as regulators, banks, investment companies, rating agencies, investors and the public are also investigated. Finally, a change plan, methodology and approach are recommended for development of the GCC debt capital market.

Keywords: *Debt Capital Market, GCC, Case Studies, Change Plan for GCC.*

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List of Abbreviations

AAOIFI	Accounting and Auditing Organisation for Islamic Financial Institutions
ABS	Asset Backed Securities
BNM	Bank Negara Malaysia
BIDS	Bond Information and Dissemination
BIX	Malaysia Bond + *Sukuk* Information Exchange Malaysia
CBB	Central Bank of Bahrain
CBO	Central Bank of Oman
CDO	Collateralised Debt Obligations
CMA	Capital Markets Authority
CCPs	Central Counterparties
CMBS	Commercial Mortgage Backed Securities
CLT	Cognitive Learning Theory
DCM	Debt Capital Market
DIFC	Dubai International Financial Centre
DSM	Doha Securities Market
FAST	Fully Automated System for Tendering
GBSA	Gulf Bonds & *Sukuk* Association
GCC	Gulf Cooperation Council
IBS	Institute of Brewing Studies
ICs	Investment Companies
IFC	International Finance Corporation
IFSB	Islamic Financial Services Board
IOSCO	International Organisation of Securities Commission
ISCAP	Institutional Securities Custodian Program
KFH	Kuwait Finance House
MBS	Mortgage Backed Securities
MOCI	Ministry of Commerce and Industry
NBK	National Bank of Kuwait
NBMC	National Bond Market Committee
OE	Organisational Ecology Theory
OTC	Over-the-counter
QCB	Qatar Central Bank
QFC	Qatar Financial Centre
RENTAS	Real-Time Gross Settlement System
RMBS	Residential Mortgage Backed Securities
SAMA	Saudi Arabian Monetary Agency
SDR	Special Drawing Right
SSB	Sharia Supervisory Board
SRI	Socially Responsible Financing and Investment
SSS	Securities Settlement System
SPV	Special Purpose Vehicle
YA	Year of Assessment

Declaration

This thesis results entirely from my own work and has not been previously offered in candidature for any other degree or diploma.

Statement of Copyright

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رُبّ قومٍ قد غدوا في نعمة زمناً .. والعيش ريّان غَدق ..

سكت الدّهر زمان عنهم .. ثمّ أبكاهم دماً حين نطَق..

يحيى بن خالد البرمكي (توفى 805م)

"Some live in high grace with bounties abound and blessings aplenty… silent was Time for a moment of eternity… yet when it uttered, they cried blood."

Yahya ibn Khalid (died 805 CE)

"It does not matter how slowly you go

as long as you do not stop"

Confucius (died 479 BCE)

Chapter 1

This chapter describes the methodology used in the current research and addresses the following points: the research design adopted, research approaches utilised, methods of data collection and analysis used. To achieve the aims and objectives of the research, the choices were determined considering the research problem. The chapter concludes by explaining the research criteria, followed by a summary of the main decisions made, (as discussed throughout the chapter), and summary of the chapters to follow.

1.1. Background

"Debt Capital Market" (DCM) is defined as the market where countries and corporates raise medium and long-term funding through the issuance of security paper in the form of conventional or Islamic bonds "*sukuk*s". Investors buy these securities in primary markets at issuance or trade them in the secondary market afterwards. The DCM can play an important role in managing the fiscal policies at a national level.

DCM can channel the surplus liquidity in Gulf Cooperation Council (GCC) towards the creation of infrastructure projects across the region. The core research objective of the thesis is to identify the most effective means to promote DCM as a source of financing in GCC. Especially at a time when the GCC must capitalise on the emerging role and opportunities of DCM origination.

The GCC provides an attractive niche market for risk-return investment opportunities and long-term tradable financing instruments. At present, there is considerable potential for DCM growth and for maximum benefit, certain measures must be taken by regulatory bodies to facilitate fixed income. The GCC nascent debt market would benefit from DCM issuances, as these are the most suitable instruments to fill the gap in long-term financing.

1.2. Research Objectives

The main objective of the research is to use current trends in the DCM issuances in the GCC by investigating the potential of their success. The research aims to question the suitability of DCM as a long-term funding source that could be capable of financing mega-projects such as hospitals, schools, roads, railways, commercial cities and other public and infrastructure facilities in the GCC.

There is a need for long-term financing instruments such as bonds and *sukuk*s in GCC, especially high in regions (e.g. Saudi Arabia, UAE and Qatar) that have been evolved in the same very rapidly. Particularly after all the GCC countries joined the World Trade Organization (WTO) and liberalised many vital sectors for foreign investments, hence promoting mega-investment opportunities for strategic investors, and improving the sovereign credit environment. Hence, the study will aim to address the following research questions and objectives:

a) What is the capital market ecosystem in GCC region?
b) Identify the prospects for Islamic DCM in GCC.
c) Evaluate the development and impact of DCM on other markets.
d) Understand the key challenges/issues facing this area of Islamic finance.
e) How are these challenges being addressed?
f) Identify the stakeholders, their roles and importance.
g) Develop the strategies and tactics required for change.
h) Monitoring the development in Islamic debt market and future forecasting over the next 3-5 years.

The GCC market provides an attractive niche market for risk-return investment opportunities and long-term tradable financing instruments. There is considerable potential for DCM growth in GCC, and for investors to gain maximum benefit, certain measures must be taken by regulatory bodies to facilitate fixed income origination. The nascent debt market is primed for DCM issuances in the GCC as these are the most efficient instruments to supply the gap in long-term financing and asset securitisation instruments.

DCM would channel the surplus liquidity towards the creation of infrastructure projects across the regions of GCC. The core research objective of the present thesis is to identify the most effective means to promote DCM as a source of financing in GCC, especially at a time when the GCC must capitalise on the potential opportunities through DCM origination.

1.3. Research Rationale

This thesis aims to question whether DCM could leverage the current economic growth in the GCC. The economies of the Gulf region are showing unprecedented growth and DCM could become one of the growth drivers for development in GCC. The features of DCM as long-term securitised liquid financing instruments have tremendous potential of public acceptance and investment. This argument suggests that DCM will be the major factor for their growth. Moreover, the study will show that development of DCM will be able to fund the current GCC infrastructure boom as oil prices have started on a downward cycle. An additional aim of the research is to identify the means to promote a more profound understanding, importance and awareness of DCM and the increasing demand of issuances. Thus, the research will identify the competitive advantage of DCM in the GCC. To meet the research aims, case studies of South Africa, Malaysia and Indonesia are analysed. All three of these countries fall into the emerging markets bracket and these countries have developed their DCM and leveraged investment opportunities for their respective economies. Both Indonesia and Malaysia provide DCM development with the backdrop of Islamic financial markets and law. With this context, the case studies provide a great opportunity to benchmark the GCC as an emerging market looking to enhance its implementation of DCM. These case studies provide extensive lessons learned and will help answer the key questions in this thesis. The case study analysis has provided in-depth examination of data and the decisions taken for GCC development in DCMs accordingly.

1.3.1. Proposed Research Questions

The discussed phenomenon indicates that DCM is critical for growth in the GCC, but this raises the question; what changes are required in the regulations to drive DCM growth in the GCC region and why has this not happened already?

Therefore, proposed research questions are:

- How did underdevelopment of clear framework and regulations impact DCM in the GCC after the oil price drop of 2014?
- What are the similarities and differences experienced by recent emerging markets in the development of the DCM compared with the GCC?

The practical nature of the issues facing development of DCM remain under researched and academically this remains a gap. The relevance of such a study can be framed by asking the following key questions:

a) What are the recent and future trends from DCM issuances in the GCC?

b) In what ways would the establishment of a clear and viable local unified regulatory, accounting and auditing framework infrastructure enhance DCM issuance in the GCC?

c) What are the barriers to DCM origination in GCC?

d) What are the barriers for an active secondary market in the GCC?

e) What are the reasons for the banking system dominance of financing over financial instruments such as DCM?

1.3.2. Overview of the Research

Islam through its economic philosophy has defined a complete system that prescribes specific patterns of economic behaviour for all individuals and societies along with Islamic way of life. The concept of Islamic finance is only a part of the key elements of the Islamic economic philosophy and these elements helps the reader to develop a general framework of Muslim economic thinking and demonstrate the rationale and the principle of Islamic finance.

Islamic finance is one of the fastest growing sectors in the global financial scene. It is growing at an annual rate of 15% with an estimated market size over US$1 trillion in terms of funds under management operating in over 100 countries worldwide. Islamic finance is an emerging field that is gaining acceptance in native markets as an equitable form of finance as well as abroad where it is increasingly seen as a viable means of creating value in the market as a form of ethical banking.

Several factors have increased the interest among retail investors that parallels general societal trends towards observance of Islamic precepts. The overall increase in the relevance of Islamic finance in the economies of Muslim countries have resulted in greater cooperation and collaboration between practitioners of Islamic finance on the one hand and both conventional western financial institutions and *sharia* scholars on the other. This has developed the market further. Growth and competitiveness within the sector may be limited unless uniform accounting/governance standards are introduced. This will result in development of a better understanding of the Islamic products and markets by regulating authorities and *sharia* scholars along with increase in availability of skilled and experienced personnel.

This sector is relatively young as it marked its presence in 1975 with the basic retail banking services. By the new millennium, the Islamic finance market evolved to a new level internationally with the growth in Islamic bonds– '*sukuk*' which introduced the Islamic DCM.

Under *sharia*, borrowers tend to issue *sukuk* (Islamic Bonds) which is a form of securitisation but is structured as an asset backed with recourses to the originator and is similar to US trust certificates (Box, 2007). Islamic securitisation is a pass-through asset-based structure where investors will be looking at the risk of the underlying assets. However, it was noticed that few researchers used the term securitisation on *sukuk* but refer to it as merely a collateralised borrowing. Under Islamic finance, ethical requirements dominate capital markets efficiency.

While all financial markets require legal guidelines; *sharia* compliance requires that financial activities must also follow moral principles (McMillen, 2008).

For commencing businesses in the GCC, creating goods and services requires *sharia*-compliant financing instruments such as *sukuk* to generate profit which will be distributed between the financier and the entrepreneur according to a pre-agreed contract. Such a contract should take into consideration clear rights of both parties, so that one does not exploit the other. In addition, Islamic financial tools should be as competitive as their conventional counterparts, for example securitised liquid financing instruments.

A major obstacle for Islamic capital market growth in GCC is the non-availability of long-term financing investment tools, specifically for private and public sector expansion. Due to this, Islamic financing instruments like *sukuk* would be the best means for increasing the efficiency and effectiveness of financing for GCC sovereign issuers and would serve to meet the funding gap.

To illustrate, Saudi Arabia, in an effort to develop its own DCM, has been instrumental in actively implementing regulations for debt issuances. In 2006 the Capital Markets Authority (CMA) of Saudi Arabia had introduced the capital market law to assist the further development of the domestic bond market and listing of local *sukuk*. However, the establishment of the *sukuk* market-trading platform on the *Tadawul* (the Saudi stock exchange), despite the coinciding surge in issuances, resulted in the total value of bond traded annually remaining very limited and no trading was reported for weeks. We looked at a set of incomplete trading data that showed only 205 total trades of *sukuk* over a period of 12 months up to February 2020 as compared with 85 trades 12 years ago for a comparable period.

1.3.3. Significance of the Research

The thesis research area is about "What Factors Affect the Underdevelopment of the DCM in the GCC region?" and attempts to understand the evolution of the market, its major players and the extent it gained market acceptance and "Legitimation" in the GCC. The rationale of this research is to add value and highlight the critical need for an efficient origination in the GCC of both Islamic and conventional financing. Hence, developing long-term fixed income instruments along with feasible economic features, such as securitisation and *sukuk*, will be key tools in economic growth. With innovative structuring, competitive rules and regulations, and the appropriate technical infrastructure, DCM could be a major driving force in the economic progress and development of the GCC.

Moreover, the DCM in the GCC lack the required depth and liquidity due to the limited range of financial instruments presently available, compared to the equity and the real estate markets. As such, a comparatively sizable exposure to the equity and real estate markets particularly in the GCC markets caused serious damage during the financial crisis of 2008 (Marmore, 2019).

Currently the most widely used collateral demanded by GCC based financial institutions are real estate and equity portfolios (CBK, 2008). Fixed income instruments as an asset class would add value as an alternative collateral and allow diversification by reducing the vulnerability of GCC based financial institutions to shocks in equity and real estate market exposure. DCM efficiency and effectiveness in monetizing and utilising both tangible and intangible assets, converted into tradable instruments, would generate an attractive risk/return balance for productive projects. This would minimise sovereign and corporate credit risk exposure. Consequently, one of the main objectives of the research is to demonstrate the efficacy of DCM origination and market development in GCC by exploring the prospects for their success (Hassan and Mahlknecht, 2011). The GCC DCM is gaining a considerable amount of attention in the international capital market, for several reasons including:

i) DCM can offer long-term financing solutions with favourable terms.
ii) DCM can include securitised financing instruments with tangible and intangible assets.
iii) DCM issues are relatively liquid tradable instruments.
iv) *Sharia*-compliant financing instruments are generally preferred over conventional bonds by local investors.
v) DCM can offer an alternative mode of financing and asset class from traditional bank financing and equity market tools.
vi) The global appeal and acceptance of DCM is drawing international financial institutions to broaden the market depth.
vii) GCC sovereign and corporate entities are looking to diversify their financing options to minimise risk and satisfy their funding needs.

1.4. Theoretical and Empirical Importance of the Study

The theoretical importance of the research is highlighted by the context of the GCC, the reliance on oil revenues has meant that financial, political and social stability was linked directly to the fluctuating oil prices. As such alternative means of funding to overcome the budget deficit was sought as oil prices continued a downward cycle. This research looks at how this funding stability (gap) in theory could be filled with DCM, and how it could circumvent the potential issues within the region. The study empirical qualifies the theoretical views presented by firstly defining the actual reliance on oil revenues by collecting data from each of the GCC countries. This is then contextualised by understanding how and why each of the GCC countries governance hinders or drives the development of DCM. Specifically, it focuses on bond issuance and *sukuk.* The study then gathers data from key opinion leaders within the field as well as extracting the historical means by which three countries are on track for thriving DCMs. The far-reaching importance of this study is that this empirical research provides lessons learned and creates a framework for future use– it answers the question; what factors are affecting the underdevelopment of the DCM in the GCC region? By doing so, it provides the first study of its kind to provide guidance to the region for implementing DCMs effectively.

1.5. Research Content and Structure

The thesis is divided into eight chapters. The structure has derived and evolved from the research strategy adopted. The research content and composition of the thesis are as follows:

Chapter 1 introduces the research in general context. The first section of the chapter provides an overview of the research, describing the features of DCM issuances and their potential in GCC, and clearly defines the aims and objectives of the research. The chapter then introduces the basic questions, followed by a section highlighting the research rationale and motivation for conducting the research. The final section of the chapter is to establish the research methodology and methods.

Chapter 2 provides a literature review, based on books, journals, practitioner's articles or working papers. The review tackles both the DCM studies and markets as well as the theoretical framing approach from organisational ecology and institutional theories. By taking the status of the GCC debt securities, issuances, markets as a whole and formulating the use of Organisational Ecology (OE) it touches upon the use of change content and process.

Chapter 3 is a literature review of the Debt Capital Markets. It puts into context Islamic finance and instruments with an overview of *sukuk.* It also takes a look at bonds (securities as financing instruments) and asset securitisation.

Chapter 4 highlights the interplay of the dynamic economic, financial and political systems of the GCC. It provides an overview of the region, the GCC structure, economic reforms, GCC DCM and public markets and finally delves into trends as well as the problems faced by the GCC region.

Chapter 5 provides the research methodology used in this thesis. It establishes the connectivity between the research questions, objectives, and methods by means of data collection analysis and interpretation. The research has utilised qualitative research methods and empirical work for the purposes of exploring and evaluating the prospects for corporate DCM in GCC. It starts with the research philosophy, methodology, strategy and use of country case studies. The format and process of carrying out semi-structured interviews is defined, as well as the formation of key questions.

Chapter 6 analyses the case studies by first providing context of Kuwait as a GCC within which correct implementation of DCM and *sukuk* would be highly beneficial. Following this, this chapter provides an in-depth analysis of Malaysia, Indonesia and South Africa as case studies. It highlights the political will and leadership from the perspective of financial sector development and how legal and regulatory framework shaped the landscape and activities of DCM. The chapter then draws upon the lessons learned from each market and provides context for how this could be implemented in the GCC.

Chapter 7 considers the lessons learned from the three country studies and its applicability on the GCC countries. Considering the political will and agents of change after analysing the DCM eco-system and afterward developing the building blocks for an efficient debt capital system. It also includes interview data which was gathered from three senior executives/pioneer practitioners operating in GCC region in the financial sector to understand the reasons behind the lack of development of the DCM. The semi-structured interviews were used to evaluate the prospects and challenges of DCM in the GCC. It also relates the prediction and recommendation that DCM tradability and efficiency is the preferred long-term financing solutions for both sovereign and corporate issuers in the GCC. It highlights the long-term outlook for the DCM in the GCC and finally, the suggested action steps for improving the DCM development in the GCC are provided.

Chapter 8 provides a conclusion, bringing together all the previous chapters and highlights the findings and the contributions made to literature. It focuses on challenges facing the GCC market, the market predictions and recommendations and last of all, the final thoughts.

Chapter 2: Theoretical Literature Review

2.1. Introduction

This literature review is based on books, journals, practitioner's articles or working papers. The review tackles both the DCM studies and markets as well as the theoretical framing approach from organisational ecology and institutional theories.

2.2. The Status of the GCC Debt Securities

With most of its national income derived from the economic rent of the oil industry, GCC countries are considered as rentier states. Despite the governments intended market driven orientation, the public sector's role as the largest employer and its controlling ownership of major private sector companies' parallel socialist concepts (Ari et al., 2019). Accounting for approximately up to 80% of government revenue, income from the oil and gas sector have enabled the state to subsidize the private sector and fund the provision of goods and services to the public through substantial government expenditures. Arranging the economic flow of government oil revenue to the financing of public goods and services, the GCC budgets became an expenditure program, a promise to spend money and distribute benefits to the population (Mancini,2016).

Over the years, as oil became the dominant source of income, the GCC governments developed social support systems through systematic distributions of oil wealth by subsidising goods and services and extending generous government land and housing programs. However, this created a financial burden on the budgets (Havidt, 2013).

The GCC governments prior attempts to diversify the economy and decrease the state's dependence on oil rents had little success as increasing oil revenues reduced the focus on developing alternate economic sectors and instead promoted excessive spending on infrastructure or oil sector assets. The use of the public budget to finance the proposed development has led to the less than efficient design of large-scale projects and the deployment of public capital to finance infrastructure that does not improve economic diversification. The last decade has witnessed a renewed focus on infrastructure programs and economic development plans in the GCC nations, and a significant portion of the proposed diversification programs sought increased private sector involvement. To break the risky cycle of oil reliance, the GCC government has encouraged the private sector to participate in the development and financing of efficient non-oil sector assets (Mancini, 2016).

Capital expenditures for developmental efforts account for only a small percentage of total government spending, and for example, the 2015 Saudi budget reveals an 18% increase in current expenditures (Mancini, 2016). While other GCC oil producers fear bankruptcy or budget cuts in the wake of declining oil prices, most GCC states remains confident that its fiscal buffer can absorb the shock. However, as evidenced by the governments increasing need to tap the sovereign bond and *sukuk* markets both locally and internationally, confidence may be fading as the GCC countries collective deficit was projected to reach 6.5% of GDP (Table 1).

Table 1: Fiscal Deficit Estimates for GCC Sovereigns

Financing Need for GCC Sovereigns in 2017 – Fiscal Deficit Estimate

Fiscal Deficit, as % of GDP

Country	2013	2014	2015	2016e	2017f
Bahrain	-5.4%	-5.8%	-15.1%	-14.7%	-11.7%
Kuwait	34.3%	28.1%	1.7%	-3.5%	3.2%
Oman	4.7%	-1.1%	-16.5%	-13.5%	-10.3%
Qatar	22.2%	15.0%	5.4%	-7.6%	-10.1%
Saudi Arabia	5.8%	-3.4%	-15.9%	-13.0%	-9.5%
United Arab Emirates	10.4%	5.0%	-2.1%	-3.9%	-1.9%
GCC	11.7%	4.2%	-8.2%	-9.2%	-6.5%
GCC, Surplus/Deficit (USD bn)	**190.0**	**68.6**	**(114.9)**	**(126.1)**	**(97.2)**

Source: IMF

Financing Mix for 2017

Country	2017f Fiscal Deficit, as % of GDP	Absolute Value USD bn	Financing Mix (Expected) Reserves	Financing Mix (Expected) Debt	Reserves Utilization	Debt Issua
Bahrain	-11.7%	(4.0)	0%	100%	0	4.0
Kuwait	3.2%	4.0	0%	0%	0	0
Oman	-10.3%	(6.8)	45%	55%	3.1	3.7
Qatar	-10.1%	(17.3)	0%	100%	0	17.3
Saudi Arabia	-9.5%	(65.3)	20%	80%	13.0	52.3
United Arab Emirates	-1.9%	(7.9)	100%	0%	7.9	0
Overall GCC	**-6.5%**	**(97.2)**			**24.0**	**77.3**

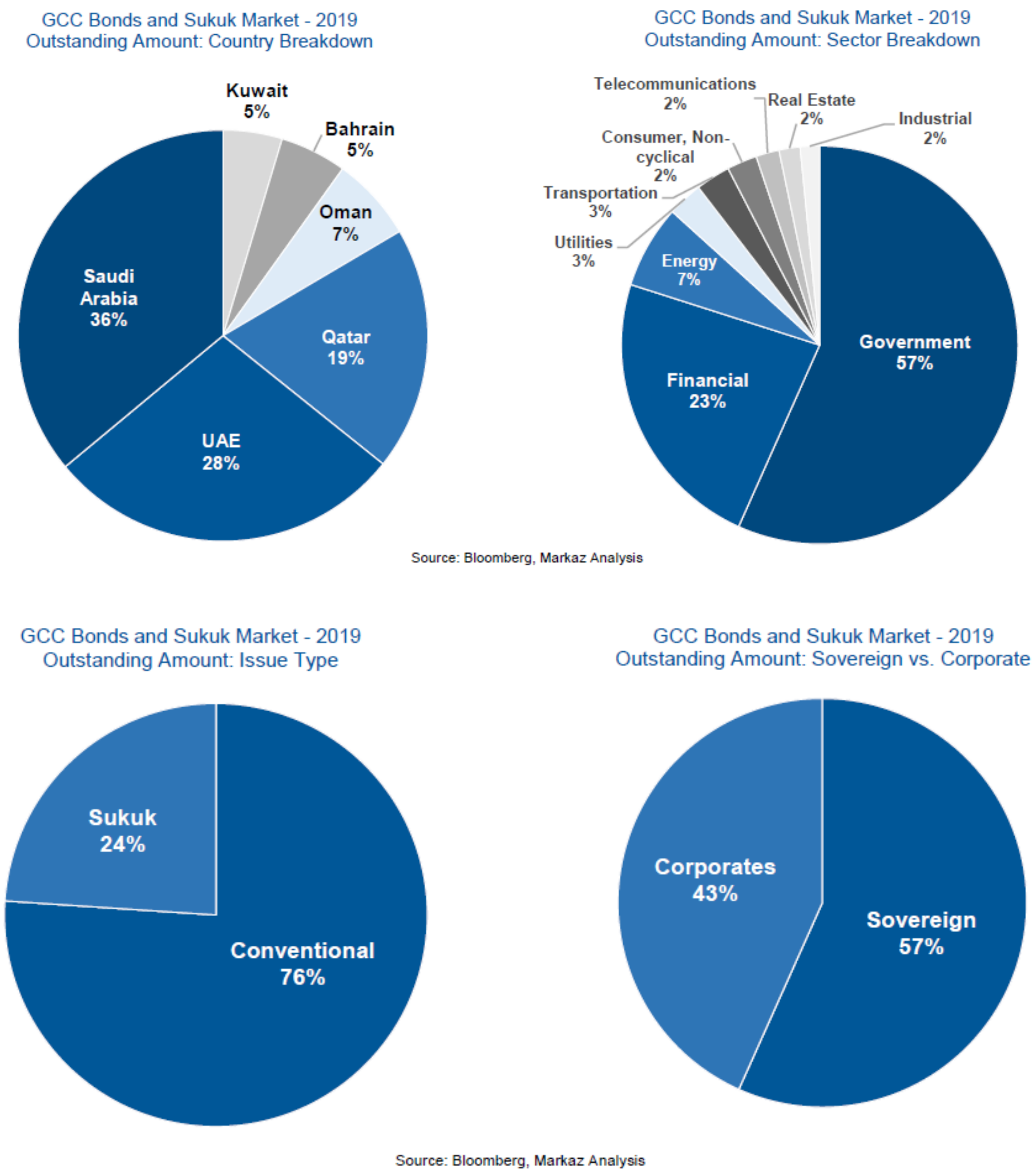
Source: IMF, Marmore Research

The sizeable fiscal buffer may stall an impending crisis and cover financing gaps in the public allocation for current expenditures, but the window of opportunity to develop an efficient DCM is rapidly closing. In addition, at the outset governments issued debt locally which had a “crowding out” effect on the private sector, later increasingly shifted to international issuances (Raghu, 2016b).

2.3. GCC Debt Issuances

Government issuances dominate up to approximately 57 % of all outstanding issuances and the remaining are Government-owned corporate issuances. Aside from infrastructure-related issuances, the primary issuances are in the financial services, real estate sector and utilities categories.

Graph 1: GCC Bonds and *Sukuk* Market Breakdown



To fill the financing gap resulting from the weak market for long term financings, sovereign and corporate issuers may increasingly turn to the DCMs in search of viable financing options. Although the bank financing market has traditionally attracted much more attention from borrowers than has the DCM, the current scarcity and high cost of bank financings will force borrowers to explore the latter options for their financing needs. As an alternative or supplement to raising private capital through the bank financing market, borrowers may instead exploit the bond market and issue of bonds or *sukuk*s through a private placement or public issuance on a stock exchange.

The durability of GCC development remains far too dependent on the health of the public budget with the Ministry of Finance acting as the gatekeeper for all allocations. The central government, the Ministry of Planning, dictates the prioritizing of DCM development, in particular those whose infrastructure priorities may not necessarily align with the needs of other stakeholders (Mancini, 2016).

To overcome the government's lack of sufficient political incentives to promote development of a viable DCM, each of the GCC countries must attempt to align public and private interests. This requires significant legal, regulatory, tax, administrative and financial reforms in GCC jurisdictions, but the requisite for such an undertaking is overwhelming. If structural and market reforms are addressed, surge in debt securities and *sukuk* issuance will grow further and will enable GCC based issuers access to the domestic and international capital market (Sole, 2008).

2.4. Debt Capital Market Studies Literature Review

The DCM studies can be split into pre- and post- financial crisis of 2008. In the former, researchers focused on the viability and importance of DCM and its benefits in increasing the efficiency of the capital market. For the latter, researchers were concerned about the lack of regulatory supervision and the lessons learned from the crisis. Naturally, researchers were trying to identify the similarities and differences between conventional and Islamic asset DCM. An attempt was made to see how emerging markets can learn from developed countries experiences by looking on the foundations of asset DCM markets in the United States, UK and late entrants (such as Spain) as well as developing countries markets such as South Africa, Malaysia and Indonesia.

The (case) studies on DCM were mainly descriptive longitudinal studies from a legal perspective attempting to identify the possible challenges facing acceptance of DCM in the West (Visser, 2008). Finance literature are primarily quantitative, analytical in nature, collect financial data on interest rate sensitivity funding costs and measure corporate capital structure efficiency. When searching online by key word on SSRN network only 7 papers were posted dealing with GCC *sukuk*s. As such, very little research is done on the GCC region primarily looking at the *sukuk* as a product either because of the limited size of the market or lacking access to relevant market data.

In emerging markets such as South Africa, Moyao & Firer, tackled key issues concerning academic research in DCM. They researched the growth of the DCM, mainly due to the need for development of banking products, solving for the mismatch between assets and liabilities of the banks. The challenges they faced were primarily associated with poor liquidity of the market and the senior bankers were not convinced with the benefits of asset-based DCM instruments as well as the lack of commitment by the banks to act as market makers as it would pose an additional cost from capital adequacy perspective. These challenges were further increased due to the lack of confidence with the quality of the local credit rating agencies and its risk assessment ability (Moyo & Firer). Similar outcomes where found in Namibia and Malaysia, although the latter varies due to the issuance of both Islamic and conventional DCM. This makes Malaysia ideal for study due to its relevance to the questions posed by our research (Zakaria & Abdul Ghafar, 2006). Some of the external challenges of any new financial innovation can be summarized as follows:

1. Western regulators lack understanding of Islamic structures and the associated tax implications.
2. Application of *sharia* rules within the framework of secular laws.
3. Restrictive ability of rating agencies in assessing the risks associated with the structures within the Middle Eastern legal infrastructure (McMillan, 2008).

Whilst there is no disagreement with the points made by the researchers, the issues with market recognition, “Legitimation” and “taken for-granted-ness” of the DCM, in the GCC requires taking steps to create a suitable environment.

The GCC region is a fast-growing region with growing needs for financing growth in energy and infrastructure that needs efficient and accessible DCM. Since 2014, the GCC governments were under financial and budgetary strain or received huge social and political pressures to reform. This in effect provides impetus to establish a platform and legal environment to develop the DCM in the GCC region (Havidt, 2013).

2.5. Organisational Ecology Literature Review

As discussed in Chapter 1, the theoretical framing deploys an organisational ecology approach to explore the underdeveloped DCM and how it can emerge and grow. In some respects, this study will set a precedent for a financial market which is still evolving in terms of regulatory and legal framework relating to the GCC financial industry. This research will focus on academic and practical issues relating to the underdevelopment of the GCC DCM to reach a point and scale to establish itself as a viable source of funding both for sovereign and corporates borrowers. This would involve understanding the process of “legitimation” and “persuasion” within the market organisational ecology. The reason being the concept of legitimation is contextual and the traditional deductive methodologies may not prove useful to gain meaningful insights on the subject matter.

Organisational ecology allows the study of the impact and benefit on various GCC DCM stakeholders, regulators, banks, investments companies, rating agencies, investors and the general public. The use of institutional theory can help predict and develop a change plan, methodology and approach for the market development.

A literature gap utilising different approaches away from conventional accounting and finance disciplines remains to be filled. As such organisational ecology helps to better understand the behaviour and interaction of organisations with a deeper understanding of, learning, encoding, storage, retrieval, and processing of cognitive schema.

2.5.1. Organisational Ecology Research Context

It is important provide theoretical framing for the use of organisational ecological theory and institutional theory. Ecologists examine how organisational populations change and develop over time through stages of founding, growth, transformation, decline, and death (Hannan & Freeman, 1977, 1989). The theory looks at i) increase in organisational diversity and ii) decrease in organisational diversity and iii) dynamics within organisational populations by addressing the social, political and economic forces. This can for example be achieved through creation of new organisational forms and driving away organisational forms through competition (Hannan & Freeman, 1989).

There are two main theoretical approaches of organisational ecology relating to organisational change studies that is selection and adaptation. The first theoretical approach, selection, looks at organisation that change involves great risk in response to changes in the external environment or cannot take place easily. In selection, new forms appear selectively to replace old forms of organisation. This approach is associated with organisational ecology (Barnett and Carroll, 1995).

The second approach, adaption, considers major organisational changes as being an adaptive process to a previous change in technology and the environment (Barnett & Carroll, 1995). Theories of this school typically include institutional theory, contingency theory and resource dependence theory. The major differences between these two theoretical approaches concern the rate, the condition, and the outcome of change.

2.5.2. Organisational Ecological Theory

For organisational ecology theorists, the major ecological argument is that structural inertia results in organisations that cannot make major changes, but when they do change, the consequences are disruptive (Carroll, 1984, McKelvey, 1982, Aldrich, 2008, Hannan & Freeman, 1984).

Four internal and five external pressures explain inertia. The internal constraints are the political commitment for change, investment in trading platforms, scarcity of market makers and the availability of DCM trained personnel. The external pressures are banking institutions dominance, weak DCM legal and regulatory framework; limited information decimation, barriers to market entry and exit and the problems of collective rationality and the strategy (Hannan and Freeman, 1984). Underlying ecological theory, is the important assumption that organisational adaptation is limited by strong structural inertia pressure (Haveman, 1992).

2.5.3. Organisational Adaptation

Organisational ecologists argue that change occurs through an evolutionary process of selection whereby new forms appear that selectively replace the old forms of organisation because they better fit the changed environment (Barnett & Carroll, 1995, Hannan & Freeman, 1984). They argue that most organisations are inert, that they cannot change easily or that changes entail great risks and that the effect of change is generally disruptive.

On the other side, in the adaptation school of thought, are a more diverse group of academics who argue that organisations learn and can adapt to environmental change (O'Reilly and Tushman, 2008). Both sides have empirical support for their claims.

Institutionalisation theory suggests that changes in features of formal structure in an organisation can often make the organisation more aligned with the changing institutional environment. Organisations adapt by adopting structures and behaviours that conform to their institutional features, the "rationalised myths", thereby enhancing their legitimacy (DiMaggio & Powell, 1983; Meyer & Rowan, 1977; Meyer & Scott, 1993; Zucker, 1983). The theory claims that enhancing organisational legitimacy by organisational changes can result in higher survival chances and better performance (Singh et al., 1986).

Overall, ecologists believe population level changes is generally explained by environmental selection approach, that is more appropriate than organisational adaptation. Organisations that fit the environmental demands will survive; otherwise they would demise. The approach taken in this theoretical framing is to examine whether the prediction is more consistent with organisational change and their disruptive rather than adaptive effect.

2.5.4. Power and Legitimation

Nee and Cao (1999) cited that, even during dramatic social transformation, entrenched interests from previous institutional arrangements could still have incentives to maintain their former status quo. The inertia faced by reformers is not only interest-based but also locked into interrelated institutional arrangements (DiMaggio and Powell, 1983).

This power-based approach can explain how the pre-existing conventional banking system remain across the transition towards a broader DCM in the GCC. The concept of "Legitimation" is defined as "the generic fit with the schemas and a low frequency of observed schema-violations, lead observes to take for granted the behaviours that fit the schemata" (Hannan, M. 2008). Hannan et al. (2007) and Pólos et al. pursued to analyse this concept using a modal language. They built on the idea that the legitimation of a category means a heavy reliance on defaults. Competition and Legitimation (taken-for-grantedness of group organisations or a form of recognition), are the main mechanisms of prediction. Legitimation generally increases (at a decreasing rate) with the number of organisations, but so does competition (at an increasing rate). The result is that Legitimation processes will prevail at low numbers of organisations, while competition will at high numbers (Hannan & Freeman, 1977). Ecologists have focused on competition and this is partially due to the relative availability of data but also because competition conceptually is deeply deep-rooted as the prevailing mode of firm interaction. Given that early decisions are virtually "locked in stone" (Hannan & Freeman 1984, 1989) "This focus on competition is ironic in the broader scheme of natural reality since symbiosis is dramatically more prevalent in nature than is competition." (Hunt, 2017).

Parallel with power-based explanation, legitimacy-seeking emphasizes institutional continuity and entrenchment. Legitimacy-seeking accounts of institutional existence maintain that decisions, which preserve pre-existing institutions, are established in the actors' subjective orientations and beliefs about what is most legitimate, appropriate, or morally correct (Dowling & Pfeffer, 1975).

Institutional legacies thus shape the opportunity structure and strategic preference of social actors but limit the range of normative selections invoked for institutional responses (Hausner et al., 1995; Streeck & Thelen, 2009).

2.5.5. The Limits of Institutional Continuity

Established institutions and practices face erosion or replacement where their legitimacy becomes seriously questioned. Oliver (1992) categorized the political conditions where "delegitimation" or "deinstitutionalization" can be predicted as: (1) deteriorating performance of extant institutions, (2) contention between emergent social actors and the status quo, (3) mounting pressure for institutional innovation and re-adjustment, and (4) reduced reliance upon institutional constituents requiring continued stringent conformity. In this view, to deviate from the entrenched institutions is either a defence against threatened failure or political response to power shifts between established and emergent social actors. Thus, institutional innovation occurs through political efforts to resolve tension arising from the reduced validity or legitimacy of entrenched norms and practices such that survival needs to be assured.

2.5.6. Change Content and Process

Organisational change is a transformation of an organisation between two points in time (Barnett & Carroll, 1995). The importance of studying the process effect has been highlighted by Amburgey et al., (1993). The process of change refers to the way transformation occurs, which involves decision making, the communication system, speed of change, the barriers suffered and the consequences. The consequences of change are not only the difference of old and new characters, but also the cost associated with the disruption caused by the process of change, which would reduce the benefits of any positive content effects.

Furthermore, since culture is influenced by previous experiences and reflects the imprinting of the institution's legacy, once established and taken for granted, culture is difficult to change (Stinchcombe, 1990). Thus, organisational culture also has inertial tendencies (Hannan & Freeman, 1984, Schein, 2017). Changes which break codes generally encounter cultural opposition, so such changes are usually problematic.

The cultural code is restricted in that it only allows a limited range of possible rules and structures, so many possible alternatives are not morally acceptable; and the membership understands and embraces the culture and becomes willing to enforce sanctions when any violations are detected (Jacobs et al., 2008), while not discarding changes that are similar to those made previously Amburgey et al. (1993: p71).

In context of the GCC countries and cultural aspect, The GCC group of countries' populations indicated some similarity in their culture, religion, traditions, political systems and local languages. GCC was formulated after establishing association between the Arab countries (Ibrahim, 1989). GCC countries were reported to share similar individual and managerial traits as they share common cultural heritage (At-Twaijri, 1989). A study conducted by Ali and Al-Shakhis (1989) aimed to examine the managerial beliefs of Iraq and Saudi Arabia. It was found that, even though both countries are similar culturally, they had differences in their regional and social dimensions. The results of the study gained support from the results of Hofstede's (1983).

At-Twaijri et al., (1996) examined the population of GCC group of countries from 4 cultural dimensions, namely Power distance index, uncertainty avoidance index, individualism index and masculinity index. The data was generated from a sample of 500. Questionnaires were distributed to the managers of the oil companies, however, only 204 were analysed. It was observed that the lifestyle of the GCC countries changed because of the influence of the western culture. The uncertainty avoidance Index had increased tremendously because of the threat from the neighbouring countries, which further added instability within GCC group of countries. It was inferred that Islamic teachings still had significant impact on the economies of GCC, and due to which their individualism index was reported low. The tribal bodies and Islamic people took care of each other or it could be said that people had pressure to look after each other, due to which masculinity score was increasing and reached close to mid-point. The societies of GCC are changing with the changing global, competition, policies and influence.

The literature reviewed in this chapter is on the leading edge of several current academic theories and it connects institutional theory and ecological disruptive theories. It also considers external environment factors affecting it. Considering the research context, of DCM underdevelopment is one ongoing characteristic of the GCC financial industry. I have attempted to extend our understanding of organisational change within the GCC DCM, which had never been done before. The aim to understanding the market impediments and how to overcome them, will allow the exploration of the conditions of organisational change.

2.5.7. Debt Capital Market Ecology

Ruef (2000) notes, organisational forms emerge over time as a social process and a specific form's actual emergence cannot always be readily demarcated by an exact date or a particular organisational event. Initially, the issuance of debt securities in GCC has proven to be challenging more so to *sukuk*. The use of such an instrument was considered costly due to the lack of legal and regulatory frameworks to facilitate Islamic financial products. So, when considering the debt market environment, we can identify three key roles: issuers, intermediaries and investors with the various types and different categories.

With relatively insufficient transactions in place, the *sukuk* market was still considered in its early stage with numerous uncertainties regarding its potential. Several factors need to be developed for establishing a market for *sukuk* and bonds. First, the development of a viable secondary market is crucial to recognize fixed income securities as desirable instruments. In addition, clear regulations and regular transactions are still required for companies to exploit these sources of capital. Harmonization of directives and standards between the industry regulating bodies such as AAIOFI, IFSB and other related entities.

2.6. Theoretical Framing

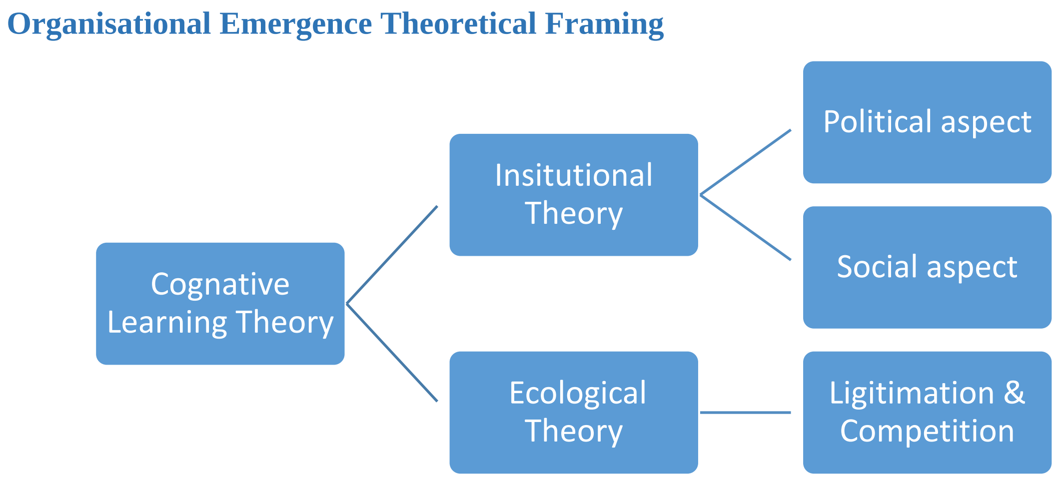
We focus on two very different kinds of processes behind the emergence of an organisational form, suggested by contemporary organisational theory. First, institutional theorists emphasize how formal institutions, such as regulatory bodies, assist in the establishment of a new organisational form. Ecological theorists view these institutions as providing social order and reducing uncertainty, as well as control or domination. Social order can be established by having a market framework and market regulations. Second, they focus on how expansion aids in establishing a form such as the emergence of a new institutional form that is the GCC DCM (McKendrick & Carroll 2001).

The theory of density-dependent organisational evolution holds that as the number of organisations using a particular identity code increases above critical minimal levels, the code becomes an organisational form (Polos et al. 2002). To highlight social codes in ecological analysis "it represents both cognitive recognition and imperative standing. A social code can be understood as (1) a set of interpretative signals, as in the "genetic code," and (2) a set of rules of conduct, as in the "penal code." (Le Mens, Pólos & Carroll, 2011). The Penal code of players belonging to the DCM can be identified in accordance with set rules and regulations, and by examining the debt market environment, we can identify three key players: issuers, intermediaries and investors.

Institutional theory and organisational theory can be brought together by the application of Cognitive Learning Theory (CLT). CLT focuses on outcomes of problem or situation solving (active thinking), which requires the processing of known facts and then reacting in an oriented and objective way. It assumes that by learning the meanings assigned to stimuli, a person learns the meanings of various objects and events. CLT suggests that events are stored as organised information and form cognitive structures in memory (Wood & Bandura, 1989). Cognition defines a person's ideas, thoughts, knowledge, interpretation, understanding about themselves and the environment.

For organisational emergence is described by at least two different theories– institution and organisational ecology theories. We will analyse the political aspect of legitimation and competition of organisational ecological or industry insiders in the absence of authority involvement.
The economic and political development of new organisations can be viewed from an institutional theory perspective and provides for better understanding of how the market is recognized as a viable alternative source of funding for the GCC region. It relates to how it can be developed and what the building pieces are (see Figure 1).

Figure 1: Organisational Emergence Theoretical Framing



Investors of debt capital are either institutional or individual investors whose objectives include receipt of annuity income, risk averse exposure, and the diversification of their investment portfolios. In addition to investors and issuers, the efficient working of the market requires an institutional infrastructure and regulations within which the system can operate. Debt securities institutional form include both primary and secondary market makers, credit rating agencies, trading platforms, investment banks and credit-enhancing agencies. Figure 2 below shows a graphic representation of DCMs structure. The market consists of a population of institutions and players/change agents and is governed by the economic, business, legal and regulatory structures.

Figure 2: Roles of Different Players in DCMs

Source: (Abraham, A. and Seyyed, F. 2012)

Some GCC countries such as Kuwait were lacking *sukuk* and trust laws. For example, regulations relating to the establishment of special purpose companies was absent and required to encourage firms to issue *sukuk*s locally. Which begged the question of legitimation and whether the market players and the regulators started to recognize such efforts as viable and serious source of alternative funding to banks. As we will see in the following sections, deepening the GCC markets will require developing and enhancing each of the elements identified in the above framework.

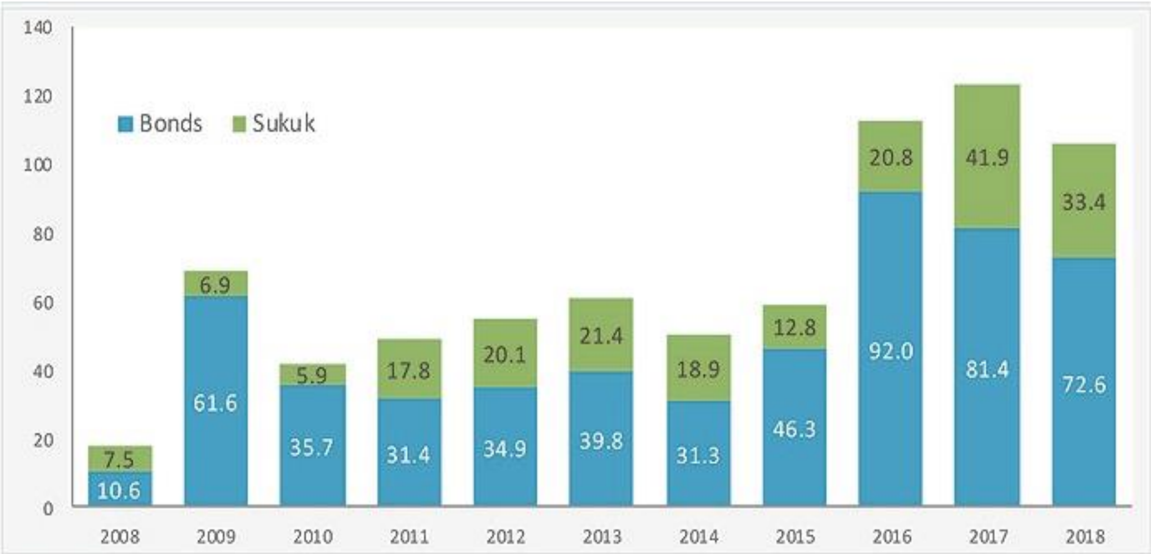
It is possible to view the DCM as an institutionalised form through a classification scheme. First, we define the key players in the market population "as a set of entities bound with a common form interacting together and competing for on the same source", these are divided into the following key players:

- Sovereign & Corporate issuers.
- Global banks with regional presence that are securing the major sovereign issues.
- Regional banks with regional distribution capabilities working alongside the global players.
- Local banks and investment companies that find it hard to compete with banks (both global and regional) except when there is a locally denominated currency security issue.

These key players take similar forms due to their originates from homogeneous origins in the financial industry, activities and often retain their primary identities. Homogeneity makes self-identification, regulation, and solidarity less problematic; it also makes enforcement of the code via sanctioning a more straightforward process.

In applying the theory, ecologists often count the number of organisations (density) in a market across time. Our historical review of the DCM as an institutional form shows the validity of both theories in describing some of what occurs in the early stages of a market or industry. The debt issuances in the GCC starts from a lower local level and grows into the international market (see Graph 2). Correspondingly, as ecological theory would forecast, the number of issuers entering the market rises steadily over the early years, eventually slowing down and stabilizing and finally declining slightly. This is characteristic of the organisational density route timeline (see Hannan and Carroll 1992, McKendrick et al. 2001).

Graph 2: Fixed Income Issuances in GCC (USD Bn)



Source: Bloomberg, KAMCO Research
Note: Bond and sukuk issuances in the report includes instruments with original maturity >1 year and Country of Domicile/Country of Risk is for the specified region.

The pattern varies over time with economic cycle, oil prices and country (see Graph 49). The data trend indicates that *sukuk* issuances are expected to continue growth of the Islamic capital markets, with the primary issuers being governments, quasi-governmental entities and government-owned corporates. In 2019, the number of issuances by GCC corporates exceeded sovereign issuances, (the first time in 6 years with US$61billion to US$52 billion respectively), indicating a strong return to the DCMs. Altogether, issuances by GCC governments, banks, and corporates totalled more than US$85 billion in fixed-rate bonds and US$29 billion in *sukuk* in 2019 (Graph 2).

From a theoretical view, there has been a gradual market recognition of the DCM supported by the extreme need of sovereign issuers to tap into the DCMs to bridge their budgetary deficits. The market shifted to organise and established identity code used by outsiders, whether rating agencies or international investors, to evaluate whether the GCC DCM qualifies as a legitimate issuer – this in essence crystallizes taken-for-granted and legitimation. In sum, there is an organisational form, appearance of formal institutions and the expected path of population density.

The consensus of the audience in ecological sense, (can be customers or rating agencies) can give a meaning to a label on grade of membership (how close or far) within the class of category, can be observed by the increasing acceptance. In the case of the DCM, the audience and change agents who do the codifications and change are a character of institutional sociology would be expected to react. In addition, considering the lack of political will at the early stage, to dispel rentier mentality and encourage DCM in the GCC, a sufficient incentive for the government to facilitate pro-market change became necessary. The argument was to let the market play, as a change agent, only establishing the initial set of successful securities issues that the market would develop rapidly. The regulators will need to address the regulatory gaps and start regulating this growing side of the market.

Therefore, well-functioning capital markets are "now widely accepted as essential to the long term growth and competitiveness of [emerging market economies]," (Suárez, 2011) although implementation of the requisite financial infrastructure to foster such market development necessitates governmental cooperation. In particular, the development of a bond and *sukuk* markets would require significant coordination efforts among the central bank, the ministry of finance, and the securities regulator (Mancini, 2016).

An important formal association arises and develops. Based on institutional theory, there is an association in the market; issuers, investors or intermediaries unify under collective identity. According to McKendrick & Carroll 2001, an example of the emergence of an organisational form (overlooking the non *halal* nature of the industry) was the American craft brewer's industry association that assisted in the emergence of an organisational form. "They went outside the industry association of major brewers to establish the Institute of Brewing Studies (IBS) in Boulder, Colorado. The IBS was instrumental in providing information on breweries to both the public and to potential entrepreneurs; in lobbying effort to gain legal status for small brewers in various states; in setting standards for brewers, breweries, and products; and in explicitly defining and fostering the organisational form identities associated with contemporary craft brewing". Similarly, Dubai based Gulf Bonds & *Sukuk* Association (GBSA) was established in 2010 as an industry networking organisation as non-commercial platform that harnesses issuers, investors, banks, ratings agencies, legal firms as well ask key service providers.

2.7. Cultural Factors

There is anecdotal evidence that local citizens from the GCC are risk averse and tend to avoid overextending themselves beyond their means. This general consumer behaviour is evident in public culture sayings and practices.

However, this is changing with the millennial generation having a larger consumption appetite and open to taking credit. This reserved cultural attitude has played a significant role in the popular resistance to the idea of sovereign borrowing as evidenced in the parliamentary rejection of the public debt law in Kuwait in 2018.

Chapter 3: Debt Capital Market: A Literature Review

3.1. Introduction

This chapter provides a literature review about the DCM. It will include a brief history about Islamic finance, philosophy basics and how it evolved from market and regulatory perspectives. It then relates Islamic finance to DCM in context of modern use. This chapter will provide an introduction and context for following chapters that discuss Islamic finance instruments.

3.2. Islamic Finance Market Development

To avoid political censure and therefore not projecting an Islamic image, Mit Ghamr Savings Bank in Egypt became the first, in 1963, to issue Islamic finance by opening savings based on profit sharing (Orhan, 2018). The bank lasted until 1967 until it was closed down by the government. This sector is relatively young as it started in the early 1970s with basic retail banking services. In 1973 the Islamic Development Bank (IDB) was established. This act gave momentum to the rise of Islamic finance regionally, as a number of private banks were established in accordance with *sharia* in Dubai, Kuwait, Bahrain & Egypt.

In the Far East and Malaysia in particular (early 1980s, the Islamic finance endeavour was more government-sponsored rather than the result of private sector initiative with the establishment of the dual finance practice of conventional as well as "interest free finance" with an average growth rate around 11% p.a. (Ahmed, 2011). Islamic finance fundamentals developed with the spread of Islam into the world as a divine message coping with changes of time and place. By the new millennium, Islamic finance market moved to a new level internationally with the growth in Islamic bonds "*Sukuk*". This represented and marked the presence of the DCM.

Over the last 40 years, the industry now accounts for US$2.2 trillion in assets. Today there are more than 10 countries, operating a dual banking model, where Islamic banks account for over 20% of banking sector assets, reflecting their systemic importance. In addition, 44 countries to date have introduced some form of legislation or regulations to support the development of their domestic Islamic finance industries. Although, the growth of Islamic finance has been notable over the last four decades, its penetration is still only approximately 2% of the global finance industry (Al Hashel, 2018).

While over 100 countries are implementing some form of Islamic finance, the industry remains relatively small outside of core markets in the MENA areas and South and Southeast Asia. Still, the Islamic finance industry, with its universal value proposition of inclusiveness, can help address many of the current economic, social and financial challenges, subject to necessary conditions such as implementation of relevant Islamic finance standards, corporate governance, ethics, and proper risk management.

3.2.1. Macro-Economic

Petro dollars and increase of Gulf based wealth with demand for suitable investment products and investments services has led the way for the development of Islamic Investment banks/ companies in the early 90s. They offered asset management, private equity, investment advisory and merchant banking services through companies such as The International Investor, Arcapita Bank and Gulf Finance House, and many of them today have mixed fortunes.

3.2.2. Demand Driven

Strong Muslim customer demand both immigrant and non-immigrant in line with their faith for *sharia* compliant financial services and transactions. This has led to the wave for the development of the first Islamic retail commercial banks, for example Dubai Islamic Bank and Kuwait Finance House during the late 70s and 80s.

3.2.3. Philosophical Basis

The *sharia* is the path or guide by which a Muslim leads their life, in terms of every side, activity and detail of life. It is a religion, morals, principles and much more, including aspects constituted by the "law".

The principles are embodied in the two main sources namely: the *Qur'an* (Islam's holy book); and the *Sunna* (practices, examples and decisions of the Prophet Mohammed). Principles are also discerned by other methods, most importantly the consensus of the community of *sharia* scholars (*ijma*) and analogical deduction and reasoning (*qiyas*). The *sharia* is not a uniform concept. There are multiple schools of Islamic thought (m*athahib)*: for example, the four main traditional schools of Sunni Islam (*Hanbali, Maliki, Shaafi* and *Hanafi*) dominantly effect modern Islamic finance.

3.2.4. Regulatory Aspects

In all countries—except Sudan and Iran—Islamic finance exists alongside conventional banking. For Islamic banks, this means navigating a dual regulatory framework: the country's laws and regulations as well as *sharia* compliance. An overview of the regulatory aspects that governs the Islamic financial institutions is included in this segment.

3.2.4.1. *Sharia* Supervisory Board (SSB*):*

Each Islamic financial institution has a *sharia* Supervisory Board (SSB). *Sharia* scholars, most frequently sitting on an SSB comprised of at least one scholar (commonly three), perform interpretation of the *sharia* as applied in contemporary Islamic finance. Deciding on what is *halal* (allowed) or *haram* (forbidden), the SSB uses two main sources of Islamic law: the *Quran* and the Sunnah—sayings and actions of the Prophet Muhammad during his lifetime. Board decisions are taken by majority vote and binding on the bank. Individual investors, banks, financial institutions, family offices, standard-setting organisations and other industry participants retain these scholars (including structures and documentation) to provide advice and fatwas or opinions on commercial and financial transactions. *Fatwas* are extracted specifically in respect of discrete and definable transactions and activities.

3.2.4.2. *Sharia* Compliance Firms

With growth in the industry, several private firms have developed due to the scarcity of *sharia* and resulted in a new form of consulting, that emerged over the past few years offering *sharia* compliance services or consultancies. These firms help develop products or acquire sharia endorsement (on products and services) to gain access to the Islamic market for their clients (Islamic banks, conventional lenders and companies). Often, they employ Islamic scholars who, functioning like externalised *sharia* boards, issue Islamic rulings (*fatwas*) and provide guidance.

3.2.4.3. Islamic Finance Industry Standard Setting

At the international level, there are two supervisory bodies for Islamic finance: the Bahrain-based Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) sets basic standards for the Islamic finance industry in terms of *sharia* and accounting while the Malaysian based Islamic Financial Services Board (IFSB) uses risk assessment to form the basis of recommendations.

These bodies collaborate with institutions such as the IMF or the World Bank to promote *sharia* compliance globally. In United Arab Emirates and Bahrain, AAOIFI standards and recommendations are mandatory for Islamic financial institutions, but these are non-binding in most other countries. It is up to each country's government to enforce certain rules through their central banks who impose these rules on *sharia* boards.

Capital Market are spaces where it is possible to buy and sell financial securities like bonds, debentures, shares, debt instruments, derivative instruments like the futures, options, swaps and ETFs. Hence, the capital market is comprised of either “equity” side or “debt” finance side. These are traded on the primary or secondary markets. The same is applicable to the Islamic capital market in terms of characteristics and structure except for what is *sharia* permissible. The research in this thesis focuses on the debt side rather than the equity side of the capital market. having defined Islamic finance markets, we will shed light on the different types of security instruments used in the capital market either conventional or Islamic. The emphasis will be placed on Islamic contract types and *sukuks*.

3.3. An Overview of Bonds: Securities as Financing Instruments

Typically issued as a fixed income loan, to a company or government, a bond by an investor to a borrower. Bonds, with details of the loan and payments, can represent evidence of debt between the borrower and lender. As well as companies, states, municipalities and sovereign governments can use bonds for financing projects and operations. Bond owners are deemed creditors/ debt holders of the issuer. Bonds include details of maturity date (end date) by which the principle of the loan is due to the owner and usually includes the variable or fixed interest payments (the coupon) terms made by the borrower.

3.3.1. Characteristics of Bonds

Some of the common basic characteristics of bonds include:

- The nominal amount the bond is worth at maturity is the face value.
- The issue price is the original price at which the issuer of a bond sells it.
- The coupon rate, expressed as a percentage, refers to the rate of interest the bond issuer will pay on the face value of the bond.
- Coupon dates are the dates of interest payments made by the bond issuer (often as semi-annual payments).
- The maturity date is date on which the issuer will pay the bondholder the face value of the bond.

3.3.2. Bond Types

Bonds' issuers have a different type of collateral and structuring, which can be ranked in terms of seniority or in terms of claims for example, unsecured, subordinated (junior) and secured securities. In secured senior bonds, bonds are backed by a legal claim on an identified asset that belongs to the obligor in a default case (Reilly & Brown, 2019). For instance, mortgage bonds are secured by tangible assets, and in the case of financial distress, the assets can be sold to fulfil the bondholders' obligations (Sundaresan, 2014). Additionally, one of the most popular bond types is called zero coupon bonds, which are also called discount bond that does not make any regular payment of interest (Bomfim, 2005, p. 305). Therefore, instead of receiving periodic payments of interest, the bondholder obtains a single payment at maturity that equals the entire interest gained along with the principal amount (Hirschey & Nofsinger, 2010, pp. 465- 466).

Debenture bonds, which are unsecured obligations, secure only the obligor's credit since they rely on the corporation's credit strength (Reilly & Brown, 2019). As a result of relying on high credit companies, these bonds are offered at a low rate of interest along with no particular pledge for the assets involved (Melicher & Norton, 2014, p. 239).

Although, bonds commonly have a fixed rate, bond investors may prefer adjustable interest rates on a daily, monthly or annual basis to track the interest rates in the market. This allows the interest rate payment on a given bond to be changed and adjusted periodically according to changes in an underlying interest rate standard (Hirschey & Nofsinger, 2010, p. 465).

Moreover, public bonds are a typically fixed obligation with a long-term debt securities package in affordable and convenient denominations offered to financial institutions and individuals. They differ from other debt instruments, such as privately placed debt obligations and individual mortgages, as they are sold to the public instead of channelled directly to a particular lender.

3.4. Asset Securitisation

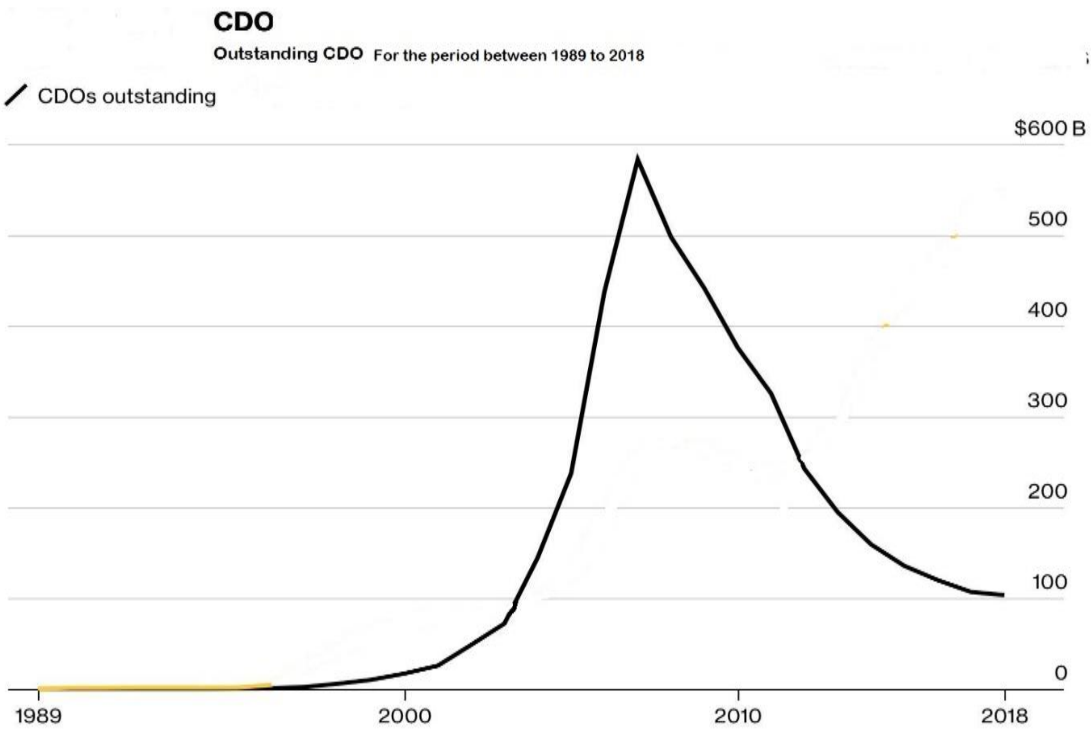
As a subset of DCM, asset securitisation is a well-researched topic especially in the United States given the size and the rate of growth in the market. Securitisation is generally the process of pooling a number of cash flow based financial assets, legally isolating those assets from the originator, structuring the predictable cash flows of those assets into the form of marketable securities, providing credit enhancement to the securities, obtaining a credit rating for the securities, and issuing the marketable securities to investors (Jobst, 2009).

3.4.1. Securitisation types

The challenge is in comparing and contrasting with the Islamic Asset securitisation in its infancy stage along with its potential. Securitisation commenced in the United states in 1970 as the US administration's Ginnie Mae started a market Mortgage Backed Securities (MBS). Investors were taking credit risk on the assets pooled rather than on the originator of the assets. Then moved on to another asset class which is the Residential Mortgage Backed Securities (RMBS), Commercial Mortgage Backed Securities (CMBS), Asset Backed Securities (ABS) and finally Collateralised Debt Obligations (CDO) where volumes reached US$200 billion in 2000 and grew to more than

US$2 trillion in 2006 (Davis & Ishmael, 2008). However, the market collapsed with the sub-prime market meltdown as we can see from Graph 1 below (the reasons of which is not the subject of this research).

Graph 3: CDOs Outstanding 1989-2018



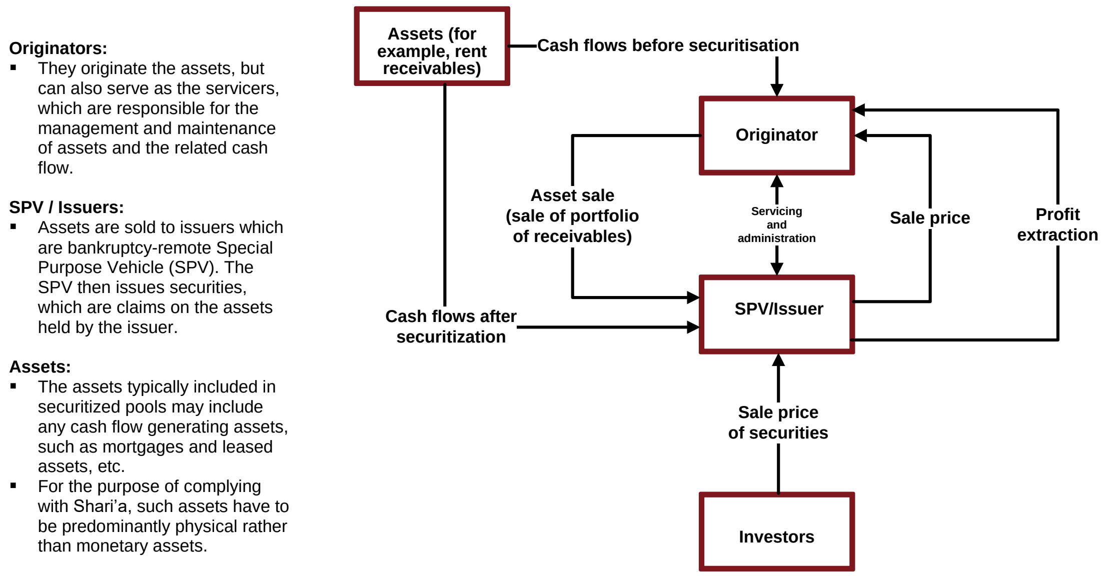
Note: CLO: Collateralized loan obligation; CDO: Collateralized debt obligation[5]
Source: Sifma

In asset backed securitisation, investors consider the credit worthiness of the collateral assets underlying the *sukuk*, not the corporate credit worthiness of the assets' originator. This requires legally isolating the collateral assets from their originator and making a detailed analysis of those assets regarding their historic performance (McMillen, 2008). The preferred method of legally isolating collateral assets from their originator is done by means of an SPV (Jobst, 2007). The preferred method of analysing collateral assets is by detailed analysis of accounting records with respect to voluntary prepayments, delinquencies, defaults and recovery rates.

3.4.2. Securitisation Structure

An SPV can be any independent legal entity, a trust, a corporation, limited liability Company or a limited partnership. However, Jarboe & Furrow argued that failure to evaluate and monetization of intangible assets and non-recognition of standardized tools, could hamper the development of the capital markets which could be another area for growth in securitisation (see Figure 3). After securitisation of assets, a market for trading these securities did not exist for the underlying illiquid assets. Thus, securitisation improves the efficiency of the capital markets and increases the availability of credit. The creditworthiness of these marketable securities is based on the creditworthiness of the assets, not the company that originates them. Again, capital market efficiency is improved by focusing on and valuing the credit of the assets, not their relationship to and the credit of the originator:

Figure 3: Securitisation Structure



Source: (Adapted from: Lieske & Blumenfeld, 1999:8)

3.5. An Overview of Islamic Financing Instruments

The primary objective of funds under the Islamic financing, should be to minimise losses and enhance the incremental value of investments for the benefit of the investors, whether long term in project financing or short-term trade related transactions. The shape of Islamic instruments is linked directly to the type of the underlying asset. Islamic financiers have developed certain basic types of contracts that preserve the principles referred above. The structure of each transaction is based on these contracts which differs according to its own particular facts.

3.5.1. *Modaraba* (Trust Finance)

When a party with excess funds (*Rab almal)* deploys these funds with another party who has the necessary skills to use them productively (*Rab alamal* or *Modarib*), then Under the Modaraba contract the Islamic bank provides the capital needed to fund a specified enterprise. The customer contributes management and other expertise to the same enterprise. The customer is responsible for the day-to-day management of the enterprise and is entitled to management fees from the enterprise's profits. The customer also receives an agreed percentage of the enterprise's profits as a management fee. The balance of the profits of the enterprise is paid back to the bank. The bank's management fee must be paid from the profits of the enterprise and if the enterprise makes a loss the bank must forego its management fee.

Modaraba has formed the basis for several Islamic investment funds. Customers subscribe to the *Modaraba* fund with the bank, exercising its professional investment skills, invests in appropriate ventures. Shares in *Modaraba* funds may be bought and sold as tradable stock and quoted on local stock exchanges.

3.5.2. *Morabaha* (Cost-plus Financing)

This is a popular method of Islamic financing which is frequently used in trade financing arrangements. Typically, the Islamic bank will buy goods from the supplier and then on-sell the goods to the customer at an agreed marked-up price. The bank may hold title of the goods for only a brief period but the profit generated by the bank on the marked-up sale price is nevertheless a profit derived from a sale transaction and is not therefore prohibited as *Riba*. Frequently, *Morabaha* financing is short-term, say 3 to 6 months, although longer periods are possible. The amount of the mark-up will also reflect conventional bank pricing, deal size, credit risk and so on. From the Islamic bank's point of view there are also important considerations as regards the degree of risk of buying and selling goods, including warranties as to the title and fitness for the purpose.

3.5.3. *Mosharaka* (Profit Sharing)

This is a method used to provide venture capital or project finance in accordance with Islamic principles. Largely similar to *Modaraba*, the *Mosharaka* contract permits the customer to contribute towards capital of the enterprise. The customer and the investors (depositors) in the Islamic bank will proportionally share the profits of the enterprise based on capital contributions (after deduction of management expenses and production costs) and the bank receives its agreed fee for managing the investors' funds. Any losses of the enterprise will be borne by the customer and the investors in direct proportion to their capital contributions.

3.5.4. *Istisna* (Pre-Manufacturing Finance)

Istisna is a contract relating to acquisition of goods based on order or specification, where the price is tranched with job milestones. Examples include payments made to the builder or developer for the purchase of a house at different stages of completion.

3.5.5. Bai al-Salam

Bai al-Salam refers pre-payment for goods that are delivered at a later date. Normally, the goods must be in existence otherwise no sale can be made, but here an exception is made, providing the goods are defined and the date of delivery is fixed. Usually the sale is for tangibles, excluding gold or silver (due to their monetary values). As long as quantity, quality and workmanship can be described, then *Bai al-Salam* covers the transaction, conditional on advance payment. Although there is no option of rescinding the process, there is an option to revoke based on defected goods.

3.5.6. Ijara (Leasing)

This is a medium-term source of finance. The bank acquires the asset and leases it to the customer for an agreed sum payable in instalments over a period of time. In order to conform to the *sharia*, the Islamic leasing contract is based on profit sharing. The rentals which constitute the bank's return are calculated not on the basis of the capital involved but rather on the profitability of the asset once it is employed by the customer lessee. This can be done by making the rental payments a fixed percentage of the annual profit attributable to the output of the leased asset. The Islamic bank is the owner of the goods which are to be treated as on trust in the hands of the lessee. Although the lessee makes payments during the useful life of the asset, the lessee will not assume ownership over the same. The cost of insurance and the cost of maintenance of the leased asset have to be borne by the lessor in order to be acceptable according to Islamic law.

This is usually not the case in conventional leases when the rentals reflect the additional costs of the lessor. There is unanimity among the four main schools of Islamic law that *Ijara* is a binding contract. It can be cancelled only if the purpose of the lease has disappeared or is destroyed.

(Hire-Purchase) is very similar to *Ijara*, except that there is a commitment from the customer to purchase the equipment at the end of the rental period. The pre-agreement includes that post-lease, the customer purchases the equipment at an agreed price from the bank, with rental fees contributing towards the final price.

Table 2: Comparative Features of Islamic Banking Financing Techniques

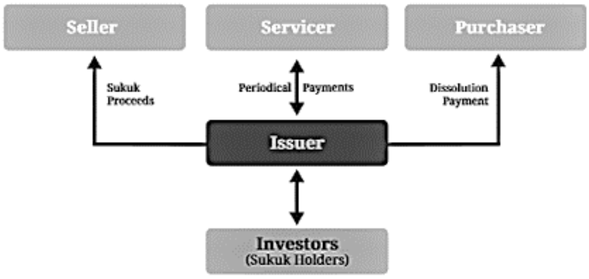
Techniques	***Modaraba***	***Mosharaka***	***Ijarah***	***Morabaha***	***Bai al-Salam***
Features Nature of Financing	Investment based	Investment based	Leasing based	Combination of trading & debt	Combination of trading & debt
Role of Capital (in management of funds)	Nil	Full control	Full control on the use of finance	Full control on the use of finance	Nil
Risk-Bearing by Capital Provider	I. To the full extent of the capital as well as of the opportunity cost capital. II. For the entire period of the contact	I. To the full extent of the capital as well as of the opportunity cost capital. II. For the entire period of the contact	I. To the full extent of the capital and the opportunity cost capital II. Until the asset completes its life or is disposed of	I. To the full extent of the capital II. Only for a short period until the goods are purchased and taken over by the finance-user	I. To the full extent of the capital II. Even after the expiry of the contract until the goods are disposed of
Uncertainty of Rate of Return	Complete Uncertainty	Complete Uncertainty	Complete Uncertainty	Uncertainty only for a short period of the contract	Complete Uncertainty
Cost of Capital	Uncertain	Uncertain	Fixed and predetermined	Fixed and predetermined	Uncertain

Source: (Khan, 1994)

3.6. An Overview of *Sukuk*

Sukuk is an Islamic finance instrument for which demand is increasing worldwide. *Sukuk* (plural of *sakk*, or certificate) are trust certificates that represent an ownership interest or usufruct (*manfaa*) of an underlying asset pool, therefore “entitling their holders to returns resulting from the sale or lease of the assets.” *Sukuk* are commonly referred to as Islamic bonds, yet these investment certificates were introduced into the market as an Islamic alternative to conventional covered bonds.

Figure 4: Basic *Sukuk* Structure



Source: (Azzad, 2012)

Unlike a traditional bond or debt instrument, *sukuk* cannot pay interest (*riba*), and periodic payments to the holder instead rely on the profitability of the underlying contracts or assets.

Investors are not conventional creditors entitled to interest payments but are rather owners or partners in the underlying business entitled to a share of the profits and risk of the enterprise. The fundamental prohibition of *riba* and the resulting emphasis on profit and loss sharing remain the main driver on the structure of *sukuk*.

Sukuk are the most important and most rapidly expanding component of the finance side of the Islamic capital markets. *Sukuk* should not be confused with "bonds", despite their persistent characterization by the media. They are either asset or whole business securitisations, and are structured with asset isolation and the servicing of the securitisation instrument (the *sukuk*) is from asset cash flow.

Under *sharia,* borrowers tend to issue *sukuk* (Islamic Bonds) which is a form of securitisation but structured as asset backed with recourse to the originator and is similar to US trust certificates (Box, 2007). Islamic securitisation is a pass-through asset-based structure where investors will be looking at the risk of the underlying assets. It was noticed some researchers use the term securitisation on *sukuk* when it is merely a collateralised borrowing.

Naturally, not all asset classes are rendered *sharia* compatible for Islamic Securitisation. Islamic securitisation and conventional securitisation are similar and share the same characteristics as listed below:

1. Investors have ownership interest in their investments.
2. Income is derived from the cash flow generated by the underlying asset.

3. Investors are exposed to the risk of the asset.

Under Islamic finance, ethical requirements would dominate capital markets efficiency. And, while all financial markets require legal guidelines, *sharia* compliant financial activities must also follow moral principles (McMillen, 2008).

The process of asset securitisation commences with the creation of an independent Special Purpose Vehicle (SPV). Then sale of collateralised assets by the originator to the SPV, the ownership of these collateralised assets by investors by means of their investment in the SPV, the isolation of the risk and return of the collateral assets to the investors - these are standard conventional Asset Backed Securitisation (ABS) procedures and features. They are also what *sharia* compliant financial transactions require.

Sukuk may also be viewed as a vehicle for Islamic securitisation because *sukuk* is in fact securities backed by the assets of an underlying Islamic transaction. Whereas conventional securitisation permits the isolation and assignment of operational cash flows from a project or transaction, Islamic securitisation should transfer a portion of ownership of the assets to the *sukuk* issuer.

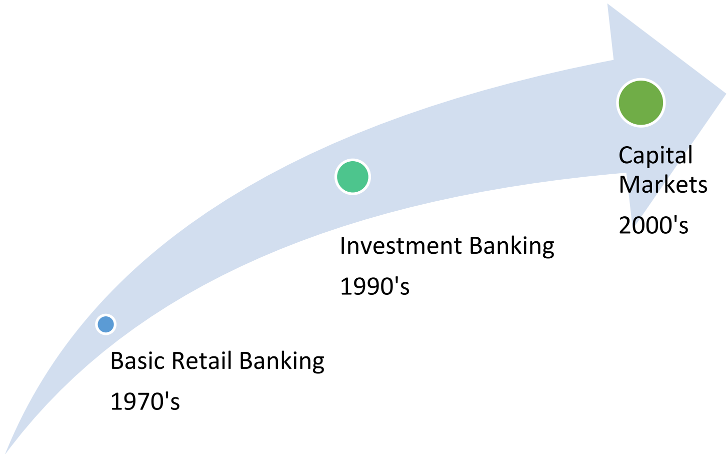
More in-depth analysis about the *sukuk* market characteristics and evolution is given in the chapters to follow.

3.7. Conclusion

We have discussed the different types of security instruments used in the capital market either conventional or Islamic in terms of key characteristics, limitations and structures in the present chapter. Islamic tradeable financial instruments may not have been familiar 20 years ago, but today they are commoditised and have become the major debt-based contracts which are widely used in the banking sector. The introduction of the *sukuk* structures and the tradability have contributed to the growth of the Islamic finance assets in the market. In Chapter 4, we will be examining the landscape of the DCM in the GCC in terms size, demographics and context.

Islamic finance offers a comprehensive proposition to address the key economic and social challenges that we face today, but only if it is done properly, and build the industry on a solid foundation of the key pillars. Around 40 years back, establishing an Islamic bank was like a dream as some of the early pioneers would say. However, considerable progress has been made in the last four decades and establishing an Islamic finance with a global reach. In fact, Islamic finance industry is aiming for its next growth leap in its evolutionary trajectory, as we will discuss in the next chapters.

Figure 5: Islamic Finance Evolutionary Trajectory



Source: Author’s schematic visualisation

Chapter 4: Economic, Financial and Political Dynamics of the GCC

4.1. Introduction

In this chapter we will give an overview about the Gulf Cooperative Council's political and economic structure, after the market reformed and growth initiatives were undertaken to face the impact of the oil revenue decline after 2014. The importance from an economic and political point of view for this emerging market will be discussed.

4.2. Overview of the GCC

Established in 1981 as a political and economic alliance of six countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates) in the Arabian Peninsula, the GCC promotes social, cultural, economic and security cooperation. The countries with their geographic proximity, similar political systems, common sociocultural stances, made it their immediate goal to protect themselves from threats post the Iran-Iraq War. All current member states in the GCC are monarchies, with three constitutional monarchies (namely Kuwait, Qatar and Bahrain), two absolute monarchies (Oman and Saudi Arabia) and one federal monarchy (the United Arab Emirates).

4.3. Geography & History

Iran, Iraq, Jordan and Yemen surround the six GCC member countries. The GCC countries have a land area of 2,673,110 square kilometres. Forming a semi-closed basin, the Arabian Gulf jointly makes up the largest oil reserves in the world and also the largest commuter route for oil tankers. Oil was discovered in 1908 in the Persian Gulf, but it was not until the1930s that the region regained its international appeal after major discoveries. Historically, life in the Arabian Gulf revolved around natural pearl diving and trade with India and East Africa.

In the period from 1820 until its withdrawal in 1971, Britain was the dominant power in the region. Britain's initial interest in the Gulf region in the 17th century, was driven by the development of trade. However, the nature of Britain's involvement began to change, after it consolidated and expanded its colonial holdings in India. (Allday, 2014). The General Treaty of 1820, allowed local Arab rulers to agree upon other treaties that formalised Britain's dominant position in the region. It also meant that the rulers were unable to act independently without

Britain's approval. 'Pax Britannica' provided stability to the region, by protecting the ruling families and safeguarding their territories, this brought increased volumes of trade.

In return for British protection of their families' rule against external threats, the Arab rulers signed the Perpetual Maritime Truce in 1853 in which they formally forfeited their right to wage war at sea. The situation continued until early 1970s when Britain relinquished its direct political control over the region, but retained a great deal of influence as well as political, economic and military links with Britain.

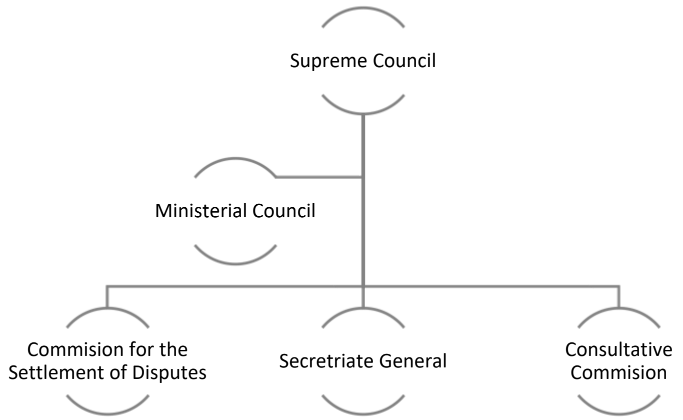
Figure 6: Geographical Map of the GCC

4.4. GCC Organisational Structure

Governance wise, the GCC comprises of six main divisions that carry out various tasks, from the preparation of meetings to the implementation of policies. The **Supreme Council** is the top decision-making group that meets once a year and is made up of the GCC heads of state. It regularly holds a summit every year to discuss cooperation and regional affairs. For important matters, decisions taken must be unanimous. The **Ministerial Council** is formed of foreign ministers or other ministers, who meet every three months to propose policies and execute decisions. The **Secretariat-General** is an administrative body that organises meetings and observes the enactment of policies. The **Consultative Commission** advises the Supreme Council and is composed of five representatives from each member state. The **Commission for the Settlement of Disputes** is formed to look for diplomatic solutions to problems among member states.

The **Secretary-General** is appointed by the Supreme Council for three years and rotates among the member countries.

Figure 7: GCC Organisational Chart



4.5. Main Security Agreements

In 1984, the GCC established a coalition land force, the "Peninsular Shield Force" based in Saudi Arabia, tasked to defend the six nation states. It is composed of infantry, armour, artillery and combat support elements, numbering 40,000 in total which is formed from all the six member states. In addition, the Internal Security Pact which called for closer coordination of internal security and surveillance policies, lead to greater information sharing and unified plans for joint actions. All the members except Kuwait approved the pact in 1994. In November 2012, Kuwait became the last member state to ratify at the pact in the GCC summit in Bahrain.

4.5.1. Economic Importance

Every year the six member states of the GCC hold a summit to discuss the security, cultural, economic, social cooperation and regional affairs. Having some of the world's largest hydrocarbon reserves, the GCC countries are predominantly the main exporters; with Kuwait, Qatar and Saudi Arabia having 70-80% of their total exports as oil and gas.

Figure 8: GCC Exports by Category

In 2018, the EU became the first trading partner for the GCC and accounted for 14.6% of the total trade. This was followed by China (12.2%), Japan (8.5%) and India (8.4%)[1], with China and India rapidly becoming key trading partners as reported by the Economist Intelligence Unit (EIU) in conjunction with Falcon and Associates.

Certainly, The GCC is a growing area, it includes emerging market countries with overall population of 54 million inhabitants with joint GDP of 3.46 trillion, and its GDP is growing at an average of 2% p.a. The GCC has more than 25 % of the world oil reserves and 13% of gas reserves but the region relies on its budgetary reserves and increasingly on direct bank funding for its projects and general funding requirements. Outlook of the GCC nations are provided below:

[1] Source: European Commission

Figure 9: GDP Growth

Source: World Bank Group.

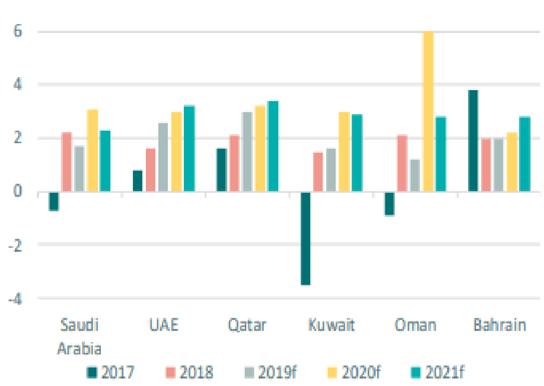
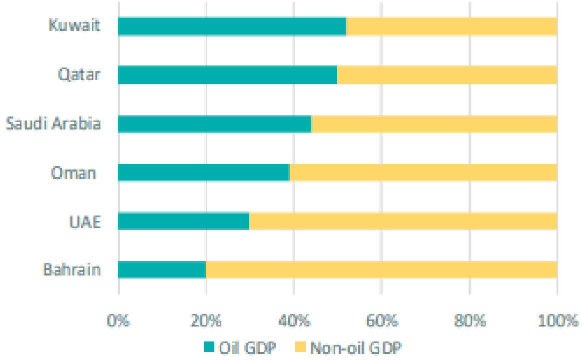


Figure 10: Oil GDP

Source: World Bank Group.
Note: Annual average for 2015-17.



The International Monetary Fund (IMF) has projected a stronger growth outlook in 2018, although low oil prices are expected to continue to hamper the Gulf states' GDP growth. According to a report published in 2019 by the World Bank, Bahrain is the most vulnerable GCC country due to low oil prices, limited savings and high debt levels (Varma, S., Hussain, S., 2019).

The Arabian gulf region, including Iraq and Iran is the most important single oil zone in the world. Despite possessing almost half the world's oil reserves, together the GCC countries are facing swift depletion of oil and gas. Coupled with an increasing population, in many GCC countries in the last decade, the countries have tried to expand beyond the energy sector; such as tourism, construction and finance.

Table 3: GCC Forecast 2019-2021 (annual % change unless otherwise specified)

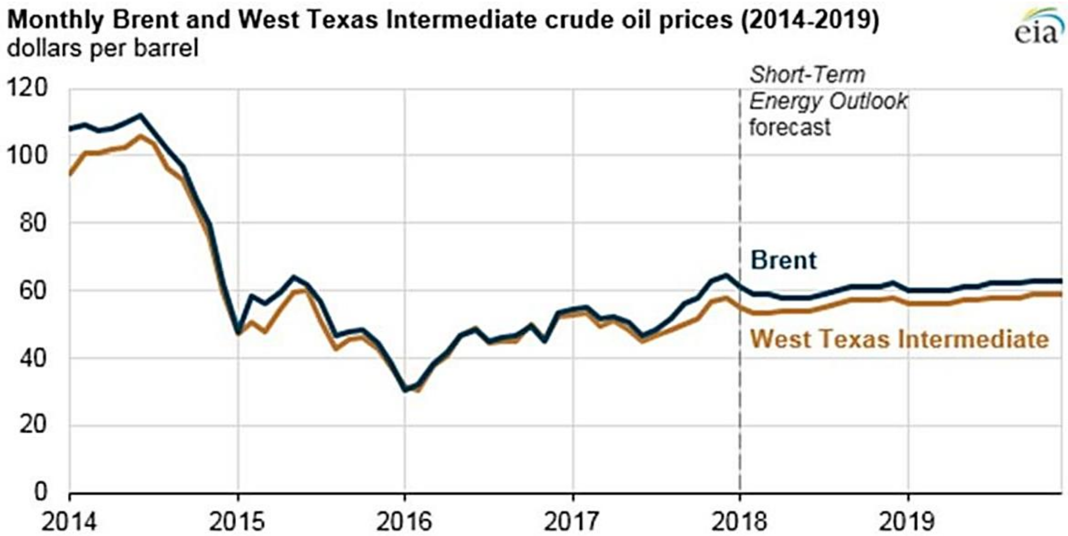
	2017	2018e	2019f	2020f	2021f
AGGREGATE GCC COUNTRIES					
GDP at market prices	**-0.2**	**2.0**	**2.1**	**3.2**	**2.7**
Contributions to growth					
Private consumption	0.6	0.9	0.7	0.8	0.8
Government consumption	0.1	0.4	0.6	0.3	0.2
Fixed investment	-0.5	0.4	1.0	1.4	1.7
Net exports, GNFS[1]	-0.2	0.2	-0.2	0.7	0.1
Current account balance (% of GDP)	**2.5**	**7.6**	**7.0**	**6.9**	**6.7**
Fiscal balance (% of GDP)	**-7.0**	**-3.4**	**-3.7**	**-2.7**	**-2.1**
Terms of trade	**-0.5**	**-0.7**	**-1.4**	**-0.2**	**-1.2**
INDIVIDUAL GCC COUNTRIES					
GDP at market prices					
Bahrain	3.8	2.0	2.0	2.2	2.8
Kuwait	-3.5	1.5	1.6	3.0	2.9
Oman	-0.9	2.1	1.2	6.0	2.8
Qatar	1.6	2.1	3.0	3.2	3.4
Saudi Arabia	-0.7	2.2	1.7	3.1	2.3
United Arab Emirates	0.8	1.6	2.6	3.0	3.2

Source: World Bank, *Macro Poverty Outlook – Spring Meetings 2019.*
Notes: e = estimate, f = forecast. GDP at market prices measured in constant 2010 U.S. dollars.
1/ Exports less imports of goods and non-factor services (GNFS).

4.6. GCC Economic Reforms

The sustained fall in oil prices from the end of 2014 resulted oil GDP growth taking a hit. This was especially evident in GCC countries with expansionary phases and facing strained budgets. (see Graph 4).

Graph 4: Brent and WTI Crude Oil Prices



As a response to lower oil price projections and OPEC production cuts, the GCC countries are increasingly using stimulus programs to support growth (PNG Report, 2019).

Fiscal balance as a percentage of GDP can be used as "an instrument to measure a government's ability to meet its financing needs and to ensure good management of public finances". The increased government expenditures and lower revenue growth are a result of decreased oil prices which led to government deficits (negative fiscal balance as a percentage of GDP) in GCC countries except for Qatar and Kuwait.

Table 1: GCC Fiscal Balances 2009-2020

Fiscal Balance, as % of GDP	KSA	Kuwait	UAE	Qatar	Oman	Bahrain
(2009-2014 Avg.)	4.1	29.3	3.2	12.5	3.8	-5.0
(2015)	-15.8	5.6	-3.4	4.5	-15.9	-18.4
(2016)	-17.2	0.3	-2.0	-5.4	-21.3	-17.6
(2017)	-9.2	6.3	-1.4	-2.9	-14.0	-14.2
(2018)	-5.9	8.7	1.2	5.3	-7.9	-11.9
(2019 e)	-6.1	6.7	-1.6	7.0	-6.7	-8.0
(2020 f)	**-6.6**	**3.8**	**-2.8**	**6.9**	**-8.4**	**-8.1**

Source: IMF

This partly explains the need to borrow from the market. Additionally, governments seem averse to economic structural reforms notwithstanding the social effects of new taxes, removal of subsidies, wage bills and expenditure cuts. Political opposition to fiscal reform is also widespread in some countries. Table 5 below compares gross debt as a percentage of GDP for all the six GCC economies from 2014-2020 which indicates the country's ability to pay back its debts. Without exception, all GCC economies registered increases in the level of debt; with Oman and Bahrain at the higher end, and has led to key reforms such as selective taxes and introduction of value added tax in Bahrain, Saudi Arabia and UAE (2018 and 2019).

Table 2: GCC Gross Debt 2009-2020

Gross Debt (% of GDP)	KSA	Kuwait	UAE	Qatar	Oman	Bahrain
(2009-2014 Avg.)	5.8	4.6	18.6	30.5	5.4	34.7
(2015)	5.8	4.7	18.7	35.5	15.5	66.0
(2016)	13.1	10.0	20.2	46.7	32.7	81.3
(2017)	17.2	20.7	20.0	49.8	46.4	88.2
(2018)	19.0	14.7	19.1	48.6	53.4	94.7
(2019e)	23.2	15.2	20.1	53.2	59.9	101.7
(2020 f)	**28.4**	**17.4**	**20.3**	**48.0**	**63.9**	**106.9**

Source: IMF

In recent years, all GCC economies carried out reforms to stimulate private enterprises as well as improving the region's economic diversification. GCC nations are also diversifying their external market integration and improving investment friendliness. The box below illustrates the selected key reforms initiatives in the GCC countries compiled by the World Bank 2019, IMF Article and Oxford Business Group. These reforms mainly deal with improving the business environment with a view to improve international attractiveness measures globally. Trade and foreign ease of investment through regulatory framework reforms is used to attract inward investments which is the reverse of historic trends i.e. being capital exporters globally.

Figure 11: Reforms and Growth Initiatives in the GCC

Selected reforms and growth initiatives announced in 2018-19

Source: World Bank 2019 Doing Business Reports, IMF Article and Oxford Business Group.

	Domestic business climate	Trade & foreign investment climate	Other areas of reform
United Arab Emirates	• Fees exemptions for selected companies with fines accumulated as end-2017 (Dubai), for businesses with expired licenses (AD), late license renewal fines (till end-2018 Dubai) and late payment fees on property registration (Dubai). • Dubai municipality market fee halved to 2.5% and 19 fees in aviation industry eliminated. • All new business licenses exempted from the requirement of having a registered office or a work space for two years and permanent home licenses allowed (Abu Dhabi). • Instant licensing systems for most commercial activities to be implemented. • A new Local Production and Procurement Support Program encourages public institutions and large companies to procure from local suppliers (Dubai). • Accelerated settlement of all delayed payments to private sector contractors announced (Abu Dhabi). • Bank guarantees for labor were replaced with a low-cost insurance policy.	• 100% foreign ownership of UAE based businesses allowed in selected sectors. • Dual licenses allowed for companies operating in free zones, enable enabling on-shore operations and to participation in public procurement tenders. • New initiatives to facilitate ecotourism to be developed (Abu Dhabi). • Abu Dhabi Accelerators and Advanced Industries Council ("Ghadan") to be established to support high value-added investments {Abu Dhabi). • 10-year residency visas introduced for specialists in medical, scientific, research and technical fields, entrepreneurs and exceptional students; 5-year residency allowed for other students. Visa extensions eased for dependents and graduating students. 5-year renewable residency visas announced for retirees. • A review of all fines in the healthcare and education sectors initiated. • A review of real estate and infrastructure building regulations initiated with a view to easing compliance.	
Bahrain	• A competition law has been promulgated to become effective on February 1, 2019. Privatization plans have been announced for logistics sector. • A new Bankruptcy Law contains provisions for cross-border insolvency, and special provisions providing a higher threshold of protection against the insolvency of SMEs. The law also introduces provisions under which a company's management is allowed to remain in place and continue business operations during the administration of a case. • Reforms protecting minority investors by strengthening shareholders' rights in major decisions, clarifying ownership structures and requiring greater corporate transparency. • Legislation regulating the processing and transfer of data for commercial purposes, which should help reinforce Bahrain's standing as a regional ICT centre.	• Portal scanners were deployed, and the single-window system was upgraded. This helped improve Bahrain's cross-border trade efficiency by reducing bureaucratic processes and speeding up the import and export of goods.	

	Domestic business climate	Trade & foreign investment climate	Other areas of reform
Qatar	• Privatization initiatives in some sectors, for example health and education.	• Approved a law which permits 100 per cent ownership for foreign investors in most sectors. • Plans to establish SEZs have been announced.	• Announced a visa-free entry program for 80 nationalities to stimulate tourism, approved a draft law to grant permanent residency to foreigners who provide "outstanding services to Qatar", put in place a worker dispute settlement committee, and a trust fund in case workers face bankruptcy.
Saudi Arabia	• Bankruptcy law was promulgated in August 2018. Private sector participation law was drafted and circulated for public consultations. • Introduced a new electronic procurement platform (Etimad) and announced a new public procurement law (effective from July 2019) which should reduce potential risks of corruption and waste in procurement. • Updates to companies law and competition law. • Law requiring Saudi Electricity Company to compensate customers for violations of guaranteed standards. • Female empowerment: women permitted to drive June 2018, Consent of male guardian no longer needed to start a business February 2018, Access to certain jobs in the military. • Fund of Funds created by PIF to invest in venture capital and private equity funds. Restructuring of the partial credit guarantee scheme for SMEs (Kafalah program). Investment Fund created to invest in SMEs.	• Steps to improve government processes including for new business licensing are ongoing. Some relaxation of FDI restrictions is underway. • Trade facilitation and customs modernization initiatives are underway. KSA launched an electronic trade single window that simplified the submission of documents and the overall customs clearance process. The Kingdom launched a new National Single Window (NSW) for trade–called FASAH with MASAR a module that allows tracking. • Authorization of qualified foreign companies to have full ownership of engineering firms. • Foreign investment licenses available for 5 years (1 year previously). • Regulations approved for issuance of tourist visas.	• Gasoline and electricity prices were raised on January 1, 2018 and a plan for further increases in energy and water prices over the medium-term was set out in the 2018 budget. Citizens' accounts, covering over one-half of the Saudi population, were activated in December 2017 to provide financial compensation. • Prohibition of issuing new work visas for 19 professions restricted to Saudis. Issuance of a Ministerial decree to limit work in 12 sales activities to Saudis effective September 2018. Amendments to Nitaqat introduced, increasing the mandatory employment ratio of nationals to expatriate employees. • Programs to help with transportation and childcare costs have been rolled out nationally. • Inclusion of KSA in emerging market index. The Capital Markets Authority raised foreign ownership limits, eased registration limits for qualified foreign investors, enhanced the clearing and settlement process and introduced securities lending and short selling. More recently, it established a central counterparty company to prepare the market for derivatives trading and enabled the listing and trading of government debt instruments. • Creation by the Public Investment Fund of a mortgage refinance company.
Kuwait	• Eliminated the paid-in minimum capital requirement. • Introduced a requirement of an independent review of related party transactions & clarifying ownership and control structures.	• In March 2018, the government announced the Northern Gulf Gateway project, which aims to connect Kuwait and its hinterland countries with China's Belt and Road Initiative, beginning with the operation of the new Mubarak al-Kabeer port.	• Important capital reforms that led to Kuwait's inclusion in the FTSE list include the segmentation of stocks according to market capitalisation and liquidity in April, intended to incentivise improvement. More recently, Kuwait started the publication of foreign ownership data for Kuwaiti banks for the first time. This is required by index providers to assess foreign ownership limits.
Oman	• Royal Decree 2/2018 established a Centre for Competition Protection and Prevention of Monopoly.	• Recent efforts include a reduction in the number of licensing requirements in some sectors and automatization of business registration and licensing through a new Invest Easy e-service platform.	

Source: World Bank 2019, IMF Article and Oxford Business Group

4.7. Developments and Trends in the GCC Capital Markets

The following section discusses the overall financial and bond/*sukuk* markets landscape in the GCC and its development vis-à-vis other fund-raising options. It discusses existing economic structures in the GCC region, which was addressed in the last chapter, followed by a more specific focus on the GCC financial markets. This research follows the current trends of the GCC debt markets. We will highlight and analyse the reasons why these markets are gaining prominence globally.

4.7.1. Macro Overview

Macroeconomic developments in the GCC countries are undergoing economic and structural reforms. This important transformation also gives rise to an important study on how financial systems of the GCC countries can support these reforms and enable the necessary financial intermediation roles to take place in a more efficient manner.

The GCC region is unique, to name just two; it sits on one of the world's largest oil and gas reserves with Saudi Arabia, United Arab Emirates (UAE) and Kuwait being part of the top ten global oil producers representing approximately 25% of the global crude export. Secondly, the GCC region hosts the highest concentration of monarchy-led governments in the world. One can argue that all of the GCC economies share the monarchy-business elite political economic model. This is dynamically changing now by undergoing at the fundamental level with more members of the respective ruling family participating directly in the economic sphere.[2] This monarchy-ruled system sets up a distinguished style of governance politically, economically and socially.

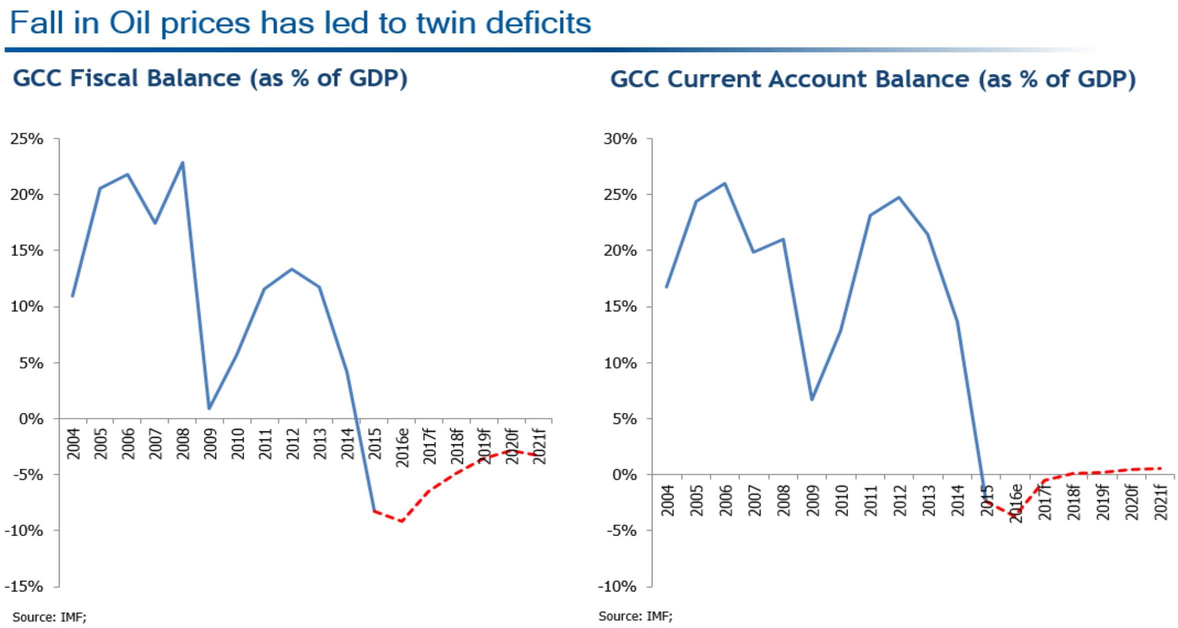
These two factors combined, make the GCC countries unique oil-rentier states. Whereas other oil-rentier states have seen political economic turmoil with change or fall of regime, the GCC nations have, to this date, been somewhat insulated from such political disruption. More interestingly the GCC nations have thus far successfully weathered the storm with very minimal domestic reforms especially in the financial sector. The GCC economies have traditionally little incentives for financial reforms as the domestic economy has enjoyed liquidity from the oil sector over the last decades. These petrodollars have allowed the GCC economies to accumulate sizeable external reserves and provided the GCC states with the ability to reinvest in domestic and foreign assets (Ari et al., 2019).

[2] This is evident in many GCC economies like Kuwait, Oman, and Saudi Arabia. See Kamrava, Nonneman, Nosova, and Valeri, 2016.

4.7.2. The Twin-deficit Hypothesis

The year 2014 marked the downturn of oil prices as it hit its lowest level in decades. Although prices have rebounded, they barely recovered to the pre-crisis level hovering at around US$70 per barrel. The dwindling oil price has taken its toll on the GCC economies. Since the oil price drop started in late 2014, the GCC economies have run twin deficits - both budget and trade deficits (for positive correlation between budget and trade deficit see Darrat, 1988; Abell, 1990; Zietz and Pemberton, 1990; Bauchman, 1992; Rosensweing and Tallman, 1993).

Graph 5: Twin Deficits in the GCC



The trend in fiscal and external imbalances have been rather alarming since 2015 reflecting the falling oil prices and declining government revenues. Table 6 below compares the fiscal and current account balance for all the six GCC economies from 2014-2017. With the exception of Kuwait and the UAE, all the other GCC economies registered twin deficits between 2015 and 2017.

Table 6: Fiscal and Current Account Balance in the GCC

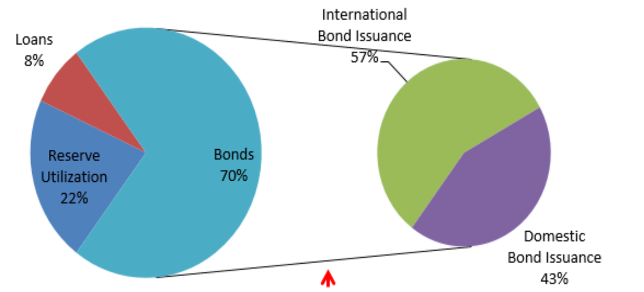
GCC Economies	Fiscal Balance (% of GDP)				Current Account Balance (% of GDP)			
	2014	2015	2016	2017	2014	2015	2016	2017
Bahrain	(5.00)	(18.40)	(17.70)	(13.20)	3.30	(2.40)	(4.70)	(4.60)
Kuwait	22.36	5.59	0.63	3.96	33.45	3.50	(4.51)	1.97
Oman	(3.40)	(17.20)	(22.00)	(13.00)	5.10	(15.40)	(18.80)	(14.30)
Qatar	12.30	(0.90)	(9.20)	(5.80)	24.00	8.40	(5.40)	3.80
Saudi Arabia	(2.30)	(14.80)	(12.80)	(8.90)	9.80	(8.70)	(3.70)	2.20
UAE	5.00	(2.10)	(3.90)	(2.60)	4.60	4.90	3.70	6.90

Source: Central Banks of various GCC economies; Saudi Arabia Monetary Agency

The IMF in 2016, stated that funding these deficits would require large drawdown of government financial assets in addition to issuance of domestic and foreign debt. Observations made across the region then confirmed the IMF's hypothesis with many GCC economies drawing down a significant portion of their respective financial buffers in 2017 (see Figure 12 below).

Figure 12: Financing Need for GCC Sovereigns

Expected Financing Mix



Expected Financing Mix, 2017 (USD bn)		
Overall Financing to be Raised	**111.3**	**100%**
Reserve Utilization	24.0	22%
Loans	8.8	8%
Bonds	**78.5**	**71%**
- International Bond Issuance	*44.5*	*57%*
- Domestic Bond Issuance	*34.0*	*43%*

Expected Financing Mix to Cover Deficits

Country (Reserve Utilization/Debt Issued)	A. Projected Deficit	B. Reserve Utilization	Expected Debt Issuance (A-B)	International Issuances	Domestic Issuances	Expected Loans
Saudi Arabia (20%/80%)	(65.3)	13.0	**52.3**	20.0	30.0	2.3
UAE (100%/0%)	(7.9)	7.9	-	-	-	-
Qatar (0%/100%)	(17.3)	-	**17.3**	10.0	1.8	5.5
Oman (45%/55%)	(6.8)	3.1	**3.7**	2.0	0.7	1.0
Kuwait (0%/100%)	0.0	-	**10.0**	10.0	-	-
Bahrain (0%/100%)	(4.0)	-	**4.0**	2.5	1.5	-
GCC	**(101.3)**	24.0	**87.3**	**44.5**	**34.0**	**8.8**

Source: Marmore Research; Note: Kuwait is expected to issue USD 10bn worth of bonds in 2017 though it is not projected to report a deficit as per IMF estimate

Saudi Arabia, for instance, used its extensive reserves to finance its current account deficit and partially privatized Aramco in Q4 2019, floating 1.5% and generating US$119 billion to the government. This was paired with the introduction of new taxes to help fund its twin deficit. The latter tool, issuance of debt, did not gain much traction. Although, according to Standard & Poor's Global report, there is a continuous increase in *sukuk* issuance volume, the outstanding *sukuk* by end of 2018 was US$477 billion representing 0.5% of global debt securities (Zawya, (May) 2019). Such volume represents insignificant portion of the global volume of US$100 trillion which indicates that there is room for growth and a change in fiscal management strategy.

There is no denying that most of the GCC economies have relatively sufficient reserves to bridge the deficits at least in the mid-term. Nonetheless, in the long-term, the GCC economies must employ more balanced strategies to achieve sustainable economic development with diversified funding sources to support them. Given the currency pegs with Special Drawing Right (SDR) adopted across the GCC region (except Kuwait), adjustment to lower oil prices should ideally be accomplished through fiscal consolidation. This however may curtail the government's ability to expand public spending for critical development and socio-economic programs. The GCC economies could make their exchange rates regime more flexible in the near run, but external adjustments through exchange rate depreciation remain difficult. However, it is unlikely that the current currency regime will be abandoned due to strong focus on maintaining the right fiscal policy.

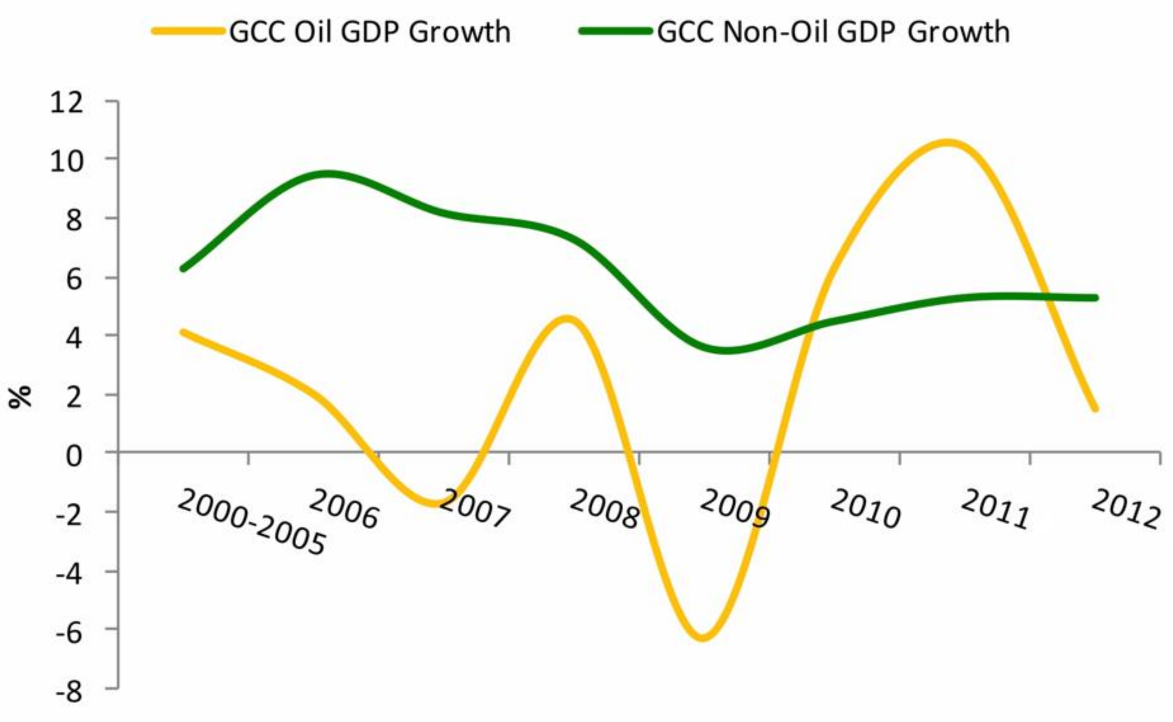
Hence, the dilemma continues for the GCC economies to strike the balance between maintaining expansionary fiscal policy and mitigating declining oil revenues. This dilemma opens an opportunity for debt-financing mechanisms. Caught with falling oil exports that further tightens government revenues, the GCC economies must start seriously developing and deepening their capital markets. This is crucial as a developed capital market can act as a more sustainable alternative to funding the government budget and reducing oil-dependency for public expenditure. A sound debt market will offer more fiscal and monetary flexibility to policymakers in the GCC economies.

4.8. The GCC Economic Dilemma

The debt market is not a stranger to the GCC economies. Nonetheless, its development has never been consistent, and its depth has been hampered by the too strong a role played by the public, (rather than the private), sector. From the mid-80s to the late 90s, under the low oil price environment, the governments in the GCC region accelerated public debt issuances to finance their fiscal deficits. The public sector was the only active participant during this period due to the weak private sector growth that had restricted demand for alternative financing.

Things began to take on a new turn in 2002 when oil prices started to pick up again. The return of higher oil revenues to GCC governments' coffers saw the GCC region register robust macro-economic growth numbers– resulting in balance of payment surpluses. What was also interesting, was that the non-oil sector registered an even stronger growth than its oil sector counterpart.

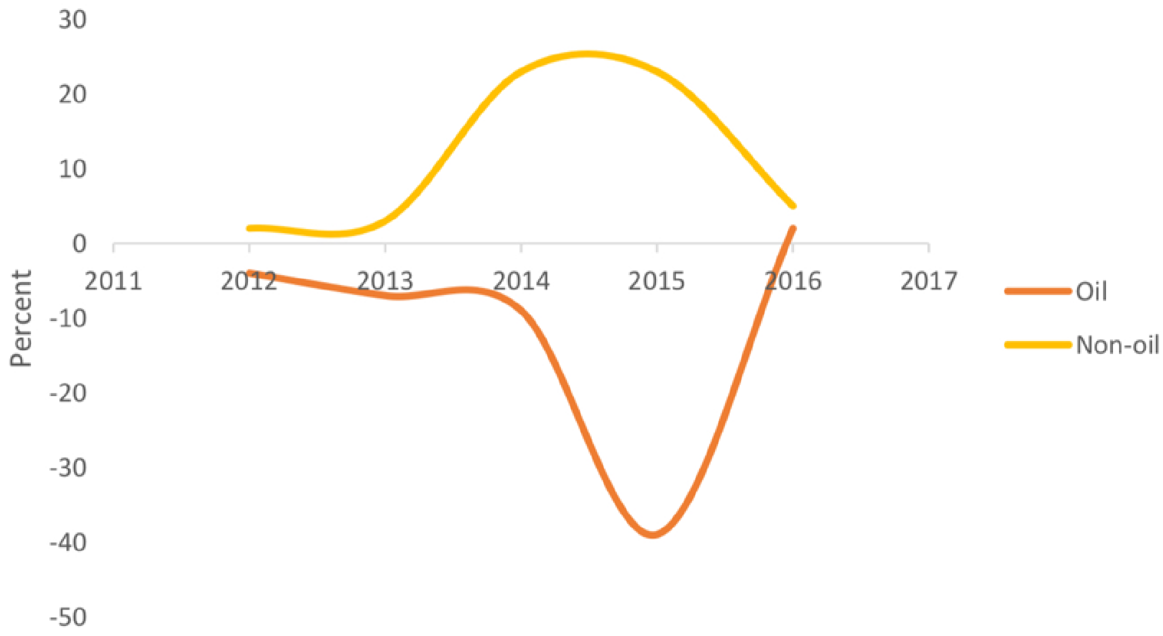
Graph 6: Growth in Oil vs. Non-oil Sector between 2000 – 2012 in the GCC



Source: Various sources Al-Shaikh, 2012; Authors' estimates

In fact, the non-oil sector remained buoyant between 2012 and 2016, see Graph 4. This growth clearly suggests real economic diversification in the GCC economies. The question is: to what extent is such diversification sustainable? Ari et al (2019) concluded that GCC countries rely heavily on public spending. There are concerns that on the back of stronger oil prices, oil-sector growth may outdo its non-oil counterpart. However, in this chapter, we optimistically foresee that strong non-oil sector growth will remain if backed up by a strong DCM which helps support long-term growth of the non-oil sector.

Graph 7: Growth in Oil vs. Non-oil Sector between 2011 – 2017 in the GCC



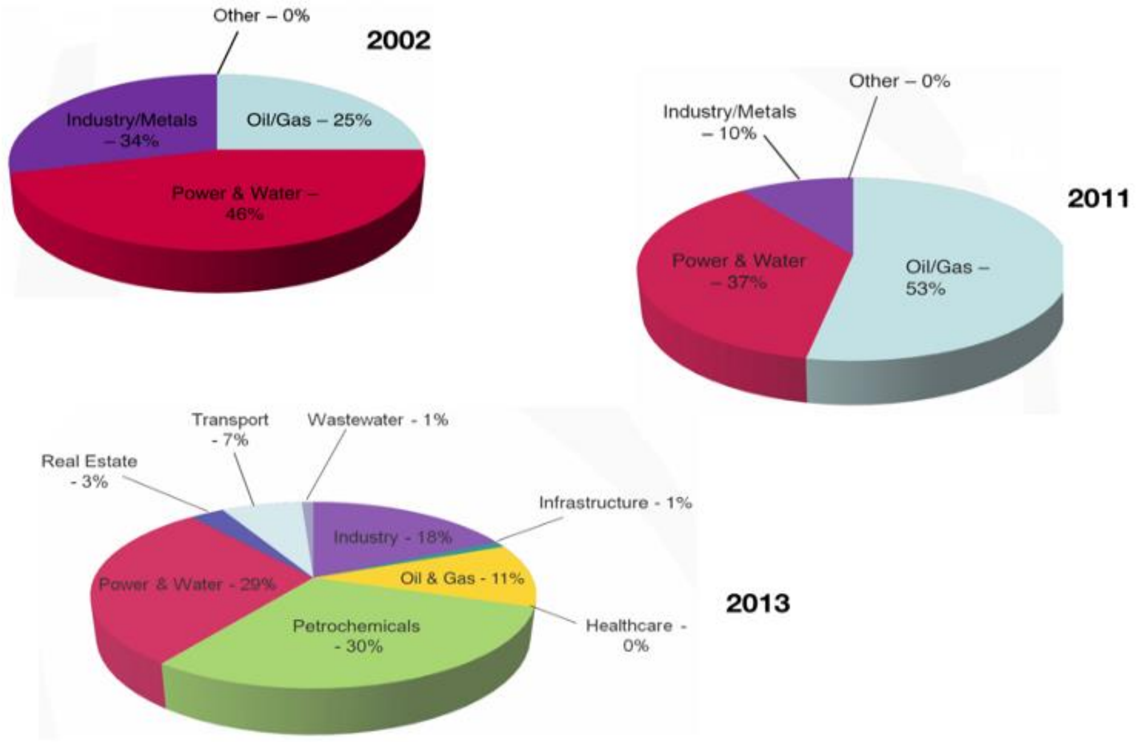
Source: World Bank database; Authors' calculations

4.8.1. GCC Public Sector Influence

The positive macro-economic outlook strengthened the GCC economies' fundamentals. The expansionary fiscal policies had seen numerous infrastructure and development projects being undertaken. It is important to note here that the banking sector was playing an indispensable role in financing these projects. Major Corporates procured their financing from conventional bank loans or from retained profits (Hertog, 2012).

In line with the GCC economies' long-term strategy of economic diversification, many of these infrastructure and development projects involved sectors that require longer tenure financing, see Graph 6. Banks, however, have reservations in extending long-term financing for infrastructure projects. The reason being, that these projects are weighed down by the risk of an asset-liability mismatch. Furthermore, there is also the issue of concentration of risk as well as regulatory requirements that restricted banks' exposure to such longer tenure financing.

Graph 8: Project Finance by Sector in the GCC between 2002 and 2013



Source: Harvey, 2013

The capital market then provided a good alternative funding source for these long-term infrastructure and development projects. The vibrant project finance market across the GCC economies heightened the necessity to diversify sources of funding as capital needs increased.

Here again, the GCC's dilemma continues. While the early years of the new millennium saw oil revenues pick up, the wealth and income distribution has not been equally distributed. Most of the GCC economies remain state controlled. This means that the state through its various agents and subsidiaries controlled much of the financial sector. Large corporates were owned by the state through majority or full share ownerships and there was marginal privately owned SMEs. Even if there exist private local companies, these mostly belong to large local merchant families who were also closely linked to the state in many of the GCC economies. As a result, private individuals or citizens were mostly excluded from the financial market with the majority of them forming part of the large public sector workforce.

4.9. Implications on GCC Stock Markets

Implications were further observed in the GCC stock markets[3]. Gray and Blejer (2007) noted that high oil production (higher oil revenues) did not lead to strong capital market growth. They observed that there is weak relationship between total oil production and market capitalisation. The reason being that more income may not generate a need for more locally produced goods and services, hence there will be no additional need for listed companies on the stock exchange market.

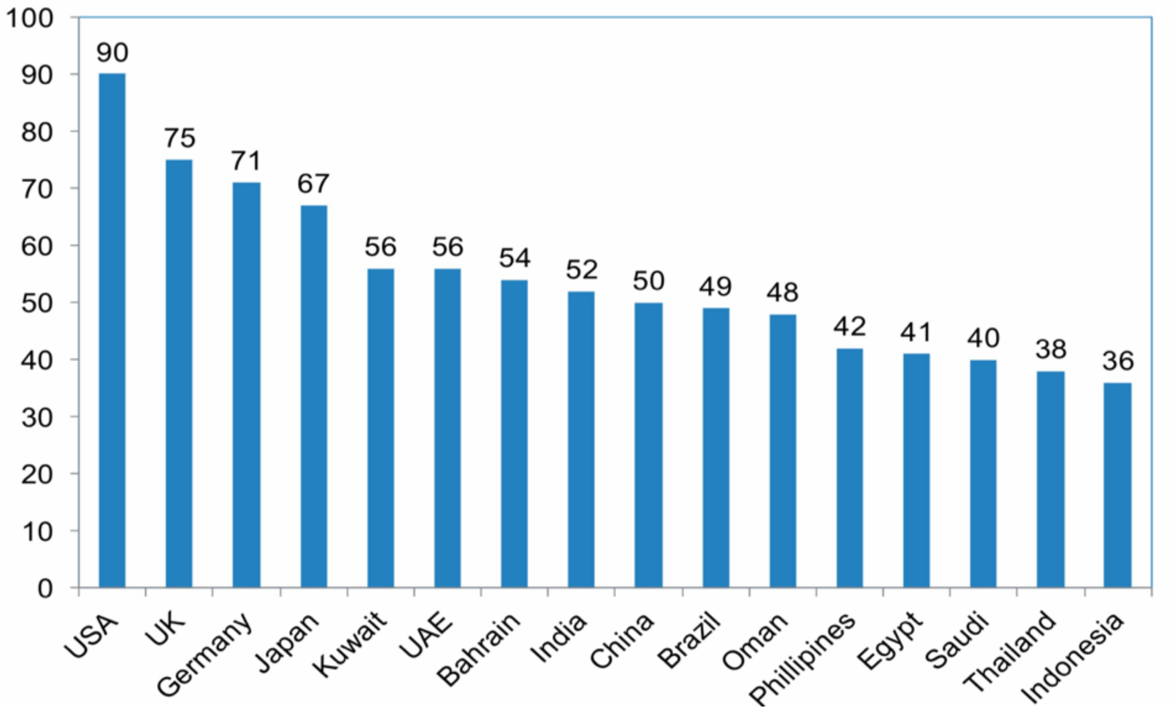
As a result, while the total capitalisation might have increased between 2002 and 2007, trading volume remained thin, and often based on speculation (Hertog, 2012). Hertog (2012) contends that much of the wealth on the stock exchanges represented a very concentrated type of actors namely the state-related entities or companies whose shares were held by a very limited number of large investors. In many GCC economies, large private sector groups remained family controlled. These conglomerates were not listed on the local stock markets.

Meanwhile, the large investors often did not trade these shares actively. State entities controlled some 30% of shares on many GCC stock exchanges with very low level of free float of actively traded shares (see Figure 3). As a result, price volatility remained high in the GCC markets (Sedik and Williams, 2011).

Restrictive or limited foreign participation in the stock exchanges did not bode well for the correct local company valuations (see Table 7). This became obvious for example in the 2006 stock market crisis in Saudi Arabia. Due to the bubble bursting that had speculatively built up in the H2 2006, valuations plummeted drastically in the UAE and Saudi Arabia. This downward trend in valuations continued even more sharply during the 2008 international financial crisis where companies across the GCC region were valued a third or less than their previous valuations just a couple of years before.

[3] The GCC region informal market existed well before the first equity market was established in Kuwait in 1977- the Kuwaiti Stock Exchange. Saudi Arabia followed suit by establishing its Tawadul All Share Index (TASI) seven years later. As of the third quarter of 2018, the total number of companies listed in stock exchanges across the GCC region stands at 689- a meagre 5% increase from almost a decade ago. States remain dominant in some of these key stock exchanges. Saudi Arabia, for instance, government-related entities held some 40% of shares as of June 2017 compared with 27% of retail investors. If one removes high-net worth individuals and individual professional investors, Saudi households only held 4% of shares in the market. A stock market culture then is still far-fetched (Saudi Stock Exchange Report, June 2017).

Graph 9: Equity Markets Free Float (% of market capitalisation)



Source: Sedik and Williams, 2011

Table 7: Market Participation by Nationality (select GCC economies)

(Percent)

Nationality	Saudi Arabia	Kuwait	Dubai
Nationals	95	92	55
GCC Citizens	2	3	6
Non-GCC	3	5	38

Source: Sedik and Williams, 2011

Al-Shaikh (2012) attributed such stock market turbulences across the GCC economies to the ever volatile and risky equity markets. It makes a strong argument for investment diversification. One such important source for diversification is the DCM. Ironically, even the debt markets remained underdeveloped across the GCC region even as the stock markets stagnated and struggled to recover. The next section will closely analyse key trends in the debt market development, focusing on bond and *sukuk* market to justify the argument for the deepening of DCM in the GCC region.

4.10. GCC Debt Capital Market

The recent global crisis in 2008 unveiled vulnerabilities of the GCC banking system (Al-Hassan, Khamis, and Oulidi, 2010). These vulnerabilities included the increased reliance on external financing, and high exposures to the real estate, construction sectors and equity prices. The financial sector of the region remained dominated by local banks, characterised by credit expansion to the private sector spurred by the high global oil price. This growth, to a certain extent, diverted the focus in developing a robust and active capital market to co-fuel the economic growth of the region. It is only in 2008 that there was a rising demand in the issuance of *sukuk* that further boosted interest issuances of *sukuk* to supplement growth of the region's bond market. The aggregate size of the bond and *sukuk* market of the GCC was only US$23 billion in 2008, as explained earlier, a miniscule size in comparison to other advanced financial markets or even emerging economies.

Having wasted diversification chances several times in the past, it is difficult to connect the shortfall through non-oil revenue such as taxes and levies. Essentially raising non-oil income through a removal or decrease in subsidies can be socially contentious. GCC citizens are accustomed to the state welfare economic model, therefore any abrupt changes to the government subsidies can unsettle the social fabric that the citizens enjoy. Given these limitations, the deficit can only widen or at best remain where the current estimates lie.

Therefore, there are only two possibilities: to draw on the general reserves or to borrow. The GCC member states differed in their approaches of dealing with the budget deficit. Kuwait's first option was from general reserves and to maintain the status quo. It withdrew US$141 billion between 2014 to 2015. While Saudi Arabia tried the same, draining its reserves by US$241 billion in the same period, it was also proactive. Given the macroeconomic and geopolitical constraints it resorted to borrowing and started with domestic borrowing before going to international markets.

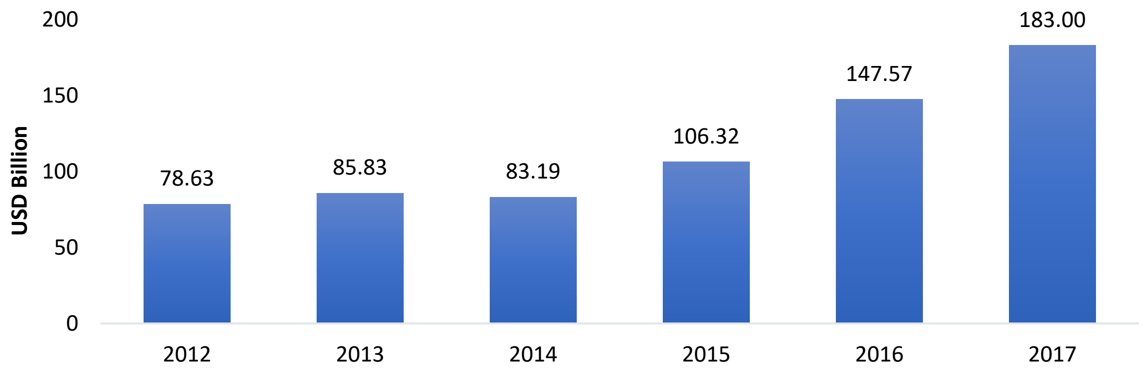
The question is if GCC countries enjoy substantial reserves and a liquid banking sector, why should it choose to tap the global bond market? The answer to the first question is simple: the opportunity cost of reserves is higher than the funding cost at the current general low interest rate environment (see Graph 10). The choice between global and domestic remains as a capacity issue for local banks. Also, governments may fear that local issuances can crowd out credit growth for the private sector (Raghu, 2016).

Graph 10: Interest Rates Movement between 2013-2018

In 2015 GCC economies focused on initiating and developing robust debt markets to ensure long-term sustainability and reducing their reliance on public funding as a structural measure. The surge of the GCC bond and *sukuk* issuances coupled with various developmental efforts by regulators and government agencies were a result of the recalibration of focus by the GCC authorities. This is partly a response by the GCC governments in managing the impact of the fall in oil price, that led to the twin-deficit. GCC corporates and sovereign related agencies were now more receptive and open to source funding from debt market compared to a decade ago.

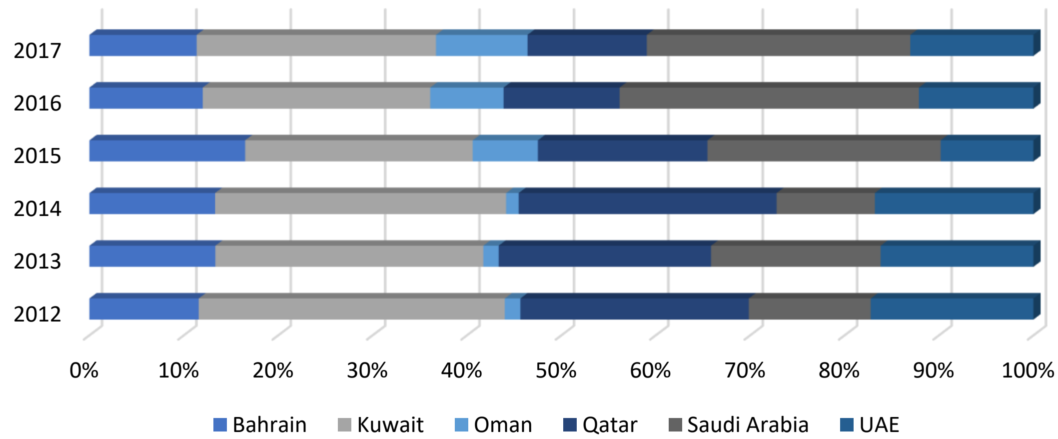
Graph 11 further illustrates the growth of bonds and *sukuk* issuances in the GCC. The size of bond and *sukuk* issuances in 2017 (US$181 billion) is twice the volume in 2014 (US$83.19 billion), representing a compounded annual growth rate of 15.11%. These figures include short term bills issued by the central banks or monetary authorities for liquidity management purposes–another important aspect to support breadth of a comprehensive bond market. Graph 12 shows a misnomer of Kuwait as the key domicile contributing to the issuances of bonds and *sukuk* in the region since 2012. While that is not the case as most of the issuances were short term Treasury bills and Tawarooq issues by the Central Bank of Kuwait which is the leading Central bank issuer in the GCC. Meanwhile, Saudi Arabia, despite having only contributed 16.8% to the total issuance of the region historically, has become one of the key domiciles for bonds and *sukuk* issuances (30% share). Similarly, Oman witnessed a growing trend by market share from only 1.6% in 2012 to almost 10 % market share in 2017.

Graph 11: Primary Bonds and *Sukuk* Issuances for the Period from 2012 – 2017



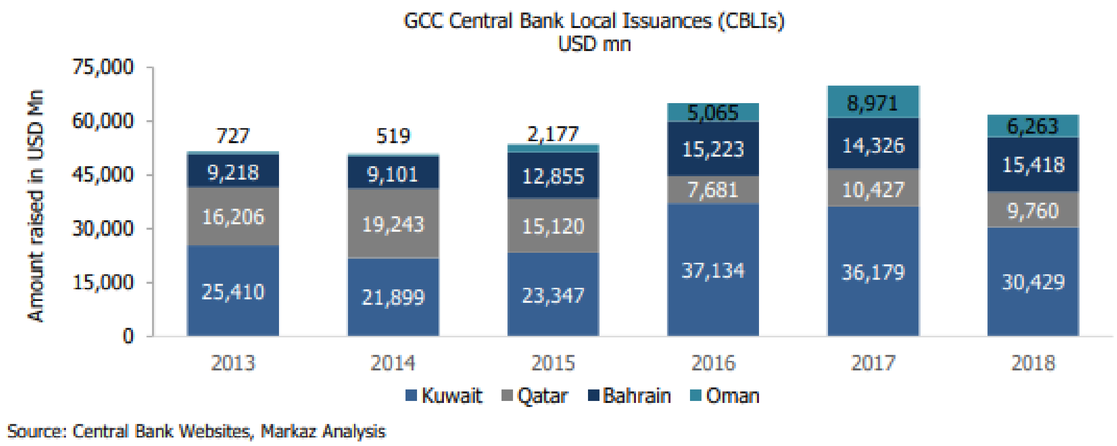
Source: Bloomberg, Thomson Reuters

Graph 12: Primary Bond and *Sukuk* Issuances by Domicile for the Period from 2012 – 2017



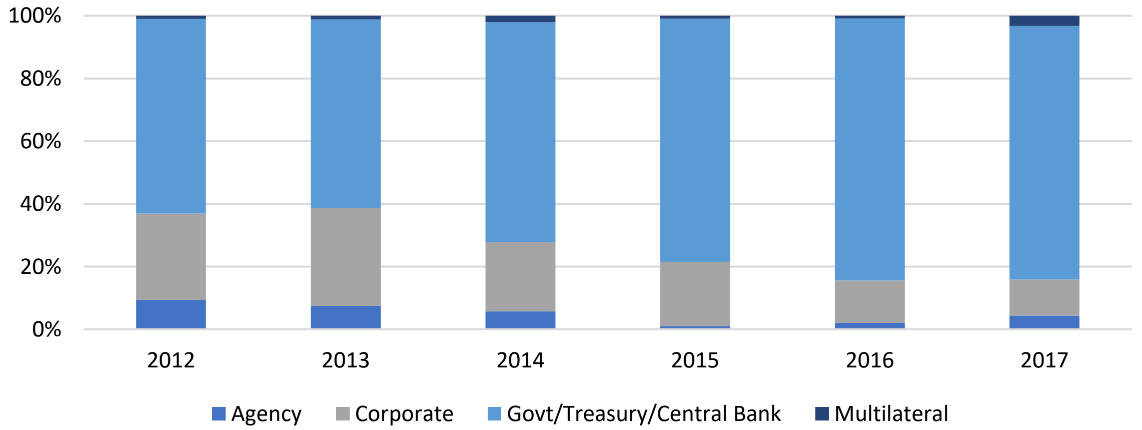
Source: Bloomberg, Thomson Reuters

Graph 13: GCC Central Banks Local Issuances for the Period from 2013 – 2018



In terms of type of issuers, there is a clear concentration of issuances by sovereign and government agencies e.g. government related companies or central banks as illustrated in Graph 14. The share grew higher from only 60% in 2012 to 80% in 2017. Mega issuances by sovereigns as part of their funding gap efforts further contributed to the rising share of this type of issuer.

Graph 1: Primary Bonds and *Sukuk* Issuances by Type of Issuer for the Period from 2012 - 2017

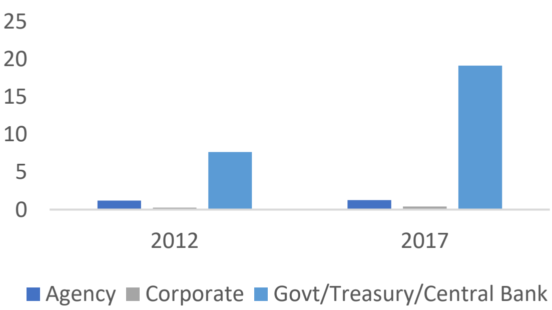


Source: Bloomberg, Thomson Reuters

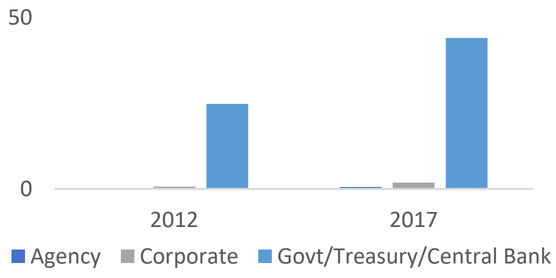
Corporate issuances remained stagnant ranging from US$18 to US$26 billion every year. No upward trend observed in the corporate issuances in the region up to 2017 and corporate issuances only contributed 11% of the total size of the primary bond and *sukuk* market in the GCC. Among the GCC countries, the UAE witnessed commendable growth of corporate bond and *sukuk* market (see Graphs 15-20 all in US$ billion)

Graph 3: Primary Bonds and *Sukuk* Issuances in the UAE in 2012 and 2017

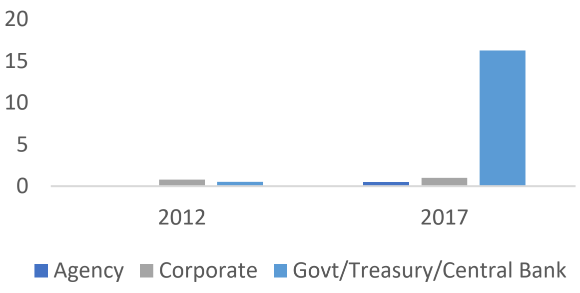
Graph 2: Primary Bonds and *Sukuk* Issuances in Bahrain in 2012 and 2017



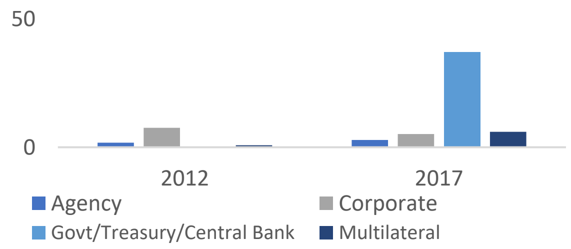
Graph 5: Primary Bonds and *Sukuk* Issuances in Kuwait in 2012 and 2017



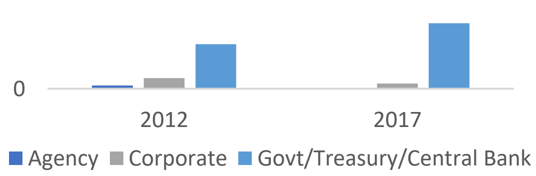
Graph 4: Primary Bonds and *Sukuk* Issuances in Oman in 2012 and 2017



Graph 6: Primary Bonds and *Sukuk* Issuances in Saudi Arabia in 2012 and 2017



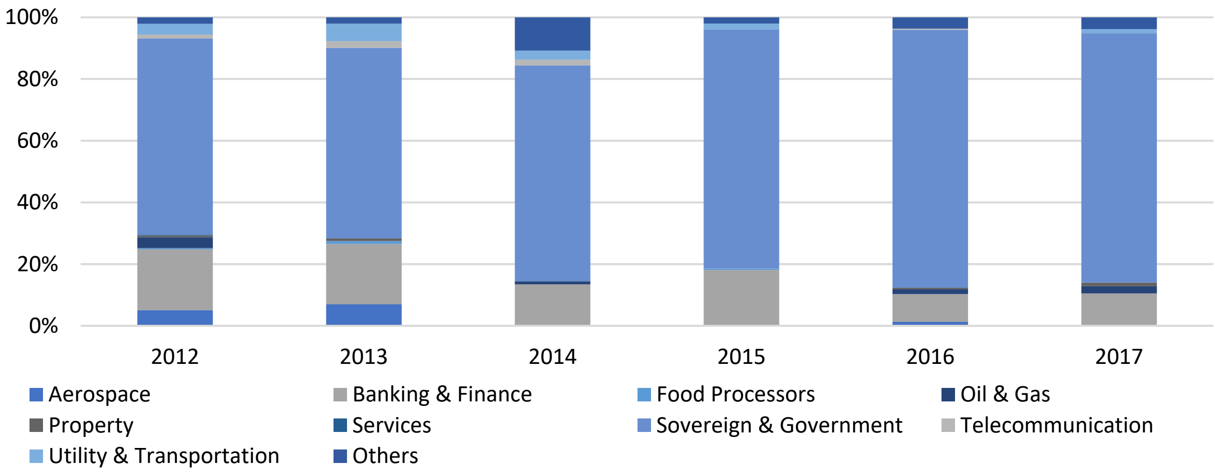
Graph 20: Primary Bonds and *Sukuk* Issuances in Qatar in 2012 and 2017



Source: Bloomberg, Thomson Reuters

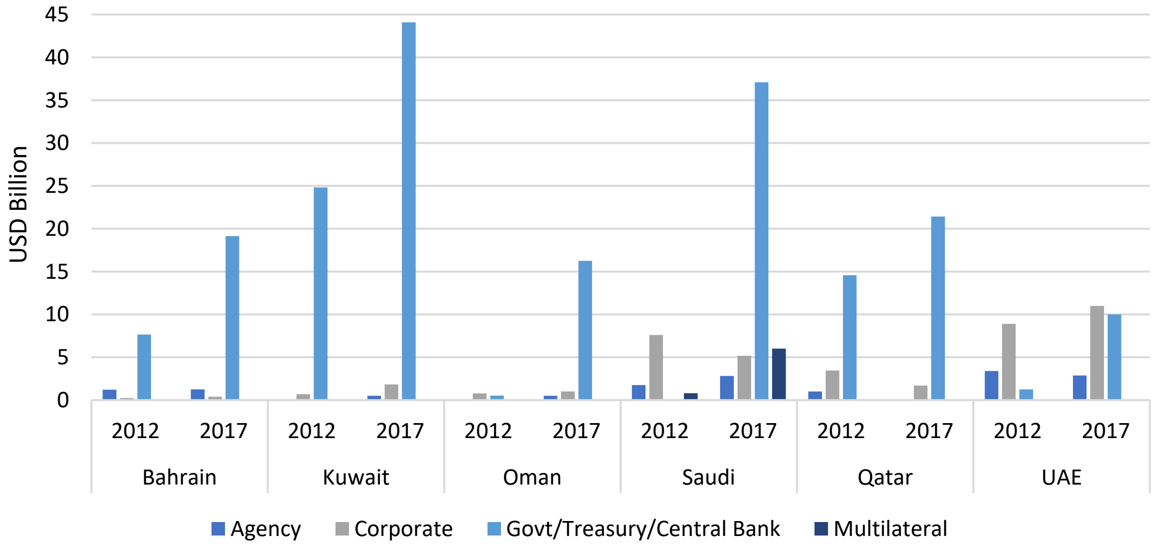
In line with the above trends, similarly by sector, bonds and *sukuk* issuances in the region were still dominated by sovereign and government agencies and the share became larger in 2016 and 2017. The second largest sector throughout the period from 2012-2017 was banking & finance. The remaining sectors are small as illustrated in Graph 19.

Graph 21: Primary Bonds and *Sukuk* Issuances by Sector for the Period from 2012 - 2017



Source: Bloomberg, Thomson Reuters

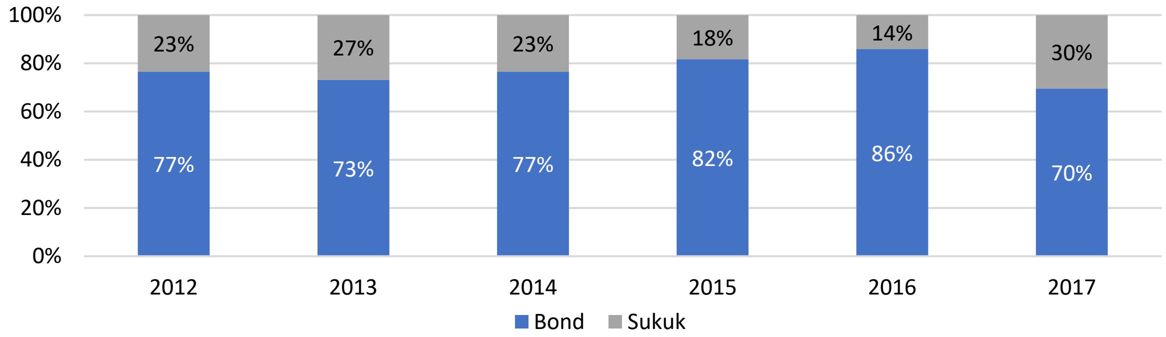
Graph 22: Primary Bonds and *Sukuk* Issuances by Sector for the Period from 2012 - 2017



Source: Bloomberg, Thomson Reuters

Despite current concentration by sovereign issuances, there are several positive indicators that the region is indeed entering a new phase of growth in its debt markets. First is the traction of *sukuk* globally, including in the region that can attract a wider investor base compared to the conventional bond issuance. Graph 22 shows the market share of *sukuk* has upsized to 30% in 2017, from only 18% share in 2015.

Graph 23: Composition of Bond and *Sukuk* for the Period from 2012 – 2017 (%)

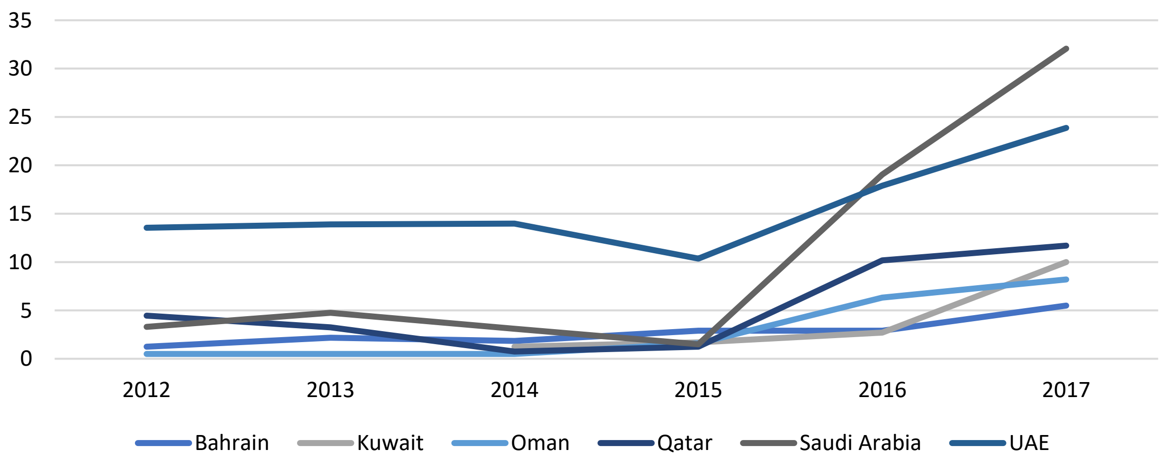


Source: Bloomberg, Thomson Reuters

The second positive indicator is the more regular issuances of US dollar issuances to tap foreign investors to bring in more liquidity into the region. Again, 2015 became the turning year for the region, illustrating growth of US dollar bonds and *sukuk* issuances in all 6 countries of the GCC region (see Graph 23). This was driven both by bond and *sukuk* issuances as depicted in Graph 24.

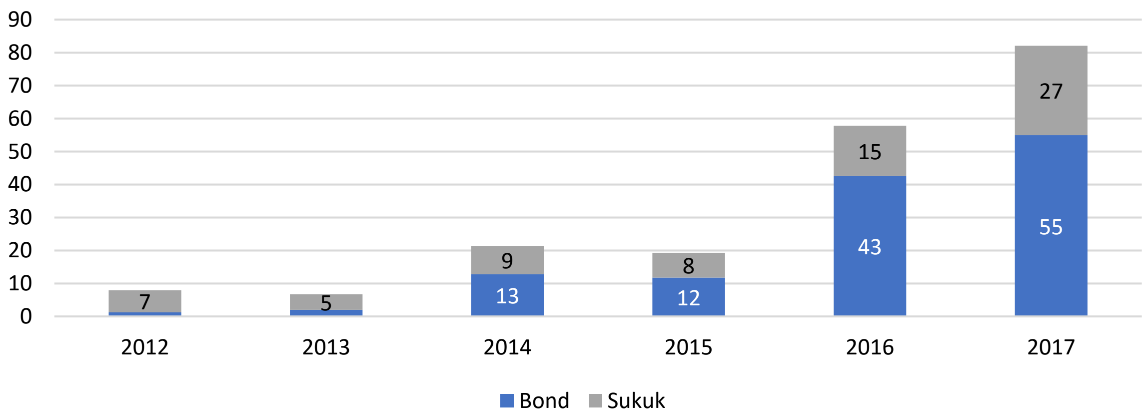
Conventional issuances continued to dominate the mix of primary GCC Bonds and *sukuk* market, raising 78.1% of the total issuances. This can be explained by established bond issuance framework and the investors familiarity with the bond market. However, *sukuks* require more legal and *sharia* structuring. The maturity term five to ten years continued to dominate the GCC market (see Graph 25). This represents a setback in terms of access for longer term funding for both sovereign and corporates in the GCC.

Graph 7:US Dollar Bond and *Sukuk* issuance in the GCC, 2012-2017 (US$ billion)



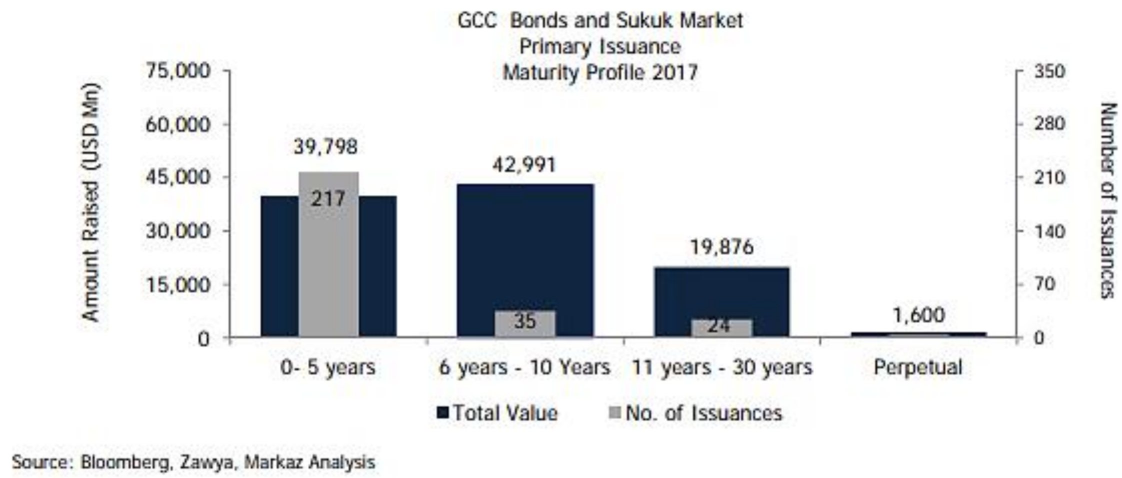
Source: Bloomberg, Thomson Reuters

Graph 8:Composition of Bond and *Sukuk* for the Period from 2012 – 2017 (%)



Source: Bloomberg, Thomson Reuters

Graph 9: GCC Bonds and *Sukuk* Primary Issuances Maturity Profile 2017



The growth of the primary bond market in the region is still behind potential and is expected to continue to rise exponentially. The following section will further discuss developmental aspects of bond ecosystem including recent development measures undertaken by the GCC nations in developing their bond and *sukuk* markets.

History has shown that debt securities have been the preferred instrument by governments to manage their fiscal balances in times of low oil revenue. The consistent dominance of sovereign bond issuances in the GCC region is a testimony to it. Even during the oil boom period (2003-2008), sovereign issuers remained the dominant thanks to the weaker non-oil sector growth (Woertz, 2008).

Having said that, such dominance was briefly interrupted between 2006 and 2007 when corporate debt issuances surged above the 50% threshold due to market liquidity abundance. Nonetheless, the financial meltdown in 2008 had spurred once again the contribution of non-sovereign debts. Investors again tilted towards sovereign debts as they saw lower credit risk associated with sovereign compared to corporate debts.

4.11. Conclusion

In summary, prior to 2015, GCC countries did not face any major funding gaps, until faced with fiscal deficits resulting from the drop in oil prices. This has led the governments to borrow more from both local and international markets. Since then, the oil market has undergone a lot of turmoil resulting in a major change to the way debt has started to form a significant part of the GCC government funds. Initially a lot of the government debt was issued locally. However, most GCC governments became aware of "crowding out" effect on the private sector and started international issuances.

The international markets needed a new asset class in emerging market debt with a low risk profile. There was a market demand for an asset class that displays lower correlation with shocks and can act as an anchor for the international financial system. The GCC DCM would be ideal in this sense because its securities would be backed directly or indirectly by the region's hydrocarbon reserves, accumulated private and public wealth and political stability. Furthermore, the value of the GCC DCM would be reinforced by a series of future fundamentals such as organic growth capacity reinforced by the desire for economic diversification reforms as a matter of public policy.

This chapter has revealed various trends that are pertinent in charting the future trajectory of the GCC financial sector. It is observed that the banking sector remains dominant in the financial sector across the GCC region. One of the key reasons is the political economy of the GCC economies. Most, if not all, of the banks are state controlled and they constitute significant influence as well as strong bargaining position in the overall economic affairs of the GCC region. Reducing their role in the economic life of these GCC economies will have potential political ramifications.

Nonetheless, moving forward into a highly volatile economic environment that requires not only economic resilience but also innovation, the GCC region has little choice but to start configuring new ways of accomplishing goals. As common wisdom from existing literature, the non-oil sector, instead of the oil-sector, is expected to drive long-term and more sustainable growth and the banks' role as financiers may be limited. It is therefore contingent upon the GCC economies to critically develop their respective capital markets.

The chapter is cognizant of the potential of the GCC's capital market including Islamic capital markets. The available data demonstrates on how underdeveloped the debt market is across the GCC region. Be it bond or *sukuk*, the GCC region is yet to position itself competitively among other developed regions. The next chapter will examine the development of the DCM challenges facing Kuwait as a development case in the GCC countries and how it can happen in varying degrees and speed.

Chapter 5: Research Methodology

5.1. Research Methods

These qualitative research methods focus on examining the promising prospects of DCM issuances in GCC. The critical issues identified in the field were elucidated using points of view of experts, Islamic capital market practitioners and thought leaders in the Islamic finance space, making use of their experience and solutions within the DCM field.

Here we define the qualitative research methods used in this thesis including several techniques to examine how financing instruments using DCM in GCC have developed and progressed.

Qualitative research is widely implemented due to its effectiveness in revealing indistinct aspects like socio-economic conditions, public customs and religious norms related to this research. The conclusions from qualitative data can be broadened to related professionals who share comparable characteristics for more accurate outcome (Denzin and Lincoln, 2005). We discuss the research philosophy, with emphasis on Organisational Ecology and Institutional Theory, and further this by answering why we have used a qualitative over a quantitative approach. The method also requires Historical methods for analysis and deduction and the use of semi-structured interviews for the contemporaneous nature of the research, this also makes use of Phenomenology. Finally, we describe the research difficulties and limitations.

5.1.1. Research Philosophy

The research philosophy used here significantly influences the results and has therefore been carefully considered including the use of Organisational Ecology.

This thesis theoretical framing deploys Organisational Ecology Theory (OE) an approach that is only recently being utilised to explore underdeveloped markets and how they can emerge and evolve. In some respects, this study will set a precedent for a financial market which is still evolving in terms of regulatory and legal framework relating to the GCC finance industry. The lack of products and issuances scale of bonds and *sukuk* in the GCC market and lack of market-depth, means that information and data are similarly rate limiting and in turn impact the direction of the analysis and the methods used.

My research will use OE and Institutional Theory (IT). OE examines how organisational populations change and develop over time through stages of founding, growth, transformation, decline and death (Hannan & Freeman, 1977, 1989). The theory looks at i) increase in organisational diversity and ii) decrease in organisational diversity and iii) dynamics within organisational populations by addressing the social, political and economic forces. This can for example be achieved through creation of new organisational forms and driving away organisational forms through competition (Hannan & Freeman, 1989).

IT considers how authoritative guidelines for social behaviour are established based on structures, including schemas, rules, norms and routines. William Richard Scott (1995, 235) contends that IT focuses on the deeper and more resilient aspects of social structure. The ostensible subject is stability and order in social life and includes consensus, conformity, conflict and change in social structures.

While OE is interested in population led studies, and how they make sense of the environment with emphasis on the concept of "legitimation" of the DCM. Legitimation of an organisation is defined as "the generic fit with the schemas and a low frequency of observed schema-violations lead observers to take for granted the behaviours that fit the schemata" (Hannan, M. 2008). OE is framed in terms of the process of persuasion and legitimation, the impact and benefit on various DCM stakeholders in the GCC region as regulators, banks, investments companies, rating agencies, investors and the general public. This will enable us to develop a change plan, methodology and approach for Market development.

The concept of legitimation is contextual hence the traditional deductive methodologies need to gain insights of what is thought to be important from the interviewee's perspective. Therefore, it will focus on the aspect of "legitimation" to understand the impediments that are affecting the development of the DCM in the GCC region.

The methodology provides evidence of political legitimation deficit has led to challenges and difficulties in the market. It is important that we look at the political legitimation process and the regulators interest in developing a legal framework for controlling the market to ensure increasing legitimacy of the population and access to the market.

We believe that there are additional issues e.g. market recognition and "taken for-granted-ness" of the DCM in the GCC region. These markets need the regulators involvement in creating the platform and the environment for the market to grow. This in turn requires focused effort and persuasion of the value proposition that DCM would bring to the overall welfare of the stakeholders. Since persuasion and legitimation are of tacit nature, this type of research methodology is considered as the most appropriate approach while examining and analysing it.

This interpretive research uses OE and IT philosophy as both can relate and interpret the details of the current DCM and can evaluate how the cases are structured from a financial perspective. Furthermore, as the sample size is small and the data collected cannot be meaningfully processed, therefore a qualitative approach is used to derive information from secondary data.

5.1.2. Research Methodology

Action-based research has become more prevalent over the years and has been utilised in a variety of industries, which include business and information. Action research provide a temporal reflection of a contemporary event with defined problem(s) and feedback to improve the initial *status quo*. The approach involves developing and testing good practice in the provision of *sukuk* DCM and the emerging shared learnings. These learnings will provide the fundamental source of revision in GCC member policies and practices and as such will make the provision more effective for DCM in the GCC.

The present study adopts an action research design approach, as it aims to solve the contemporary problem of the DCM requirements in GCC regions. The action research design collects information regarding the current phenomenon or problem, analyses the data and afterward develops a plan to solve the identified problem. The present study identifies the of underdevelopment of the DCM in the GCC and the solutions to overcome the underdevelopment. The main source of data for this research is based on documents and textual analysis. Therefore, relevant material, pertaining to GCC countries and Islamic finance, in the form of secondary data were collected from books, primary research articles, and reports. Interpretative method is used to analyse the data by critically investigating how the data and material aligns with the questions raised in this study. The dissertation adopts a case study strategy using an inductive approach to examine the country cases based on ecosystem issues and evolution.

The purpose of the study is to demonstrate that the availability of developed and innovative structures could increase the depth and volume of DCM issuances. In addition, we aim to establish that a clear and efficient legal and regulatory framework setting would enhance the DCM issuance and will drive an active DCM in the GCC. It also aims to identify the ways in which GCC could unlock the DCM potential.

The research methods will carry out systematic analyses focusing mainly on reviewing and analysing the regional DCM issuances within the GCC between 2014 and 2017. The research will focus on the GCC DCM within the boundaries, regulations and laws of the GCC countries with particular emphasis on Kuwait.

5.1.3. Research Strategy

The best research strategy to meet the objective was based on appropriateness; as "what matters is not the label that is attached to a particular strategy, but whether it is appropriate for [the] particular research" (Saunders et al. 2009). The advantages of the Historical approach are obvious for this research (see Table 8), and we will expand on this further.

5.1.4. Historical Research and Country Studies

Historical method is a qualitative research type that examines past events and arrives to conclusions and predictions. It is necessary in identifying and analysing primary and secondary sources of information background especially the time series (Leedy & Ormond). The table below summarises the key aspects of the method (Table 8).

Table 8: Historical Research Method

Historical		
	Purpose - describe and examine events of the past to understand the present and anticipate potential future effects	
	Method	
		• Formulate idea - select topic after reading related literature • Develop research questions • Develop an inventory of sources - archives, private libraries, papers • Clarify validity & reliability of data - primary sources, authenticity, biases • Develop research outline to organize investigative process • Collect data
	Analysis - synthesis of all data; accept & reject data; reconcile conflicting evidence	
	Outcomes - select means of presentation - biography, chronology, issue paper	

Source: Leedy and Ormond 2004

We will use secondary sources including both published data and research. The secondary sources tend to include journal articles, publications, textbooks, regulations issued and financial databases. Therefore, the market data on bonds and *sukuk* issuances in the GCC will target data for this particular type and they will undergo the following analysis.

This research employs a case study design for each of the four countries that requires appropriately planned and designed activity (Braun & Clarke, 2014). The case study according to Bryman (2012, p. 66) is one of the main types of research design. Some of the best-known studies in sociology are based on case study designs. Case study research provides the opportunity for evidence brought together from several wide-ranging sources to support the issues at hand in ways that is hard to achieve in different forms of research (Braun & Clarke, 2014).

A case study is not a method in itself; but a design that can draw on other methods such as quantitative or qualitative methods. It is undoubtedly true that proponents of this design often favour qualitative research methods, in fact, there is a tendency to associate the case study design, (due to its nature), with qualitative methods.

5.2. Definition of Semi-Structured Interviews

Semi-structured interviews aim to obtain perspectives, opinion, reflections and comments from those who have expertise, special knowledge and information within in their respective fields. In our case a group of practitioners and Islamic finance industry thought leaders were approached. Semi-structured interviewing is more pliable in our case than the other research methods, such as surveys as this allows for a more accurate understanding of the respondents' points of view. The flexibility of the semi-structured interview permits for a conversational dialogue with change of order of the questions and/or the way they are phrased (Myers & Newman, 2003).

To identify how the phenomena is perceived and interpreted by the actors/interviewees, a Phenomenology approach is used. The study frames the individuals experience where taken-for-granted assumptions and perceptions are made. Personal knowledge and subjectivity are emphasised with the importance of interpretation and personal perspective forming a powerful tool to understand subjective experiences and therefore gaining an insight into people's actions and motivations (Lester 1999).

The semi-structured interview is a method implemented to accumulate qualitative data by creating circumstances (the interview) that provides respondents the time and capacity to talk about their outlooks on an identified issue. Semi-structured interviews are directed in an open and relaxed manner which allows for free discussion and exchange of information (Denscombe, 2007).

5.3. Formation of the Interview Key Questions

The implementation of this focus group study was undertaken using a qualitative method approach (Bell & Bryman, 2007). The formation of the research questions revolves around how cultural dimensions can characterize successful and effective organisations and what impact it would have on the market development (Denison & Mishra, 1995). Nine semi-structured questions were used for developing, constructing and understanding the evolution of the market. They covered various aspects of the DCM, the challenges, solutions and the outlook for the DCM in the GCC.

The formation of the research questions revolves around the status of the DCM and the effects of legitimation dimensions. The interview questions were developed to frame the following aspects (and questions) of OE:

a. the Population composition
b. the audience and their categories
c. to what extent is the market legitimate?
d. proposed recommendations

Follow-up questions were asked to obtain additional insights. Each of these questions were meant to probe the interviewee into the issue of legitimation indirectly to seek their views, insights to either confirm or develop new research dimensions.

5.4. Semi-Structured Interviews Procedure

The interviews were arranged through Skype calls and they were typed by Dictaphone. The average duration of the interviews was approximately 45 minutes. These were present in the form of typed scripts and transcripts. The qualitative data provided in this paper are derived from the analysis of the interview content. Using phenomenological analysis approach, we derived an understanding of the interviewees' perspectives and experiences for developing patterns and meaningful relationships (Moustakes, 1994).

The drive for the success in investment or retail Islamic banking is the demand. It is not necessarily that a superior product is offered by Islamic financial institutions when compared to conventional banks. Other factors involve the availability of deposits (liability side) and the ability to structure investment products Islamically.

The semi-structured interviews are used in Chapter 8 with a focus group of market practitioners to gain their insights of the structural issues with the capital market and its challenges. Having identified issues, the interview was carried out with sufficient time and capacity for the interviewees about their outlooks. These interactions took place in a relaxed manner allowing for open and free discussion and information exchange (Denscombe, 2007).

To identify how the Islamic DCM is perceived and interpreted by the actors/ interviewees, Phenomenology approach is used. Phenomenology was used (as described by Lester 1999), to study the experience from the perspective of the individual, with 'taken-for-granted assumptions and perceptions. As this research is based on experiences, it is framed in terms of personal knowledge and subjectivity– the emphasis is placed on personal perspective and interpretation. The strength of Phenomenology is the insight it provides into people's motivations and actions when relating their subjective experiences.

5.5. Rigour & Relevance

The issue surrounding the management of rigour and relevance in management research is a big topic that has divided scholars from practitioners for a transiently (Fincham & Clark, 2009). Kieser and Leiner use the differing uses of logic argument when claiming that academically rigorous research cannot be relevant for Management and Organisation. The relevance of this research is based on identifying the issues surrounding the impediments for the development of the GCC DCM within the context of "legitimation". By using research methodology that aims to be unbiased and accurate, allows for application of the research in contemporary setting. These contributions will influence the design and conduct of the proposed study in identifying the stakeholders and how they interact and influence each other. Along with assessing the impact of information release on their perception of legitimation of the capital market.

The importance of the DCM is its ability to help improve the efficiency mobilization of resources and allocation in the economy. The liquidity management tools have been provided for both short-term and long-term objectives and a benchmark has been developed on the income earned on the government issues as risk free return. The development of the DCM would benefit the various stakeholders as illustrated below:

Table 9: Key Stakeholders Benefit from Debt Capital Market Development

Regulators	Securities Issuers	Investors	Consumers
1. Providing Money market policy control instruments 2. Efficient debt market management 3. Developing secondary market and setting benchmark for yield curve	1. Alternate Funding Sources 2. Reduction in the cost of funds 3. Increased Liquidity 4. Off Balance Sheet Funding (in case of asset securitisation).	1. Investment decisions independently of the originator credit standing 2. Access to new investors base away from banks 3. New secured asset class	1. To diversify their sources of funding 2. Reduced funding cost 3. Access to longer term funding

Source: Author's compilation

5.5.1. Research Difficulties and Limitations

Given the nascent nature of the bond and *sukuk* market in the GCC, and as the secondary market remains relatively illiquid with minimal trading, the historical data and length of trading is limited to the primary market. As analysis and evaluation of *sukuk* trading on the secondary market is prohibitive due to the scarcity of trading, I have not attempted to analyse the secondary debt market in this research.

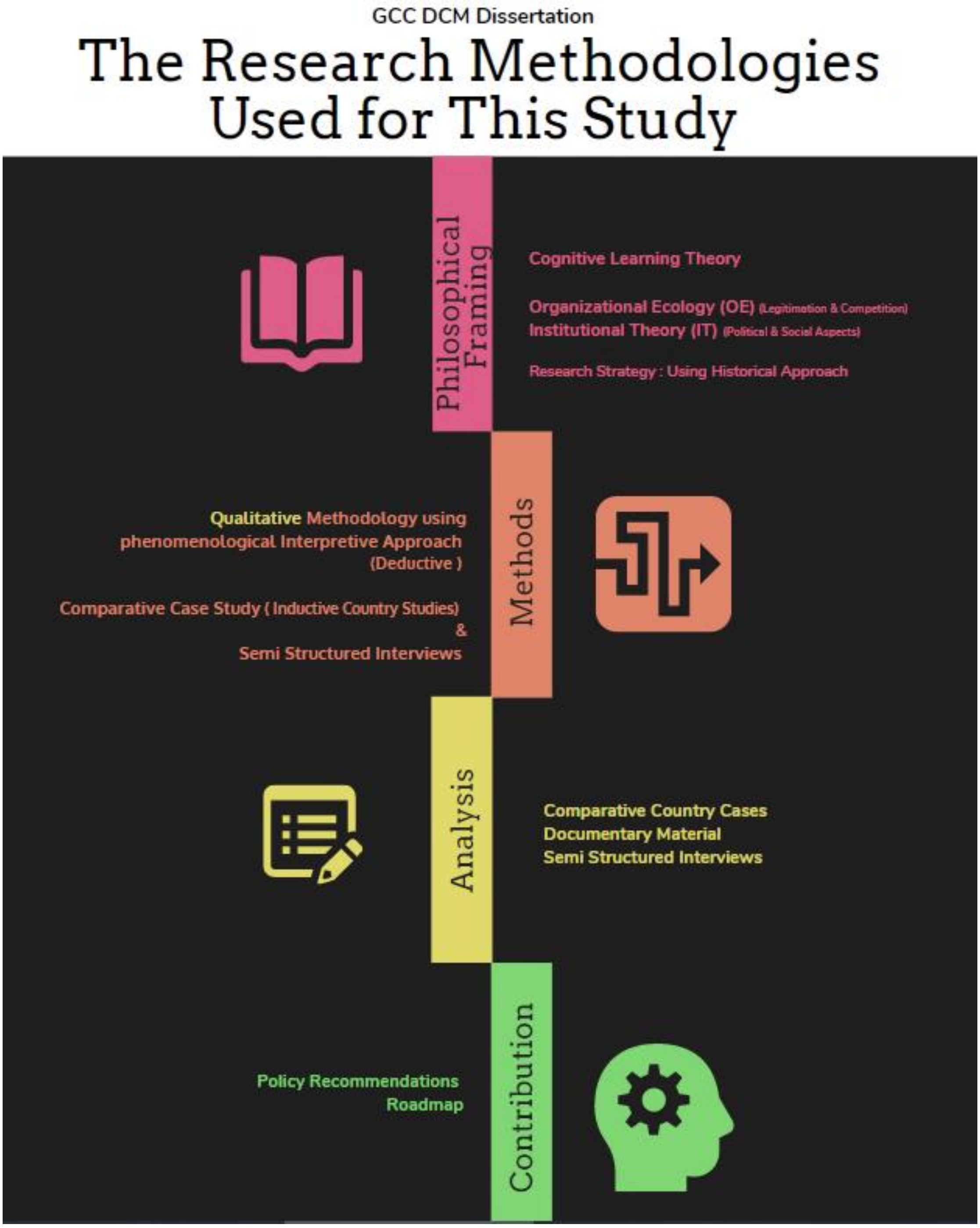
The semi-structured interviews were conducted with primarily investment bankers based in Kuwait, UAE and South Africa. These participants have been involved and working extensively in the GCC DCM for over 10 years. This focus group comprises of Mr. Iqbal Khan, CEO of Fajir Capital, DIFC Dubai, Mr. Adnan Albahar, Chairman & Managing Director of The International Investor, Kuwait and Mr. Simon Stockley, Director of Catalis, South Africa (see Appendix 3). Mr. Khan is an Executive Director and an authority on Islamic finance who has over 30 years' experience in Islamic investment Bank. Mr. Albahar is a banker and an entrepreneur who has overall 30 years of experience in Islamic finance for setting up financial institutions and product development, and Mr. Stockley is a business consultant for Islamic banks with more than 25 years of experience in asset securitisation at both conventional and Islamic banks. Mr. Khan has received several accolades including the Royal Award for Islamic Finance, a biannual prize presented by HM the King of Malaysia and a Lifetime Achievement Award presented by HH Sheikh Mohammed bin Rashid Al Maktoum, Prime Minister of the UAE Mr. Albahar is also the recipient of a number of awards, in 1994, The World Economic Forum named him as a "Global

Leader for Tomorrow" and also the Islamic Banking and Finance Forum recognized him as "Islamic Banker of the Year 1997". In 2002, the World Islamic Banking Conference in Bahrain awarded him for his "outstanding contribution to Islamic banking and finance. Mr. Stockley comes with vast capital markets experience and was involved in the first asset securitisation in Saudi Arabia. This selected group of interviewees are considered to be market leaders in the GCC given their involvement and success in developing the Islamic investment banking space and capital markets. Hence, recognition of the interviewees achievements gives weight to their views and helps in coming to the market understanding and recommendations.

The professional working relationship I developed with the interviewees, has allowed for a more free and open dialogue and has therefore enhanced the quality of the questions and consequently the analysis. This has also evolved the follow-up questions and the clarifications that were needed. Participants were able to explain their views in detail and were able to discuss issues that could be deemed sensitive on a personal basis. The interviews were started with pre-set questions, which paved the way for a detailed dialogue focused on the feedback of interviewees on the GCC DCM structural issues and challenges.

5.5.2. Methods Limitations

- The scope of the research is limited only to the bonds and sukuk issuances in the GCC area.
- The study timeline of DMC is primarily for the period from 2013 to 2017.
- Insights into the GCC DCM is from leading corporate finance practitioners through the focus group discussions.



Source: Author summation

To ascertain our findings, in the next two chapters we will draw our comparisons from the three country studies and formalise the building blocks of a well-functioning DCM.

Chapter 6: Analysing the Case Studies

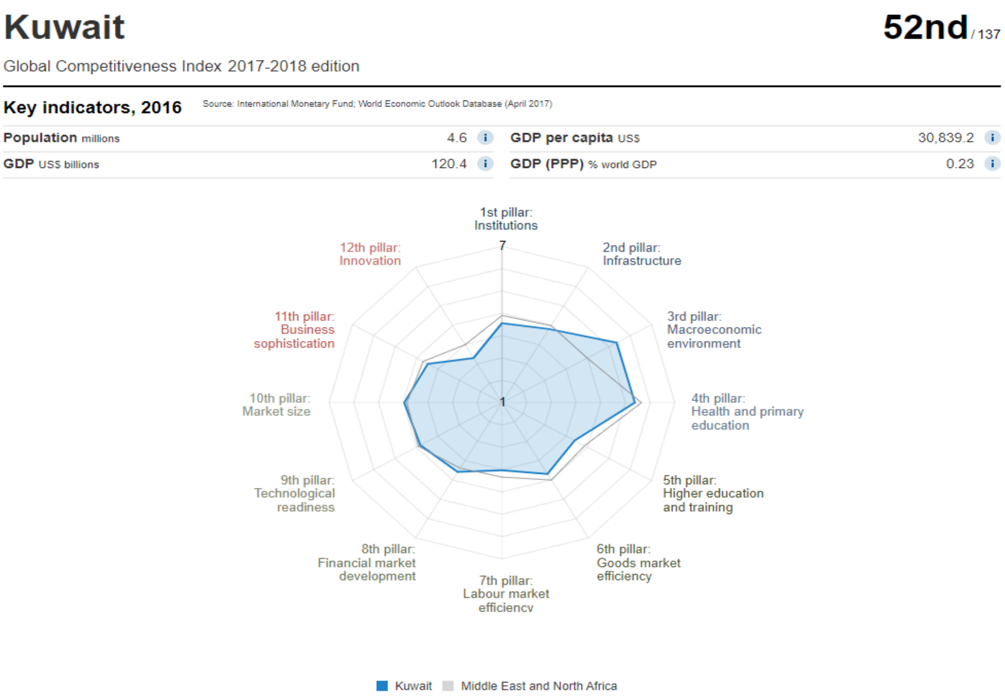
6.1. Introduction

In this chapter we focus on Kuwait as a case for an in-depth analysis. We reflect on the insights into the development of the DCM and the challenges facing Kuwait. We capture the current situation to explain how the development in the GCC countries can happen at varying degrees as it happens either slower or later. This will help us in the theoretical framing in later chapters to forecast the political implications on what institutional help is required to develop the market.

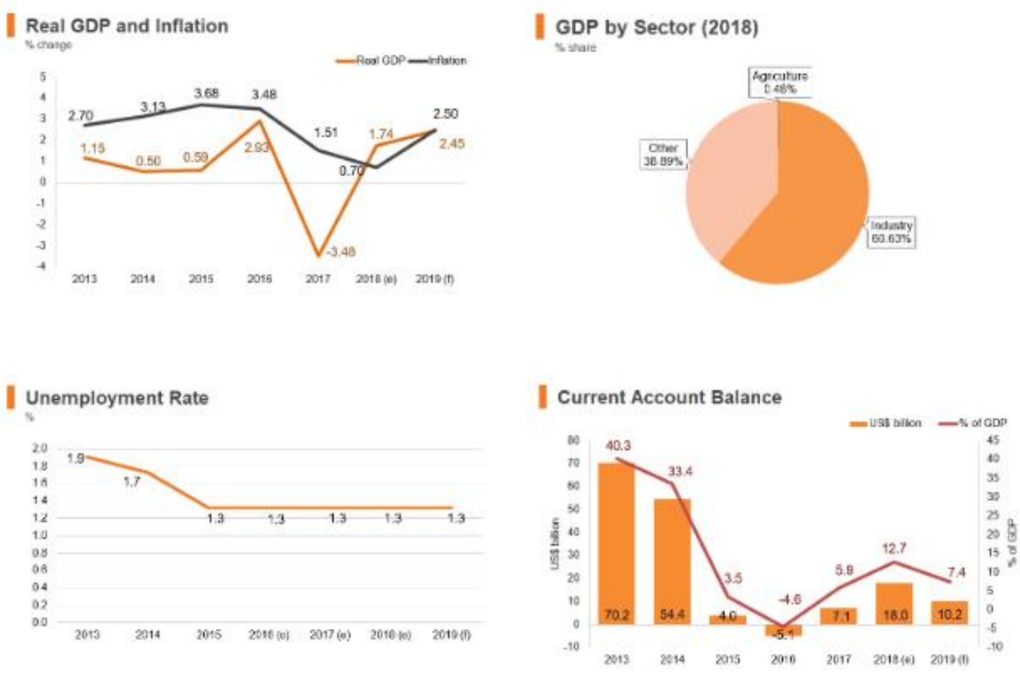
6.2. Kuwait Country Overview

As discussed previously, options to transform the political and business paradigm are challenging in the GCC where the stakes are high for political, social and financial stability. The GCC has been dependent on oil revenues for decades– with the model in line with new market risk and geopolitical realities. Similar to its neighbouring GCC countries, Kuwait relies strongly on the hydrocarbon sector which is the main investment driver for the economy during both high and low economic strength. Commitment by the government of diversification away from the near total dependence on oil revenues may drive and maintain long-term economic growth momentum (Ari et al., 2019). This will create growth opportunities for development of the DCM in Kuwait (see Graph 27 below that gives a snapshot of key economic and demographic information about Kuwait from the Global Competitiveness Index 2017-2018 edition).

Graph 27: Kuwait Global Competitiveness Index



Graph 28: Kuwait Key Economic Indicators



e = estimate, f = forecast

Sources: IMF, World Bank, IMF – World Economic Outlook Database, Fitch Solutions

6.6.1. Financial System

Kuwait's financial system comprises four sectors: banking, insurance, non-banking (financing & investments and exchange companies) and investment funds. By the end of 2018, total assets were valued at US$248 billion and in the banking sector accounted for approximately 80% of the country's GDP. There were 110 financial institutions offering financial products and services in the country.

Out of the 23 banks in Kuwait (eleven local banks and twelve foreign bank branches), six are Islamic banks, operating as per the Islamic *sharia* law. Banking naturally constitutes the largest of these with an 89% share. Figure 13 below illustrates the size of each financial service sector and its supervisory authority (CBK, 2019).

Figure 13: Kuwait Sectors and Supervisory Authorities

Source: CBK

Kuwait has five conventional banks (National Bank of Kuwait (NBK), Gulf Bank, Commercial Bank of Kuwait, Burgan Bank and Industrial Bank of Kuwait) and six Islamic banks (Kuwait Finance House (KFH), Kuwait International Bank, Boubyan Bank (now a majority-owned subsidiary of NBK), Ahli United Bank of Kuwait (in process to merge with KFH), Warba Bank and Al Rajhi Bank, and the Kuwait branch of Saudi-based Al Rajhi Bank).

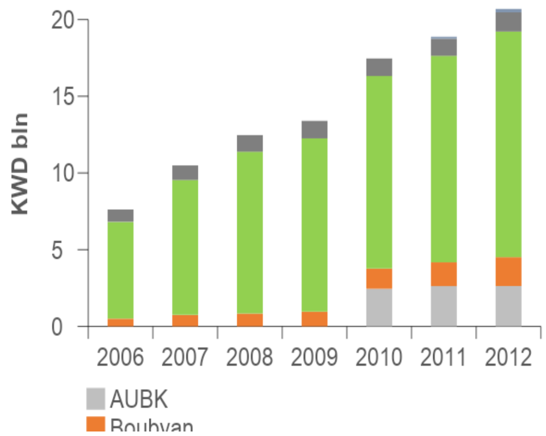
6.1.2. Islamic Banking

Dating back to 1977, Kuwait Finance House was the first Islamic bank and was originally regulated and supervised by the Ministry of Commerce under a special law. The National Assembly enacted the drafting of Central Bank of Kuwait (CBK) Law no.30 (2003) after a protracted process. It added a special section on Islamic banks to Law no. 32 (1968), referring to currency. Consequently, all Islamic banks in Kuwait came under the regulatory supervision of the CBK in May 2004.

The Islamic finance market has witnessed healthy growth in Kuwait over the last two decades. As of May 2017, Islamic banking assets amounted to KWD 29 billion (US$95 billion) making up 40% of the country's banking sector with a cumulative average growth rate (CAGR) of 6.98% per year between 2012 and 2017. Kuwait's Islamic banking assets expanded at a cumulative average growth rate (CAGR) of 19.4% per annum between 2007 and 2012. In 2012, Islamic banking assets amounted to KWD 20.7 billion (US$74.3 billion) which represented 43.7% of the country's Islamic banking sector total assets during the year, the highest percentage among GCC states (Bahrain: 13.7%, Qatar: 23.9%, Saudi Arabia: 23.2% and United Arab Emirates: 13.7%). At a growth rate of 9.6% in 2012, Islamic banking assets growth in the country exceeded that of the conventional banking assets of 7.3% year-on-year.

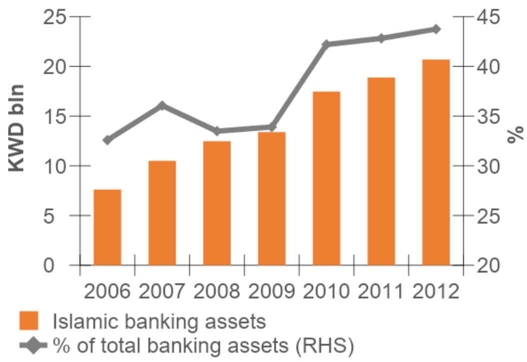
Graph 29: Kuwait's Islamic Banking Assets

Kuwait's Islamic Banking Assets (2006-2012)



Graph 30: % of Total Banking Assets

Kuwait's Islamic Banking Assets % of Total Banking Assets (2006-2012)



Source: Central Bank of Kuwait, Islamic banks, Kuwait Finance House Research

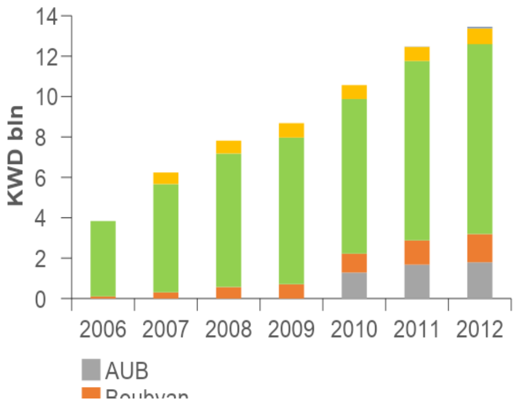
Islamic banks in Kuwait have been active in financing major development and infrastructure projects that supported Kuwaiti companies, restructured the debts of non-bank financial institutions, actively seeked investment opportunities (especially in the real estate sector) and participated in various notable *sukuk* deals in the MENA region.

Several investment and financing companies operating under principles of sharia were established in Kuwait in the 1990s. These sharia principled investment/financing companies increased significantly reaching over 66 companies. A default, on most of its US$3 billion debt, by the country's largest investment firm. This was followed by default by several Kuwait-based corporate sukuk issuers due to mismatch between assets and liabilities (Marmore, 2019).

The total deposits of Kuwait Islamic banks grew at a CAGR of 23.1% per annum between 2007 and 2012, resulting in highly liquid and primarily stable funding. At the end of Q4 2012, the Islamic deposits were at KWD 13.5 billion (US$48.3 billion) with an annual growth rate of 7.9% and represented 40.3% of Kuwait's Islamic banking sector total deposits.

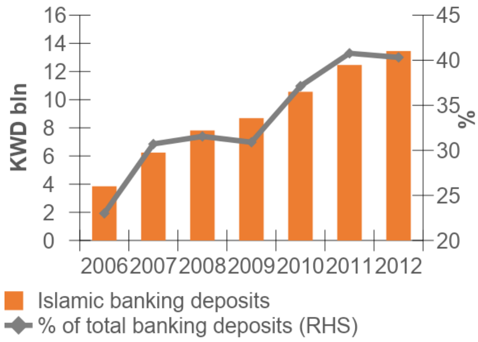
Graph 31: Kuwait's Islamic Deposits

Kuwait's Islamic Deposits (2006-2012)



Graph 32: % of Total Banking Deposits

Kuwait's Islamic Deposits % Total Banking Deposits (2006-2012)



Source: Central Bank of Kuwait, Islamic banks, Kuwait Finance House Research

6.1.3. The Capital Market

Kuwait's has substantial long-term development plans which are not met by the hydrocarbon wealth, already productively invested. As such larger amount of external funding is required by the government and the increasingly active private sector to fulfil policy objectives. To take advantage of the economic opportunities and to facilitate access to the private sector, a more diversified financial system should include Islamic financial products. The broader the financing options available, the cheaper it will become to fund these projects.

6.1.4. Bonds and *Sukuk* Sovereign Issuances

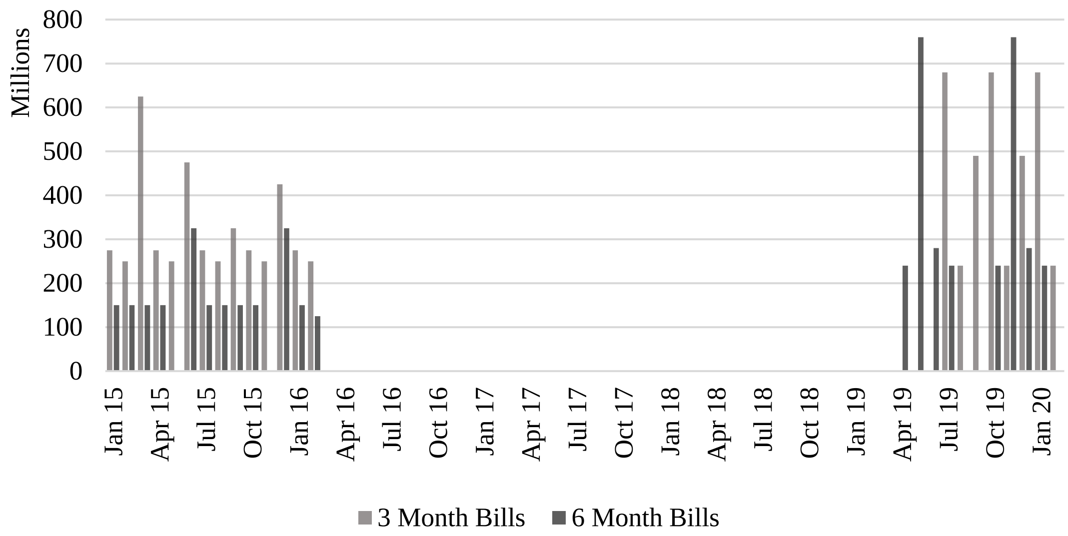
Rather than issuing debt, the Kuwaiti government, funds its operations largely from the budgetary allocations. Kuwait controls 3.2% of the world's crude oil production and on the back of strong demand for the state's oil exports, it posted 15 consecutive budget surpluses. This came to a halt in 2015/2016 when the State began its new streak in the opposite direction with five consecutive budget deficits. The Kuwaiti government has since issued 62 government bonds worth a total KWD 8.14 billion (US$26.7 billion). The Kuwaiti aggregate bonds consist of conventional bonds issued by the government. The Central Bank of Kuwait (CBK) is responsible for the management of local public debt on behalf of the Ministry of Finance as well as regulating the level of domestic liquidity for which it issues the following bonds:

- **Central Bank Bills (CBK Bills)** which are short-term debt obligations with maturities of less than one-year carrying a fixed coupon rate.
- **Treasury Bonds (T-Bonds)** which are long-term debt obligations with maturities greater than one-year with a fixed coupon rate.

The constitution of Kuwait's has made the journey in international bond markets challenging. The ministry of finance established the debt management office in 2016 to manage the bond sale. In March 2017, Kuwait issued its inaugural US$8 billion dual tranche bond (5- and 10-years maturities). The deal was oversubscribed 3.5 times and received orders of around US$29 billion (Moore, 2017). However, there was no follow-up issuance until January 2020.

For January 2020, CBK has issued a total of KWD 680 million worth of 3-month CBK bills while the longer 6-month tenure. CBK bills amounted to KWD 240 million for the first half of 2015 (see Graph 32). The issuances in January 2020 stood higher compared to the previous year's corresponding period, which has recorded no issuances at all. The standstill in issuances was a result of CBK bill issuances (including longer tenured T-Bonds) being put on hold in the build up to the National Debt Law that expired in October 2017; the issuance capacity was diverted to longer tenor bonds in order to fund the national deficit. Post-October 2017, CBK withheld from issuing fixed income securities until April 2019 when it came back to the market for monetary management reasons.

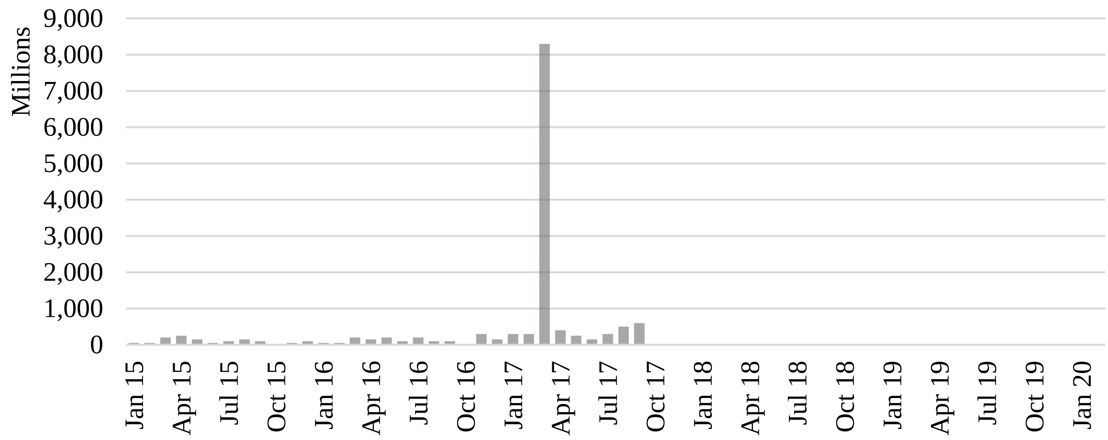
Graph 33: Monthly CBK Bill Issuances (KWD million)



Source: Bloomberg, CBK Note: There were no issuances in certain months

In 2017, however, there was a noticeable shoot up in the issuance size to KWD 8.3 billion (US$27.2 billion) for compensating the impending issuance halt. Even if we exclude the outlier in March 2017, on average T-Bond issuance sizes have been trending upwards before they halted in October 2017 (see Graph 33). The average issuance in 2015 was KWD 104.17 million and rose to KWD 133.33 million in 2016 and finally reached KWD 1.23 billion in 2017. Subsequently, total annual issuances totalled KWD 11 billion in 2017.

Graph 34: Monthly T-Bond Issuances (KWD million)

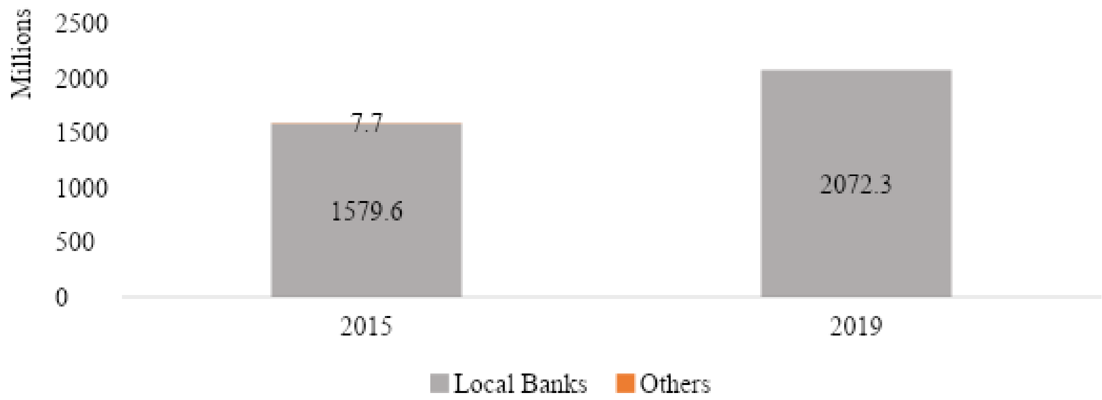


Source: Bloomberg, CBK Note: There were no issuances in certain months

According to the data provided by CBK, holders of both CBK bills and T-Bonds predominantly belong to local banks, with 99.5% holding in 2015 and 100% holding in

2016The dominant holding by local banks is apparent especially for the shorter-term CBK bills as these instruments are a major source for liquidity management (Graph 34).

Graph 35: Holding of CBK Bills and T-Bonds (KWD million)

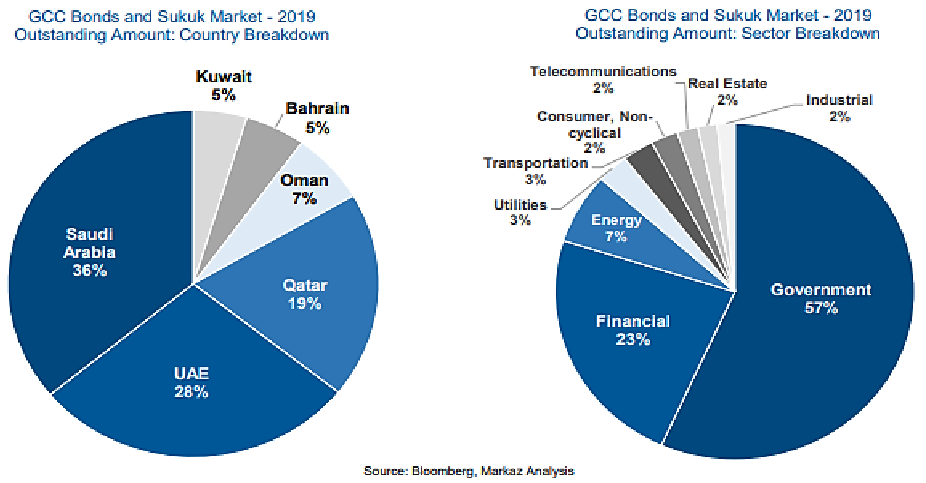


Source: CBK

Having said this, we note that to date, there has yet to be a *sukuk* issuance from the sovereign as capital requirements are generally done through internally generated funds without tapping the external debt market. This is more pronounced during an environment of high oil prices, which primarily supports the sovereign's revenue generation.

Compared to its neighbours who have significantly increased their debt levels since mid-2014, Kuwait remains in a strong fiscal position due to low public debt levels and fiscal buffers (see Graph 35). Most notably, Saudi Arabia, Oman and Bahrain have all increased their foreign debt over the last four years.

Graph 36: GCC Bonds and *Sukuk* Market by Country and Sector



The IMF forecasts that financing the remaining gap would, assuming no legal restriction on borrowing, require Kuwait's debt to rise over 40% of GDP in 2025 from 18% in 2019 (Graph 36 below).

Graph 37: Kuwait Government Gross Debt

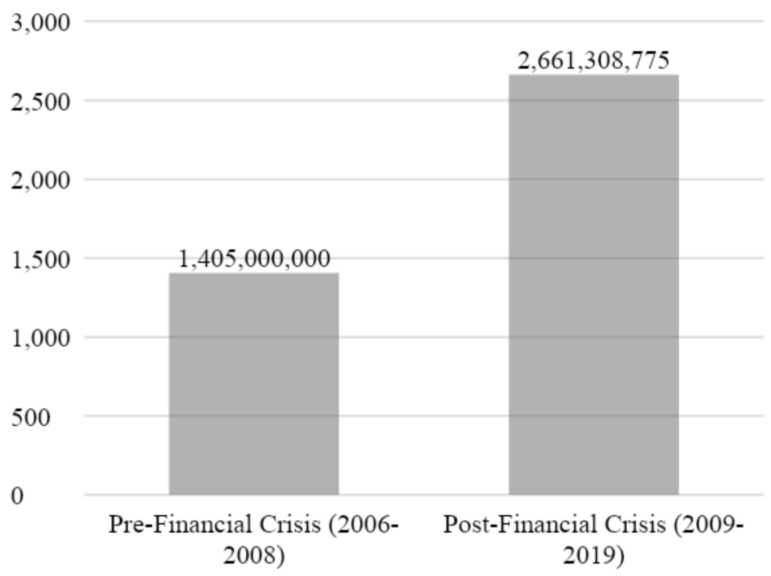
Going forward, the issuances and holding of sovereign debt issued by the CBK is expected to be stable. The stability of the sovereign's debt issuance will be dependent on hydrocarbon prices supporting the country's income generation. Meanwhile, the short-term instruments, (i.e. CBK 3- and 6-month), instruments are expected to be regularly issued to the market to assist the local banks in managing their short-term liquidity requirements.

6.1.5. Kuwait Corporate *Sukuk* Market

In Kuwait, the first corporate sukuk was started in 2006 and by 2013 had issuances valued at US$1.75 billion with the vast majority issued prior to the global financial crisis.

The Kuwaiti market was affected severely by the global financial crisis, and the sukuk market was no exception with The Investment Dar (TID) being the first GCC Company to default on a *sukuk* repayment in 2009. Investment companies were exposed and vulnerable during the financial crisis with high exposure to market risk, and weak supervision and disclosure. Many companies recorded losses and defaults due to asset/liability maturity mismatches, high loan-to-value, tight liquidity conditions and asset price deflation (Khamis et al., 2010). While the central bank intervened and injected cash into the banking system and issued directives guaranteeing deposits with all the local banks, it left the investment banking sector to its own fate.

Graph 38: Kuwaiti *Sukuk* Issuances (US$ million)



Source: Bloomberg

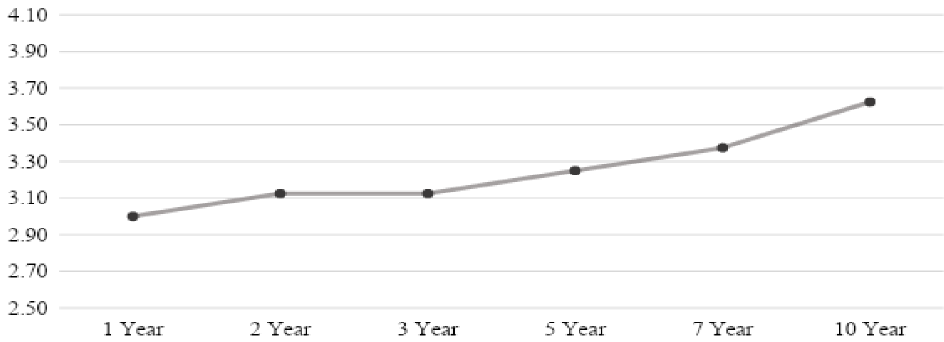
The corporate *sukuk* market on the other hand has been slightly more active. As of 11 February 2020, the outstanding corporate issuances amounted to US$2.2 billion, all issued in either US dollars or Malaysian ringgit (Table 10).

Table 10: Outstanding Kuwaiti Corporate *Sukuks*

Issuer Name	Coupon (%)	Issued	Maturity	Amount Issued ($ mm)	Ccy	SPV Domicile	Sector
Warba	2.98	2019	2024	500	USD	Kuwait	Banks
KIB	5.63	2019	-	300	USD	Kuwait	Banks
Warba	6.50	2017	-	250	USD	Cayman Islands	Banks
Equate	3.94	2017	2024	500	USD	UAE	Chemicals
Ahli United	5.50	2016	-	200	USD	Kuwait	Banks
Boubyan Capital	6.75	2016	-	250	USD	UAE	Banks
Gulf Investment Corp	5.10	2016	2021	107.9	MYR	Kuwait	Financial Services
Gulf Investment Corp	5.30	2012	2027	49.1	MYR	Kuwait	Financial Services
Gulf Investment Corp	5.10	2012	2022	53.8	MYR	Kuwait	Financial Services
Total Kuwaiti *sukuks* Amount Outstanding				**$2,210,953,725**			

Source: Bloomberg

Graph 39: Kuwait 2019 Government Bond Yield Curve (%)



Source: CBK

Kuwait and other Middle Eastern countries have been slow to develop their *sukuk* markets, the reason being is the lack of a sovereign bond market that would create a pricing benchmark for potential corporate issuances.

The lack of a sovereign bond market, that would create a pricing benchmark for potential corporate issuances, was one key reason why Kuwait and other Middle Eastern countries were slow to develop their *sukuk* markets.

Furthermore, high capital gains tax (up to 55%) and corporate profits (up to 50%) imposed on foreigners has disincentivised and severely reduced Kuwait's attractiveness for international investors. However, taxes on corporate profits were reduced to 15% in 2015 and capital gains tax was removed on investments in listed companies. Another problem for international investors in Kuwait was the extra legislative hurdles e.g. for foreigners to acquire each incremental 5% of bank's capital, approval from the CBK is required including administrative obstacles (Abbas, 2019).

Kuwait's business environment is ranked sixth in the region and 97th in the world (IFC's Doing Business Project 2018 (Table 10)).

Table 11: Ease of Doing Business in the GCC

GCC Ranking	Country	World Ranking
1	UAE	11
2	Bahrain	62
3	Oman	78
4	Qatar	83
5	Saudi Arabia	92
6	**Kuwait**	97

Source: IFC, Doing Business Project, 2018

Kuwait is the lowest ranking country in the GCC region for financial services development (2018 Arab World Competitiveness Report (Table 12)).

Table 12: GCC Financial Market Development

Info	Rank / 137	Country / Economy	Value (1–7 (best))	Trend	Dist. from highest
i	24	United Arab Emirates	4.8		
i	25	Qatar	4.7		
i	46	Bahrain	4.3		
i	54	Oman	4.2		
i	56	Saudi Arabia	4.2		
i	62	Kuwait	4.1		

Source: World Economic Forum, [i]The Global Competitiveness Report 2017–2018[i]

In summary, similar to Indonesia's circumstances, Kuwait's DCM remains relatively small even below regional average. This is in part due to the dominance of the banking sector in the financial market coupled with a tedious and complicated process in issuing tradable securities. This includes lengthy regulatory approvals, stringent disclosure requirements and financial records validity rule. These rules and requirements have impeded the development of the DCM in Kuwait. The IMF report on the impact of the financial crisis on the GCC cited that "The authorities should facilitate the restructuring of non-bank institutions particularly in Kuwait and the UAE, included by supporting viable entities while ensuring a smooth exit of non-viable institutions. Regulatory and supervisory weaknesses should also be addressed" (Khamis, et al., 2010).

6.1.6. Current Regulatory Framework

The CBK has been supervising banking and financing institutions service providers and domestic exchange companies, since 1968, through regular industry feedback consultations on legislative mechanisms. Established in 2010, the CMA took over legislative efforts and through enabling mechanisms helped level the playing field for future *sukuk* and securities listings on the primary and secondary Kuwait Exchanges. The CMA regulates and supervises the investment companies, mutual funds, the securities market, and the Kuwait Stock Exchange including the primary securities market (the issuers) and securities secondary market. The current framework consists of CBK, CMA and the Ministry of Commerce and Industry (MOCI). The MOCI carries out supervision of companies' formation and corporate governance and has a small insurance sector in the Insurance Department. These large number of bodies has resulted in a fragmented regulatory environment (Figure 14).

Figure 14: Kuwait Regulatory Framework

Source: Author

6.1.7. Capital Market: The Legal and Regulatory Environment

Kuwait is the last GCC member to embrace the international DCM whilst still being during a wave of reforms. Although some reforms are fiscal relating to; tax introduction, lifting subsidies, and deregulating power tariffs, others equally important relate to human capital and institutional excellence. Importantly, legal and regulatory framework restrictions hinder the expansion of the financial sector. A large part of the legislation governing financial transactions, is outdated (from the 1960s and 1970s). The lack of legislation clarity implies that investors and financial institutions do not have clear set of rules from which to assess future tax liabilities and legal requirements.

Finally, for Islamic financial institutions there is no separate centralized Sharia Advisory Council (SAC) at the CBK. Instead, the law requires Islamic financial institutions (IFIs) to employ an in-house sharia Supervisory Board (SSB). In January 2020, Reuters cited the Kuwait News Agency (KUNA) that the Kuwaiti parliament approved a bill to form SSB for CBK to oversee the Fatwa on major contracts for the banks in Kuwait.

The Public Debt law, 2008 expired in October 2017 and the sovereign has been unable to issue bonds internationally and since relied on general reserves fund to cover the budget deficits. Changes to debt issuance include the authorities trying to raise the ceiling from US$33 billion to US$82 billion and bond issuances with longer tenors of up to 30 years instead of 10 years (Yadav, 2018). During a period when corruption and wastefulness was levelled at the law by Kuwait’s political and business class, legal restrictions on the use of public assets in transactions, meant that the sovereign was unable to structure sukuk. Aside from the post-Gulf war US$5.5 billion syndicated loan, the argument existed that this deficit forced Kuwait to issue sovereign debt internationally for the first time in its history (Jivraj, 2020).

Hence, forestalling the issuance of new government debt and issuance of the new public debt law. The fact that Kuwait enjoys ample (declining) foreign reserves which is precluding the government from justifying its borrowing and getting the parliament's clearance.

There is difficulty in justify to the public, the need to raise sovereign debt when there is a sufficient source of income. The decision should however be contextualised through market development. This needs to be rationalised from the perspective of deepening the financial system which will benefit the economy even though it may seem that the government may not be in need of funds– similar logic to that of Singapore and Hong-Kong, both locations are successful international financial centres (Sole, 2008).

Kuwait enjoys a positive business environment, aside from the oil industry, the financial sector has the highest growth potential in the country as compared to the rest of the GCC. Being able to thrive in the competitive local banking environment, Kuwaiti financial institutions are well positioned to raise their profile as important regional players. Kuwait also has access to a large body of highly qualified professionals with substantial expertise in financial services as well as a relatively advanced technological infrastructure communications network.

Reform recommendations for Kuwait will be discussed and summarised in chapter eight.

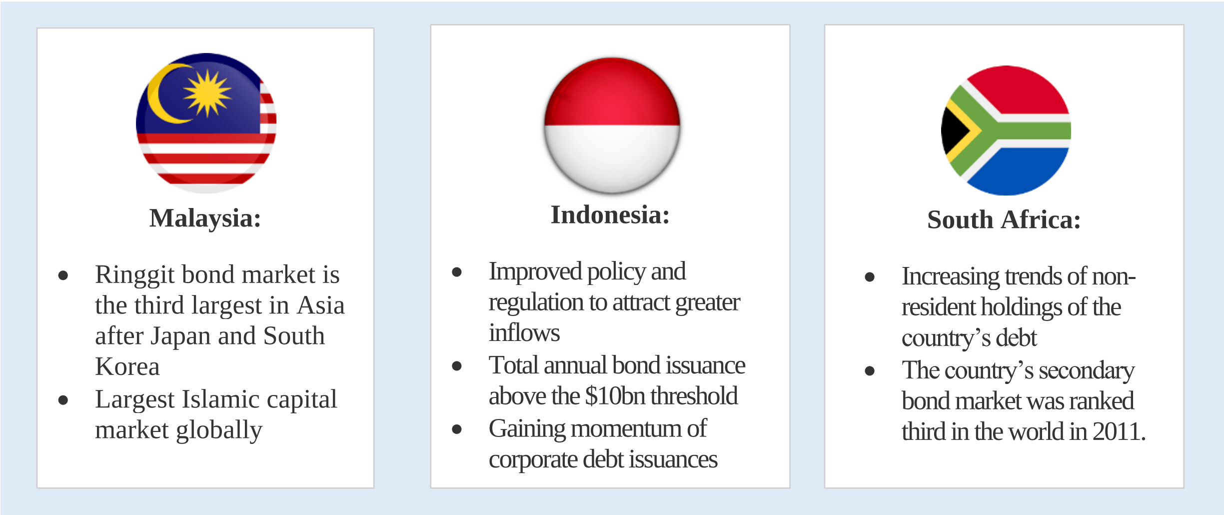
6.2. Comparative Debt Capital Markets Study: Malaysia, Indonesia and South Africa in Perspective

This section focuses primarily on the relative comparison between three selected capital markets namely - Malaysia, Indonesia and South Africa. These markets offer insights into different development phases during which capital markets began to emerge. In formulating future strategies for the GCC region, it may learn through the experience of other markets in addressing both structural and non-structural issues. Insights from the development of other markets' may accelerate the process required to hastening its debt market potentials and facilitating further economic growth.

6.2.2. The Selection Rationale

These three markets represent countries with different economic trajectories and different political and economic legacies e.g. colonial history, socio-economic landscape and regional dynamics. Consequently, this can lead one to uncover specificities of capital market development in each. The strength of these capital markets has built over time and therefore, may provide important perspectives for the GCC region (Figure 15). Another important factor is that both Malaysia and Indonesia took Islamic capital market development into consideration as part of their national strategy– which is pertinent in the future debt market development in the GCC.

Figure 1: Rationale on the Selected Case Capital Markets



Sources: Author's compilation from various sources e.g. Securities Commission Malaysia, The Report: Malaysia 2016 & Indonesia 2017 by Oxford Business Group

More importantly a comparative analysis is critical to understand the causal processes involved the production of an event, feature or relationship (Pickvance, 2005, p. 2). This chapter seeks to find variations across the three countries and as such will first cover the developmental journey of these markets and then followed by analysis of key insights from these experiences to assess their applicability to the GCC.

The major challenge is to ensure that all the country cases selected are indeed comparable. In dealing with the comparability issue, this chapter sees it necessary to develop a common analytical framework bringing together the three variables to be compared across cases: actor, context and strategies. Naturally, actors will develop strategies to pursue their interests (in this chapter to develop the DCM). Nonetheless, both actors and strategies are perennially constrained by context which interacts continuously with systemic catalysts in the ecosystem leading to a smooth, complicated or failed development of capital markets. These systemic catalysts are power, culture and governance.

6.2.3. The Literature Review

It is interesting to note that absence or lack of comparative works on capital markets can be linked to the fundamental debate between financial development and economic growth. Such a theoretical nexus between the role of finance in causing growth or vice versa can be a great motivation for scholars to expand comparative works on capital markets across the world. By identifying capital markets as an indispensable independent variable to explain economic growth – the dependent variable – one is guaranteed of producing scholarly works that catch the attention of policymakers. Nonetheless, to date, causality between financial development and economic growth remains inconclusive (Kirkpatrick, 2005).

Schumpeter (1934) became the first economist to have postulated the relationship between financial development and economic growth. It has been observed that financial markets through their institutions were able to channel savings (surplus) to deficit sectors in the economy hence promote investment activities in the entire economy (Fanta & Makina, 2017). This, according to Bose & Cothren (1996), promotes efficient resource allocation leading to economic growth. While Greenwood & Jovanovic (1990) further argue on the role of financial markets in increasing investment efficiency, Saint-Paul (1992) suggests that financial market institutions can enhance investment productivity with an overall positive impact on economic growth. Of more importance is Diamond's (1984) proposition on how the problem of information asymmetry, a key hindrance to economic growth, can be effectively addressed. In his later work, Diamond (1996) further substantiated his claim that financial intermediaries effectively lower monitoring cost of debt contracts that in turn encourage credit availability to entrepreneurs. This liquidity (also see Bencivenga & Smith, 1991) will then allow capital accumulation in the economy resulting in overall higher economic growth.

However, since the 1950s, causality between finance and growth has ceaselessly been challenged. Robinson (1952) empirically showed that rather than causing growth, financial development follows it. When King & Levine (1993), following the pioneering work of Goldsmith (1969), revealed the channels through which finance can boost economic growth through their empirical datasets, numerous studies cast doubt over such a proposed positive correlation and causality. The object of the criticism was the methodology where the econometric model employed by King & Levine (1993) might have suspiciously omitted key variables and suffered simultaneity and country-specific fixed effects. For example, the country income status does matter when observing the nexus between finance and economic growth. Calderón & Liu (2003) found a positive effect of finance on growth for the whole sample of 109 economies but found a bidirectional causality when they split the same sample into developed and developing economies (also see Blanco, 2009). Furthermore, Durham (2002) and Herwartz & Walle (2014) found a stronger finance-growth link in high-income than in low-income economies. Meanwhile, how one measures financial development also affects the finance-growth link. Using different measures of financial development namely, growth in money supply and GDP ratios, Dawson (2008) and Adu et al. (2013) found different effects finance has on economic growth.

The literature on finance-growth link, provides us with some explanation as to why capital markets, let alone comparative capital markets, remain theoretically understudied academically compared to say the banking sector. Although works on comparative capital markets (including Islamic capital markets) are emerging (Powoh, 2014; Bacha and Mirakhor, 2012; Dimson, Marsh and Staunton, 2002), these works, however, present the comparative analysis through their time-series datasets that talk about discrete structural features of capital markets. While there is no denying that such econometric analysis provides valuable insights into long-term trends and patterns, there is still a complementary need for analysing categorical features of capital markets. It is this categorical emphasis that is lacking. Some exception to this will be Patil (2010) and Roychowdhury & Srinivasan (2019). While Patil highlighted the importance of environment for driving capital markets, Roychowdhury & Srinivasan went further to specifically look at the role of gatekeepers in ensuring the institutional stability, fortitude and direction necessary for the development and the smooth functioning of capital markets. These works' focus reflects the macro-level discussion of capital market development. This chapter seeks to discuss capital markets in terms of its macro development and in situating such a discussion within a comparative framework. The chapter hopes to be able to explain variations and generalizations across selected country cases.

Specific comparative works on DCM are not abundant. Recent work by Shavshukov (2018) on BRIC countries' DCM as well as previous work by Lejot, Arner & Qiao (2004), that argued for the positive impact of DCM on limiting financial risk or contagion, provide good building blocks toward understanding the development of DCMs across the world. Having said that, however, these two representative works adopt the case study instead of the comparative methodology. While the former lends itself to explicating in detail individual case study, the latter brings an in-depth analysis of individual cases to the next level where variations are appraised across cases. It is this different methodological emphasis that makes the present chapter distinctive.

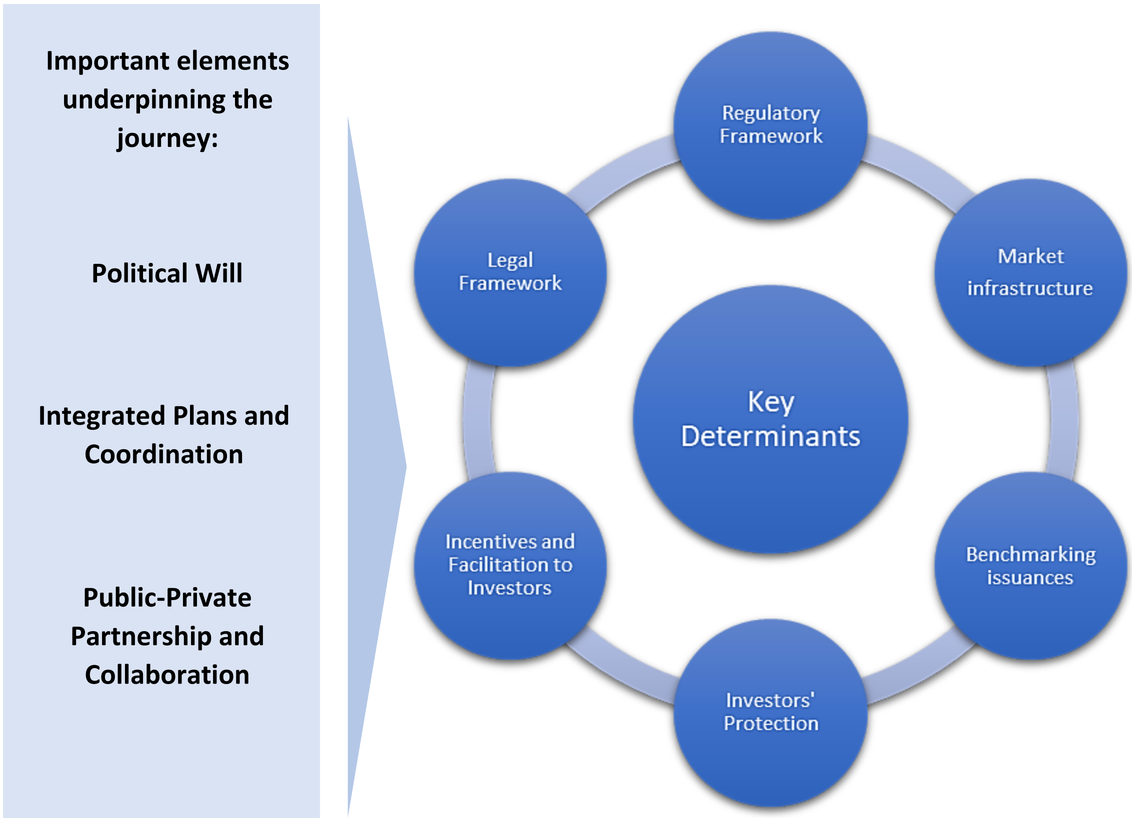
This chapter seeks to discuss capital markets in terms of its macro development, and in situating such a discussion within a comparative framework; the chapter hopes to be able to explain variations and generalizations across selected country cases.

6.2.4. Developments and Evolution: Comparative Analysis of 3 Model Countries

The development of a well-functioning capital market or debt market is dependent on the various determinants as mentioned. Figure 12 outlines key building blocks that are pertinent in the ecosystem of the capital market. However, in addition to the structural components, there are other important elements i.e. political will and public-private collaborations in a well-coordinated manner that play a significant determinant role of future success (see Figure 16).

All these factors will be discussed in the case studies in the following parts. Top-down leadership and clear coordination among the key stakeholders are apparent in all the three country studies, although the steps undertaken may vary. Private sector role is also key and will be discussed in the respective country studies. However, these determinants evolve to meet the best conditions and phases of development of a country. Timely change and well-planned execution to implement such measures or policy also play an important role.

Figure 2: Key Building Blocks and Important Forces



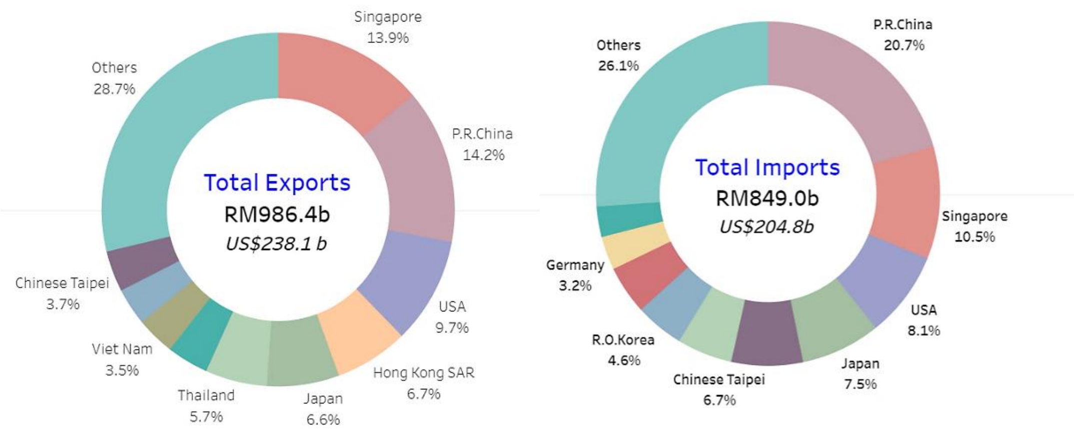
6.3. Country Study: Malaysia

6.3.2. Country Information:

Malaysia, one of the Southeast Asian countries, consists of two geographical regions namely the peninsular Malaysia and the Malaysian Borneo. The country has a 31.6 million population and is known for its multiracial and multi-religious federation of 13 states and 3 federal territories. Malaysia is a parliamentary democracy but the head of state, Yang di-Pertuan Agong. is a federal constitutional monarch.

Malaysia has diversified its economy from primarily agriculture and commodities to become a robust manufacturing and services economy. Having a GDP ratio averaging over 130% since 2010, Malaysia is one of the most open economies in the world. Approximately 40 % of the jobs in Malaysia are linked to export activities, thanks to its openness to trade and investment, that have been instrumental in employment creation and income growth. The manufacturing sector, contributing more than 20% of the GDP, is important sector for the Malaysian economy (MITI, 2019).

Graph 40: Malaysia's Major Export and Import Destinations 2018



Source: MITI Malaysia

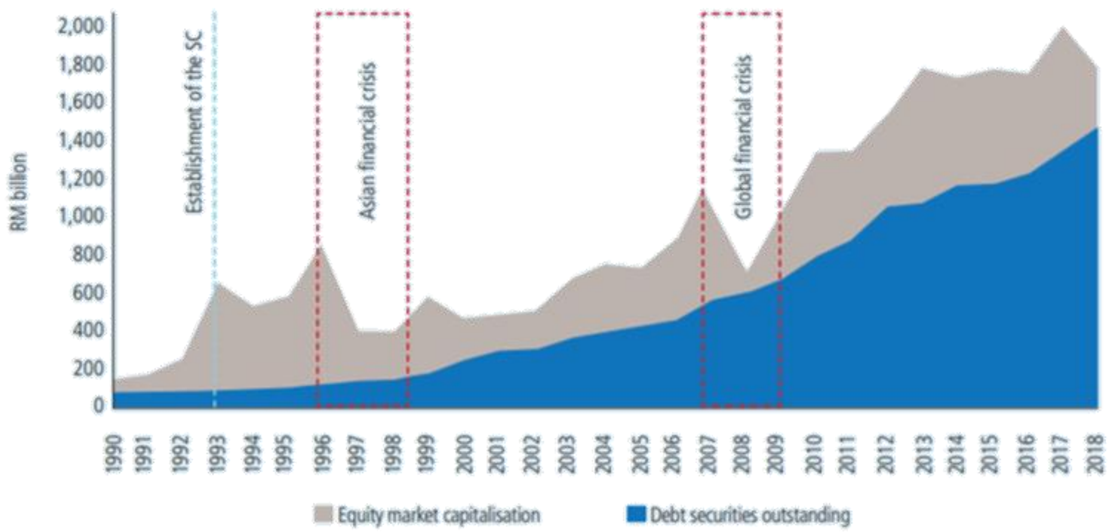
As for its financial sector landscape, Malaysia has made significant steps in financial inclusion reflected in 95% of Malaysian adults who have deposit accounts. Malaysia adopts a dual financial system where financial consumers have access to both conventional and Islamic financial services offerings. In shaping its future economic growth, Malaysia is aiming towards becoming a developed nation. It is currently transitioning from an upper middle-income economy to a high-income economy by 2024. Malaysia ranks 55th out of 157 countries in the World Bank's Human Capital Index and ranks 15th in the World Bank's Doing Business 2019 Report.

6.3.3. Malaysian Capital Market evolution

The Malaysian capital market grew substantially in size along with innovation. The country is regarded as one of the leading Islamic capital markets that runs in parallel with its established bond and equity markets. Various efforts and developments were undertaken to strengthen its infrastructure, processes and regulatory framework.

The size of the Malaysian capital market at the end of 2018 was RM 3.1 trillion comprising debt securities amounting to RM 1.4 trillion and the equity market capitalisation standing at RM 1.7 trillion. The Malaysian bond market is 95% percentage of their GDP and is the third largest bond market in Asia after Japan and South Korea. Since the establishment of the Securities Commission Malaysia (SC) in 1993, the size of the Malaysian capital market, RM699.5 billion, has grown at from a CAGR of 12.1% (, since 1993 to account for 45.3% of its capital market in 2018 (Annual Report of the Securities Commission 2018 (Graph 40)).

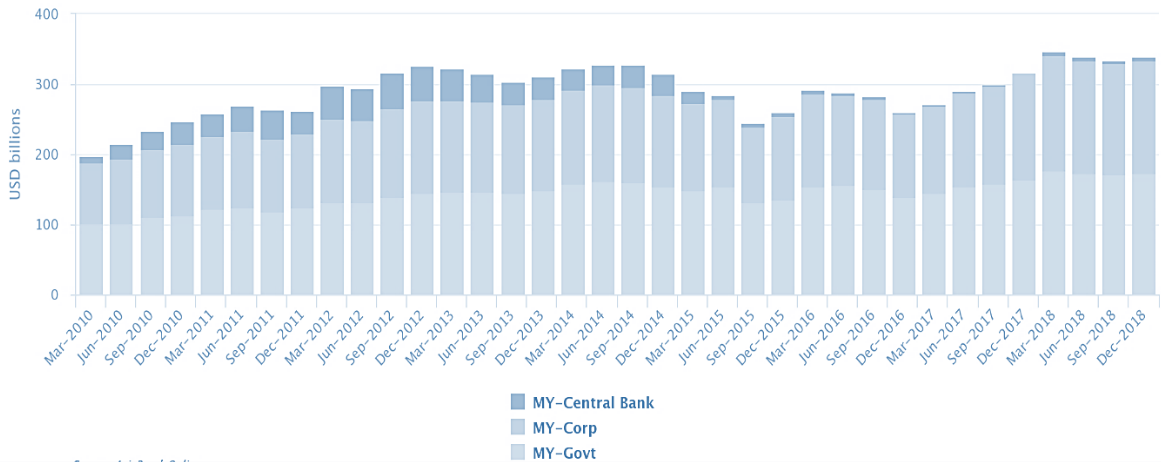
Graph 10: Growth of the Malaysian Capital Market



Sources: Annual Report of the Securities Commission 2018

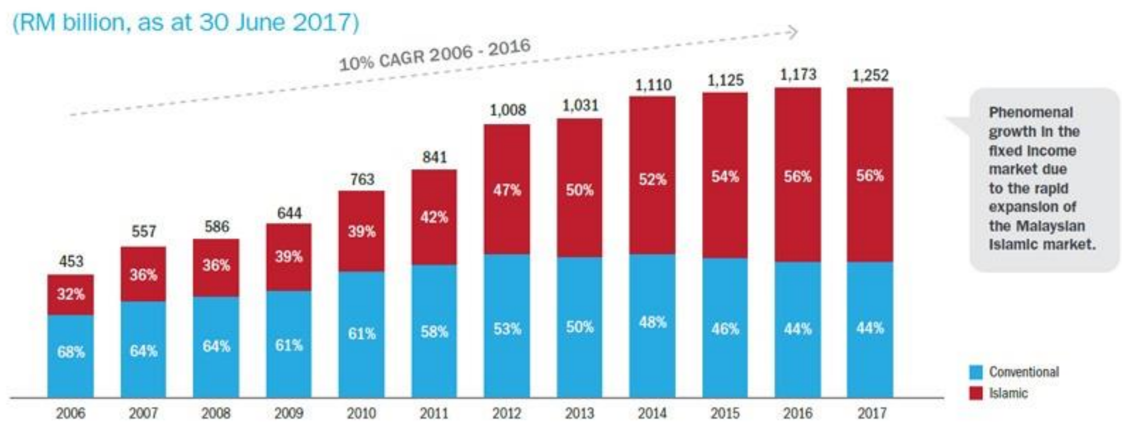
Prior to the 1990s, banking sector financing was dominant and was greater than funds raised by debt securities. It was only in the early 1990s that funds raised in the Malaysian bond market were larger than the amount of loan financing by the banking sector. These were due to several measures put in place since the1970s. The Government of Malaysia has issued bonds since the 1970s as part of its plan to support the funding needs of the country and continued to account for almost 50% of the market (Graph 41). As mentioned above, Malaysia is also regarded as the leading Islamic capital markets with RM1.9 trillion in sharia-compliant equity and sukuk outstanding. The bond market particularly Islamic bonds (*sukuk*) continues to be a very important source of primary financing, reflected by an overall CAGR of more than 10% for the period of 2006 to 2016 (Graph 42).

Graph 11: Size of Malaysian Local Currency Bond Market



Source: Asian Bond Online

Graph 12: Malaysian Fixed Income Market



Source: Capital Market Malaysia website

Since the 1980s, the Malaysian Government and authorities have taken various measures and reforms to develop its debt securities market including Islamic securities. Bank Negara Malaysia was the agency responsible for capital market development until 1993 when the SC acted as the single regulatory body to promote the development of the capital market. Various guidelines were issued as part of the regulatory measures to ensure growth and sound supervisory for capital market activities. This includes Guidelines for the Issuance of Private Debt Securities, Guidelines on Securities Borrowing and Lending (SBL) Program under RENTAS and Guidelines on the Offering of Structured Products. Additionally, there are some specific guidelines issued for Islamic Securities e.g. Guidelines on the Offering of Islamic Securities.

In 1999, the Government of Malaysia established the National Bond Market Committee (NBMC) which was responsible for providing policy direction as well as for rationalizing the regulatory framework for bond market development in the country. This Committee consists of representatives from the Ministry of Finance, Economic Planning Unit, Bank Negara Malaysia, the Registrar of Companies and Malaysia Stock Exchange.

In 1997, recognising that a well-functioning bond market requires an active secondary market, the Bond Information and Dissemination (BIDS) was established. Its aim was to increase awareness of the bond market to support both primary and secondary trading. BIDS mandate to promote transparency of information related to domestic debt securities for encouraging greater secondary trading. Bank Negara Malaysia has also introduced Fully Automated System for Tendering (FAST) in 1996 while improving operational processes. In the year 1999 for speeding up the securities tendering, it introduced the Real-Time Gross Settlement System (RENTAS) to reduce settlement risk. Moreover, for promoting lending of securities to the central bank, the Institutional Securities Custodian Program (ISCAP) was implemented in 2004. Another important milestone is the establishment of the National Mortgage Corporation of Malaysia (Cagamas) to support the national homeownership policy (Figure 16) and to leading the development of the private debt securities market in Malaysia (Barisha et al., 2018).

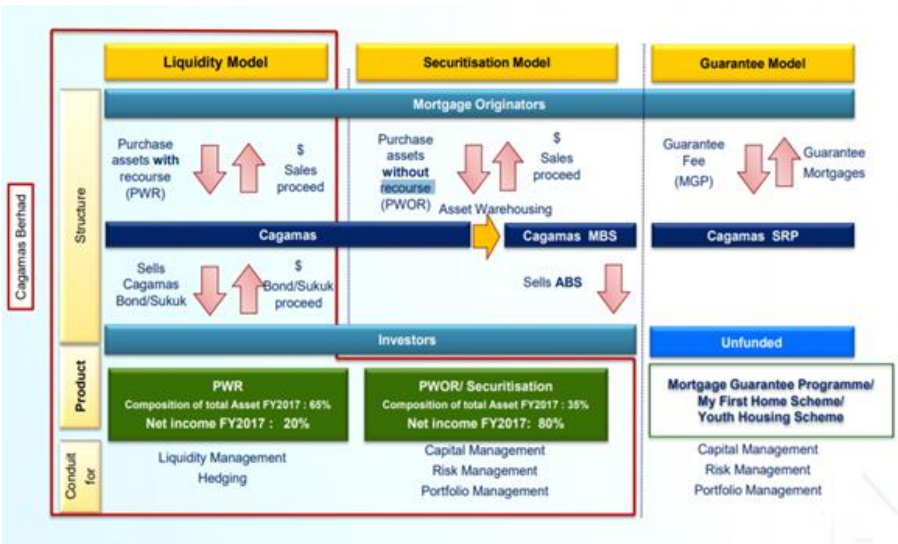
Figure 17: Cagamas: A Successful Business Model in Malaysia

Cagamas has been in operation since 1986; it was established to serve as a special vehicle to mobilise low-cost funds in supporting national home ownership policy as well as stimulate the private debt securities market in the country. To date, Cagamas has cumulatively issued RM301.9 billion (as at 31 December 2017) of bonds and *sukuk*. Its issuances comprise both bonds and *sukuk*, to finance the purchase of housing loans and receivables from financial institutions, corporation as well as from public sector.

Its business model is to provide secondary mortgage liquidity facility and has become one of the most successful by offering liquidity at a very reasonable level and stimulating access to home financing to the society at large. Moreover, Cagamas is considered one of the catalysts in stimulating growth of private debt securities in the Malaysian capital market including Islamic capital market.

Cagamas funds the purchase of housing loans and house financings through two arrangements: Purchase With Recourse (PWR) and Purchase Without Recourse (PWOR) schemes through the issuance of conventional bonds and *sukuk*. During its initial years, Cagamas introduced the purchase of housing loans without recourse but financial institutions were reluctant to sell as they were concern it would affect their good quality loans. To this end, the PWR and PWOR schemes have expanded to include SME loans, infrastructure financing and industrial hire purchase/leasing receivables. In addition, its guarantee model enabled housing loans and home financings under Mortgage Guarantee Programme (MGP). The figure below illustrates the Cagamas business model comprising of Purchase with Recourse (PWR), Purchase without Recourse (PWOR) and Guarantee Model.

The Cagamas model has benefited its key stakeholders, namely the house buyers as well as the institutional players involved in its operations. By making funds available to the primary lenders, this enabled house buyers to have access to reasonably-cost housing loans, thus resulting in a further increase in house ownership in the country. Financial institutions, on the other hand, are able to obtain the necessary liquidity and funds to further originate home financing or loans as part of their business activities.



Source: Cagamas' Presentation Journey to Success, August 2018

The first Capital Market Masterplan became the guidance to the development of the Malaysian capital market for the period of 2001 to 2010. It focuses on building a competitive capital market to meet the country's capital and investment needs and to support the long-term efforts for nation-building. During the implementation of the Capital Market Master Plan, many other measures and enhancements were made towards strengthening market processes and infrastructure. This was in the pursuit of the nation's aspiration of becoming a fully developed capital market and enhancing its international positioning in areas of comparative and competitive advantage[4]. From the onset, the nation's aim was to develop an internationally competitive system that would be highly efficient and supported by a strong and facilitative regulatory framework.

Figure 18: Vision of the Malaysian Capital Market as stipulated in the Master Plan

This vision underscores the importance for the Malaysian capital market to offer issuers the ability to raise funds using various types of instruments covering various risk profiles and maturity. Efficiency of fund-raising process and creation of an active and efficient secondary market are also pertinent aspects that were underlined in the masterplan. This also accorded emphasis on areas related to Islamic capital market where the importance of having; a well-defined and widely accepted accounting, tax and regulatory framework are deemed essentials.

The key achievements from the implementation of the 10-year plan are active issuances of private debt securities and growth in the investment management business segments as well as the development of a comprehensive and innovative Islamic capital market (ICM). During this

[4] See Capital Market Master Plan, Securities Commission Malaysia. Source: Capital Market Master Plan.

period, sources of financing have been broadly diversified to provide greater funding avenues for large-scale projects via the DCM.

The Capital Market Masterplan (2010-2011) further outlines strategies to the expansion of the capital market in creating jobs, financing business ventures, increasing ownership of assets and generating returns on long-term savings.[5] These include:

- Promote greater retail participation in the bond market through developing a framework to facilitate the offering of corporate bonds to retail investors, covering the eligible issuer base, mode of offering, format of offering documents, price transparency, investor protection and education activities.
- Improving the availability of a broad range of interest rate-sensitive products is required for the application of sophisticated fixed-income investment strategies and to promote active trading and arbitrage in the bond market.
- Widen participation and deepen liquidity in the bond market.
- Facilitate innovative products such as green funds or bonds that can be used to finance investments in low-carbon technologies and support various programs to test innovative approaches to managing climate change such as forestry and energy renewal.

These strategies have led many new initiatives to support the above areas. For example, to encourage retail bond market the SC introduced a new seasoning framework to enable retail investors to access existing corporate bonds and *sukuk* that are currently traded by sophisticated investors in the over-the-counter (OTC) market. This framework requires that *sukuk* and corporate bonds that are eligible for retail investment must, must among other things, have a minimum credit rating of A and have been in the market for at least 12 months.[6] An online information platform Bond + *sukuk* Information Exchange Malaysia (BIX Malaysia) was established by the SC in November 2017, to complement the framework for retail investors as this platform will provide the essential information on ringgit bonds and *sukuk* to retail investors in making their investment decisions. Part of the framework as guidance to market participants were New Guidelines on Seasoned Corporate Bonds and *sukuk* and amendments to Guidelines on Issuance of Corporate Bonds and *sukuk* to Retail Investors, the Guidelines on Sales Practices of

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[5] Capital Market Master Plan 2, Securities Commission Malaysia https://www.sc.com.my/api/documentms/download.ashx?id=d7ba5bf6-9224-4024-9074-58e2c9f20973.

[6] Press Release Securities Commission Malaysia. https://www.sc.com.my/news/media-releases-and-announcements/sc-liberalises-framework-for-retail-investment-in-malaysias-corporate-bond-and-*sukuk*-market.

Unlisted Capital Market Products. This is a good example where the Malaysian regulator undertake various elements of the ecosystem; namely regulatory measures, market infrastructure and liberalisation policies as incentive to encourage a business segment within the capital market.

SC launched the SRI *sukuk* framework in 2014 to promote Socially Responsible financing and Investment (SRI). A multi-dimensional effort in the context of encouraging SRI or green bond and *sukuk* issuances. To complement SRI *sukuk* framework and promote greater utilisation of green *sukuk*, tax deduction on issuance costs of SRI *sukuk* until year of assessment (YA) 2020 was announced. Supported by a joint working group between the regulator and the World Bank, the country has witnessed another landmark innovation with the launch of the first green *sukuk* in the world in June 2017 by a private company. To date, there are more than 5 green *sukuk* issuances by the Malaysian private sector. (Table 13)

Table 3:List of Malaysian Green Corporate *Sukuks*

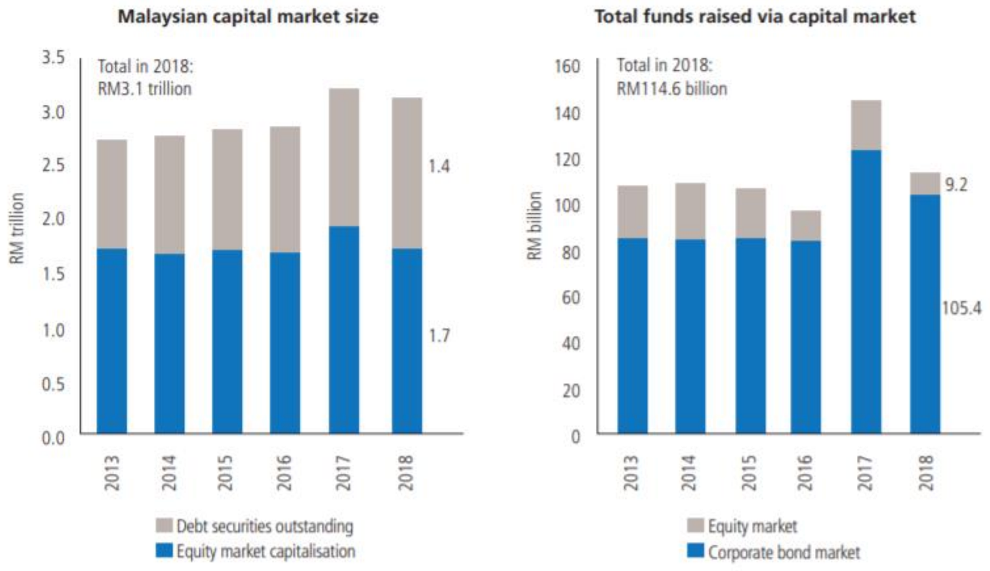
Issuer's Name	Program	Currency	Amount Issued	Size in US $	Issued Date	No. of Tranches	Country of Domicile	First Maturity	Final Maturity	Industry	Structure
Tadau Energy SDN	SRI Sukuk	MYR	250,000,000	58,453,553	7/27/2017	15	Malaysia	7/29/2019	7/27/2033	Alt. Energy	Al Ijara
Quantum Solar Park	Green SRI Sukuk	MYR	980,000,000	231,312,106	10/6/2017	32	Malaysia	10/4/2019	4/6/2035	Alt. Energy	Al Murabaha
PNB Merdeka Ventures	ASEAN Green & SRI Green Sukuk	MYR	1,874,000,000	462,944,664	12/29/2017	6	Malaysia	12/29/2022	12/29/2031	Real Estate Developer	Al Murabaha
SINAR KAMIRI SDN	Green SRI Sukuk Wakalah	MYR	245,000,000	62,841,460	1/30/2018	17	Malaysia	1/30/2018	1/30/2036	Alt. Energy	Al-Wakala Bel-Istithmar
UITM SOLAR POWER	Green SRI Sukuk	MYR	222,300,000	56,716,418	4/27/2018	17	Malaysia	4/27/2020	4/25/2036	Alt. Energy	Al Murabaha

Source: Bloomberg

While supporting growth, SC strikes the balance to also ensure stability of its capital market. Amongst the recent measures include the introduction of registration framework for providers of capital market services that requires all trustees and issuing houses (that provide capital market services) a requisite to register with the SC. A high standard of professionalism, disclosure and governance is required by the authorities by holding issuers, intermediaries and professionals accountable.

The growth of the Malaysian capital market has evolved not only from size perspective but supported by market reforms as well as being innovation driven.

Graph 13: Key statistics of Malaysian Capital Market



Source: SC, BNM, Bursa Malaysia

The unique advantages are the thriving development of its *sukuk* market that complements its bond market evolution as well as the size of private sector participation in its capital market.

Moving forward, against the backdrop of a more challenging and uncertain global environment, the evolving Malaysian capital market will support its private sector including manufacturing activities, wholesale and retail trade sub-sectors. Digitalisation and financial technology are one of the on-going focuses in the capital market sector. It will broaden the offerings and innovative solutions to this segment, as the risk perspectives demand the regulator to remain committed in responding to new emerging risks and issues.

6.4. Country Study 2: Indonesia

6.4.2. Country Information:

Indonesia is the largest economy in Southeast Asia region with diverse archipelago and cultural diversity consisting of 300 ethnic groups. Indonesia is also the world's fourth most populous country estimated at 270.63 million in 2011[7]. As a presidential representative democratic republic, President of Indonesia is both head of state and head of government and of a multi- party system. Executive power is exercised by the government.

[7] World Population Review

Indonesia is an emerging lower middle-income country and a member of the G20. It has reduced poverty drastically and as of 2019 has cut the poverty rate by more than half to 9.4% since 1999[8]. The country's GDP per capita has steadily risen, from US$823 in the year 2000 to US$3,932 in 2018[9]. However, Indonesia's economic and financial landscape still faces various challenges namely poverty and unemployment, inadequate infrastructure, corruption, a complex regulatory environment, and unequal resource distribution among its regions. 25.9 million of Indonesia's around 264 million population still lives below the poverty line[10].

State-owned enterprises (SOEs) and large private business groups (conglomerates) play a significant role in Indonesia's market economy. Privately held business groups in Indonesia dominating the domestic economy. On the other hand, Indonesia's micro, small and medium sized enterprises segment accounts for 99% of the total amount of enterprises that are active in Indonesia[11], which is also key important driver in its economy particularly to address unemployment and poverty issues.

According to the World Bank, Indonesia's economy is projected to grow at 5.1 percent in 2019 and then rise to 5.2% in 2020. Private consumption supports this projection, which is forecasted to continue accelerating as inflation remains low and the keep labour markets are strong. Indonesia's main trading partners are other Asian countries – Japan, China, Singapore and South Korea[12].

6.4.3. Indonesia Capital Market Evolution

As the largest economy in Southeast, Indonesia possesses and offers excellent opportunities to capital market investors – both equity and bond market. As a result of the centrally planned economic development, between the 1970s and most of the 1980s, the role of the state was dominant. Under this state-led development, the banking sector played an instrumental role in the financial sector. Banks became more entrenched in Indonesia's financial market as the non-banking financial sector was almost absent. However, by the beginning of the 1990s, the non-banking financial sector began to grow tremendously thanks to the privatization policy, the then

[8] Ibid

[9] The World Bank (Indonesia Country Profile)

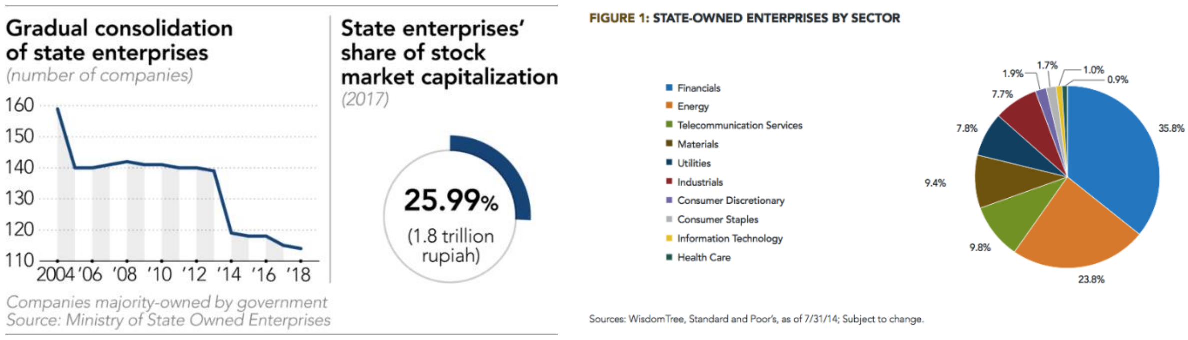
[10] The World Bank

[11] Indonesia Investment website

[12] Asia Link Business

Suharto’s government was pursuing. The privatization policy saw the government relinquished its holding of many state-owned enterprises (SOEs). As a result, Indonesia’s stock market capitalisation gradually represented substantial of SOEs’ market value. For instance, at present, the SOEs make up one quarter of the Indonesia’s stock market capitalisation. Among these key SOE players are PT Telekomunikasi Indonesia (Telkom) and Bank Mandiri with 7.2% and 4.5% share of market capitalisation respectively.

Figure 19: SOEs in Indonesia



Source: Ministry SOE Indonesia

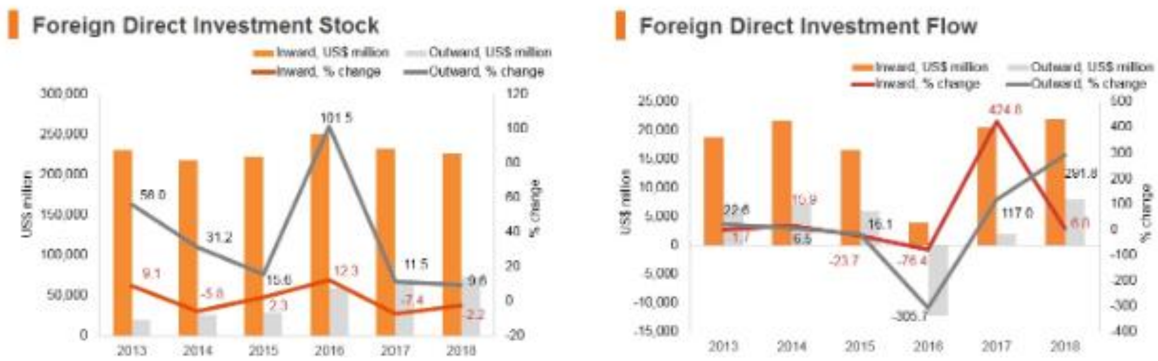
At around 47% of GDP and 0.14% of daily trading, Indonesia’s stock market is overall still small both in terms of its size and liquidity. However observable efforts have been continuous by the Capital Market and Financial Institutions Supervisory Agency (BAPEPAM), to boost investment culture through building public confidence in capital market investment. Major challenges remain, as to increase more participation especially from domestic players.13 With very small presence of fund managers, it is hard to imagine how Indonesia’s DCM can become competitive and attractive.

The presence of unsophisticated pension fund firms at present, foreign ownership still reigns in Indonesia’s equity market. As these foreign investors trade in large volumes that in turn move stock prices, domestic investors often follow the behaviour of these foreign investors[15]. Unfortunately, many domestic investors with shorter investment horizon cannot catch up with the short-lived window for arbitrage, as opposed to foreign investors with much longer investment horizons. Consequently, these domestic investors are driven out of the market.

[13] For instance, data for January 2016 shows that domestic retail investors were estimated at around 440,000. Of this small pool of domestic investors, only a handful of them are actively trading in the market.

Notwithstanding the benefits brought by foreign investors to domestic equity markets (see Kacperczyk, Sundaresan & Wang, 2018), a domination by foreign investors in Indonesia's equity market has also increased market volatility. Between mid-2013 and early 2014, Indonesia's stock market plunged in the aftermath of the U.S. Fed interest hike. Although, for a quick time, the Indonesia's stock market rose in parallel with the Shanghai stock market to historically high levels in April 2015, such episodes were short-lived. As the Chinese market melted due to domestic factors, Indonesia's market slipped (see Graph 44 below).

Graph 14: Foreign Direct Investment in Indonesia



Source: UNTCAD

Foreign ownership is not the only vulnerability source. Equally culpable is the corporate governance issue. Indonesia's equity market has among the lowest number of free-floating shares when compared to other fast developing economies namely Thailand and China. Understandably this has a lot to do with the domination of SOEs' stocks in the market where government still holds bulk of the shares. Nonetheless, even among Indonesia's largest private firms like Astra International and Unilever Indonesia, free-floating shares are below 40%. From corporate governance perspective, such high government shareholding means that firms' decision may be non-transparent as owners/founders still heavily control firm's direction. Complicating the matter, these large corporates also make up significant portion of the total market capitalisation. This suggests that Indonesia's stock market is highly concentrated and should these dominant players go wrong the effects can be negative (Rowter 2016, 11).

The situation is even more critical with respect to Indonesia's DCM. Being extremely underdeveloped, Indonesia issued no government bonds prior to the Asian financial crisis 1998. Post-crisis, the DCM featured a monopoly segment of the government bonds at the expense of the corporate bonds. The main reason for this was none other than the urgent need for the Indonesia's government to finance its growing deficit. Most of this deficit financing, which was due to growing infrastructure developments, for which required more long-term financing. As banks could not satisfy these financing needs, the government had to move toward market-based financing (Rowter 2016, 11-12)

The 2002 law sent strong signal to the market on the seriousness of the government to build up issuance capacity. This specific legislation guarantees payment of principal and interest. Complementing this legislative effort is the institutional initiative to set up the first national directorate of bond management. The directorate maintains close relationship with various market participants thus guarantee strong mandate and legitimacy from the market. Such a strong mandate had also explained recent Indonesia’s first sovereign green *sukuk* in 2018.

The robust development in the government bond segment of the DCM has seen significant reduction in government borrowing from non-market sources namely multilateral or bilateral financing arrangements. In fact, this has led to a lower share of foreign loans in GDP for Indonesia.

Foreign investors still favour Indonesia’s government bonds despite the country’s non-investment rating. However, highly attracted foreign bond investors, have presented vulnerabilities in terms of contagion and risks just like the equity market. The latest trend has somewhat softened such contagion and risks as Indonesia saw growing appetite from long-term institutional bond investors in its market. At the same time, the presence of hedge-funds has systematically declined. While government bonds have shown some progress over the years, corporate bonds did not. To date, it remains relatively small even below regional average. Part of the reason is the still dominance of the banking sector in the financial market. Coupled with a tedious and complicated process in issuing (corporate) bonds in Indonesia which includes lengthy regulatory approvals, stringent disclosure requirements, financial records validity rule and tax rates. These rules and requirements have impeded the development of the corporate bond market in Indonesia (see Rowter 2016, 11; CGIF 2018, 25).

Indonesia’s capital market development is far from perfect. Nevertheless, the potential remains large and intact. However, with such a large population, Indonesia still suffers from large informal sectors that hamper its ability to account for all financial capital resources. Unpaid labour and non-contract labour arrangements are two critical factors that lead to poor demand for sophisticated financial products and services. In addition to low education level, poor awareness of the significance of financial market is reflected by the low participation of domestic retail investors in the Indonesia’s capital market. It is therefore imperative for Indonesia to undertake further labour market reforms and work to improve its financial literacy to develop sufficient informed domestic retail investors in the capital market.

Table 4: Financial Market Structures in Select ASEAN Members (USD)

	Banks (domestic credit)	Bond market issue balance	Stock market capitalization	Total
Indonesia	39.4	12.7	48.8	100.9
Malaysia	135.3	107.3	153.1	395.7
Philippines	52.4	39.6	91.7	183.7
Singapore	99	81.2	269.1	449.3
Thailand	131.5	76.1	106.5	314.1

Source: Rowter (2016: 10)

6.5. Country Study 3: South Africa

6.5.2. Country Information

South Africa is located on the southernmost tip of the African continent is marked by several distinct ecosystems. The population of South Africa is about 57.7 million people of diverse origins, cultures, languages and religions.

The country follows a parliamentary representative democratic republic system where the President of South Africa is elected by parliament. The President is the head of government and of a multi-party system. South Africa's political transition is known as one of the most remarkable political feats when the country held the most competitive local government elections in 2014.

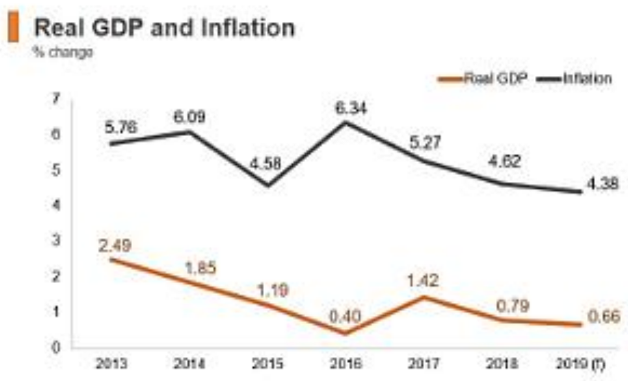
South Africa is a middle-income country with rich supply of natural resources and well-developed legal, financial, communications, transport and energy sectors. As a result of wealth from mineral resources and favourable agricultural conditions, its economy has been traditionally rooted in the primary sectors. But recently, it has had structural shift in output, away from the norm and more towards becoming a knowledge-based economy with emphasises on e-commerce, technology and financial and other services.

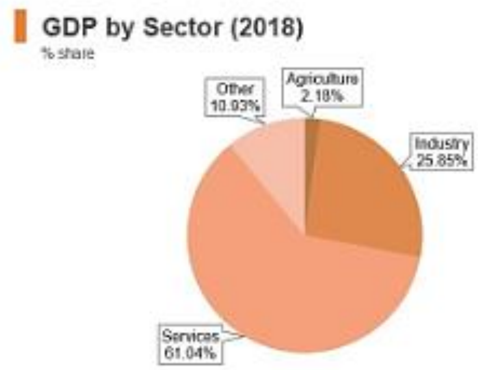
South Africa's top trading partners for 2018 are China, Germany, the United States, India and the United Kingdom. The main products exported are platinum, motor cars, coal, iron ore and gold.

The main import products are crude oil, petroleum oils (not crude), motor cars and telephone sets (including cell phones)[14].

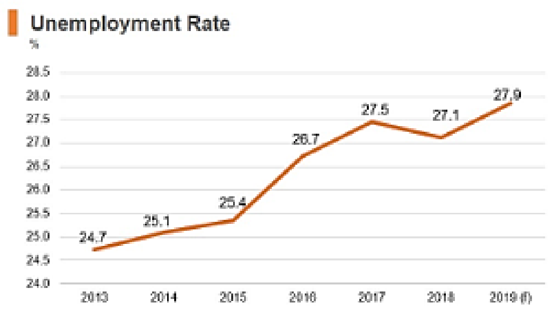
Several key remaining challenges are unemployment, poverty and inequality issues. The future of the nation's economic and financial landscape lies in fostering its economic recovery, with more job creation and addressing of its public financial issues. Having one of the highest inequality rates in the world, South Africa remains a dual economy with a consumption expenditure Gini coefficient of 0.63 in 2015. Inequality has been persistent, having increased from 0.61 in 1996[15].

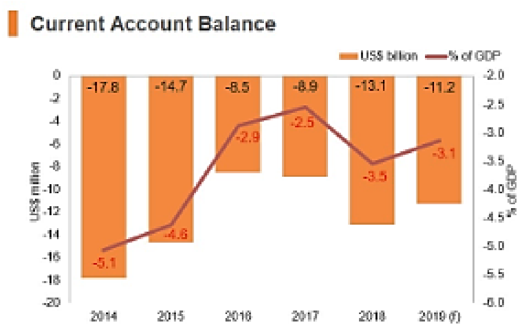
Graph 15: South Africa Economic Indicators





Source: World Bank Data (https://data.worldbank.org/country/ZA)





f = forecast
Sources: IMF, World Economic Outlook Database, Fitch Solutions, World Bank

[14] "South Africa: A 2018 trade and investment profile" by Tralac

[15] The World Bank

6.5.3. Regulatory Developments

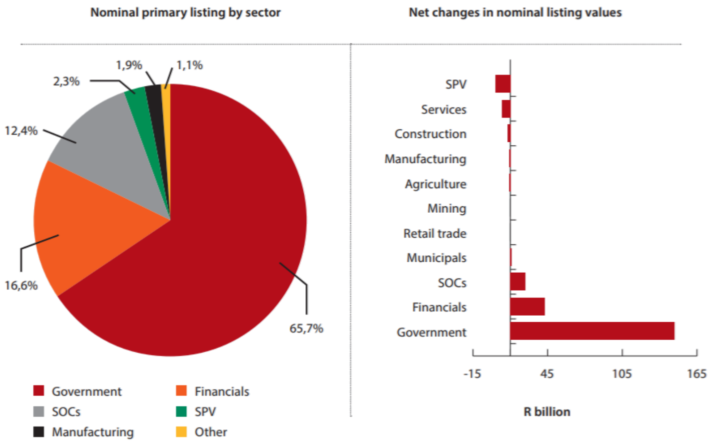
South Africa is one the most industrialized economies in the African region and the country is also a key gateway to Africa. South Africa's capital market is the most advanced in the African continent. Its centre is the Johannesburg Stock Exchange (JSE) that maintains its reputation as Africa's soundest capital market and it is the largest licensed securities exchange in South Africa.

Between the 1970s to 1980s, the South African bond market started to informally evolve when the Government ran a large deficit position and led to this demand. However, during that stage, there was no established regulatory body to oversee this segment neither the market infrastructure or information platform to facilitate any of these activities. A number of reforms and structural improvements were introduced towards the end the1980s e.g. introduction of benchmark yield curve and structure programs for regular actions period. An important milestone was the establishment of the Bond Market Association (BMA) comprising of bond issuers, intermediaries, banks, brokers and investors. Until 2016, JSE was the only securities exchange in South Africa. Since then, four additional exchanges have been licensed – ZARX (2016), 4AX (2016), A2X (2017) and Equity Express Securities Exchange (2017).

The growth has been healthy against the backdrop of improved regulation and supervision. South Africa is ranked 25th out of 137 countries in raising finance through the local equity market and has an advanced financial services sector according to the Global Competitiveness Report 2017/2018. Its legal system is recognized in terms of strength of investor protection and is ranked 21st by the same report. Generally, South Africa's financial sector is governed by several key legislations. The banking sector operates under two laws namely the Banks Act 1990 and the Mutual Banks Act 1993.

Meanwhile, the non-banking sector is regulated by an independent body known as the Financial Services Board (FSB) which regulates non-banking financial market institutions e.g., insurers, fund managers and brokering operations in the equity market. South Africa features a unique social-financial regulator, the National Credit Regulator, which regulates the country's credit industry. This special regulatory body seeks to develop an accessible credit market in meeting the needs of people who are marginalized economically.

Graph 16: Primary Listing of Debt Securities on the JSE, 31 March 2017



Source: JSE

The South African Reserve Bank was also a represented in the BMA as it aims to facilitate formalization of the market as well as to improve depth and transparency in order to form a more robust functioning of the bond market. The BMA was then granted an exchange license and transformed into the Bond Exchange of South Africa (BESA, now known as JSE).

Other developments during this phase were the introduction of electronic trading, matching and settlement, dematerialization of bonds listed on BESA and index developments for government and corporate bonds. As a result, this has spurred development of corporate bonds in the country from around R10 billion in 2001 to almost R70 billion of net issuance in 2006. By the late 1990s, the regulator wanted to reduce its role as market maker for secondary trading. Twelve primary dealers were appointed to support the liquidity in the product and promote second market transparency.

JSE has initiated automated trading in mid 1990s. Table 15 lists out current platforms and clearing system for respective markets under JSE. A more recent development in 2018, JSE has opened South Africa’s first electronic government bonds trading platform powered by MTS, the electronic bond trading platform that is part of London Stock Exchange Group. The use of electronic trading platforms will improve depth of secondary markets including improved liquidity through price discovery, reduced transaction costs and greater competition, increased transparency and lower trading costs.[16]

[16]: 7MTS is one of Europe’s leading electronic fixed income trading markets majority owned by London Stock exchange.

Table 5: South African Capital Market Infrastructure

Market	Asset class	Trading platform	Clearing	Settlement	
				Securities	Cash
Equities	Equities	JSE (Millennium Exchange)	Strate (SAFIRES)	Strate SFIDvP (SAFIRES)	SARB (SAMOS)
Bonds	Government bonds	JSE (ETP)	Strate (TCS BaNCS)	Strate (SFIDvP) (TCS BaNCS)	SARB (SAMOS)
	Corporate and other bonds	OTC (Matched on JSE (Nutron))	Strate (TCS BaNCS)	Strate (SFIDvP) (TCS BaNCS)	SARB (SAMOS)
	Cash bonds	OTC (Matched on JSE (Nutron))	Strate (TCS BaNCS)	Strate (SFIDvP) (TCS BaNCS)	SARB (SAMOS)
Money market	Government and corporate short-term debt	OTC (ETME)	Strate (ETME and TCS BaNCS)	Strate (SFIDvP) MMSS	SARB (SAMOS)
Derivatives	Exchange- traded	JSE (Nutron)	JSE (JSE Clear – previously SAFCOM)	JSE (JSE Clear – previously SAFCOM)	JSE (JSE Clear – previously SAFCOM)

SAFIRES = South African Financial Instruments Real-time Electronic Settlement system
SFIDvP = Simultaneous, final and irrevocable delivery versus payment
SAMOS = South African Multiple Option Settlement system (South Africa's real-time gross settlement system)
ETP = Electronic trading platform
DIS = Debt Instruments Solution
ETME = Electronic Trade Matching Engine
MMSS = Money Market Settlement System

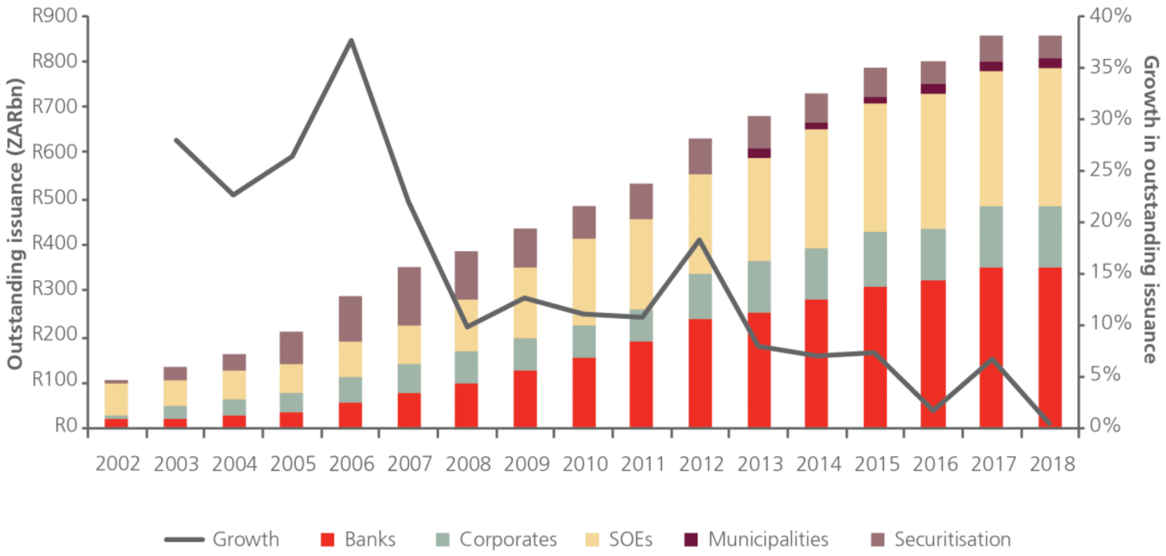
Source: JSE

As part of the plan to diversify its funding sources and tap into the wealth of the Arab world, the South African government has also issued sovereign *sukuk* in 2014. And Similar to Malaysia, efforts are directed to develop green bond market in the country. The JSE provides flexibility and commerciality with respect to its Green Bond Segment rules.

Press Release MTS, https://www.mtsmarkets.com/news-insights-events/insights/news/mts-and-jse-deliver-south-africa%E2%80%99s-first-electronic-government-bond-trading-platform.

6.5.4. Capital Market Developments

Graph 17: Growth in South African Listed Credit Issues



Source: Absa Research, JSE

Graph 48 reflects the growth in the South African listed credit market over a period of 15 years. Growing from around R105 billion in 2002 to around R857 billion, the local listed credit market has a growth rate of roughly 15% per annum. This growth is shown as a downward trend in the graph– the last five years of 5% p.a. Due to fraud, in 2013 First Tech collapsed with a R1 billion of debt being written off and leaving investors out of pocket. Consequently, appetite for corporate debt suffered and subsequent issuance reflected this. The following year the market experienced its second default and one of considerably larger size for African Bank (Bern, 2018).

A large number of funds and investment managers were affected by African Bank's default of almost R15 billion and subsequent years issuers contemplated lower demand and increased cost of issuance.

6.5.5. Rising Debt Problems

The First Tech and African Bank defaults signalled a new phase in the local corporate market as a number of other issuers subsequently experienced "problems", coupled with the challenging economic circumstances affecting the South African economy, which reduced issuance volumes and affected both investor and issuer sentiment. In addition, State Owned Enterprises (SOE) sector afflicted by the revelations around "State Capture" scandals and the associated governance failings, held back market growth as investors avoided association with SOEs. While their governance issues were being addressed, these issuers have still been unable to return to the market for lack of confidence. Given the economic challenges facing the local economy, along with SOEs, many corporates have been cautious towards borrowing. In fact, the graph reflects near-zero growth so far in 2018.

Due to regulatory changes following the financial crisis, local banks have become active participants on the buy side of the market that led to improvement in liquidity. Current regulatory incentives have created a more diversified investor that is motivated to purchase the listed debt of a number of highly rated companies which is positive for market liquidity. Several financial institutions have also tuned towards local listed debt, which has aided both liquidity and price discovery. With more demand in a slow-growing market, there is more competition for highly rated borrowers lowering the funding costs.

Its DCM is well-developed and liquid and serves as an important source of funding for public and private sectors. In fact, Fanta & Makina (2016) argues that the bond market plays a unique role in promoting economic growth in South Africa compared to the stock market, bank and non-bank institutions. Based on the JSE website, more than 1,600 debt instruments were listed on the JSE and roughly R25 billion is traded daily. However, the corporate bond market is still relatively illiquid due to deficiencies in the price discovery process.17 The JSE offers trading, clearing and settlement for equities and in bonds and derivatives (commodity, interest rate, currency and equity).

6.6. Learning Outcome

The DCM development depends greatly on the national development, ecosystem of the financial sector, informed public and visionary leadership. The three countries demonstrate there is no single approach to create a viable capital market. More fundamentally, all countries point to one foundation – the national willingness to develop a more competitive and sophisticated financial sector for the benefits of the nation. This holds true for all the three countries analysed. A well-functioning DCM must exist within the larger national economic development plan to elevate not only the economic sectors but equally as important the social and political sectors. In short, capital market development is pursued holistically for the good of the nation.

This linkage between capital market and national development is what makes capital market development in Malaysia, Indonesia and South Africa unique and acquire their own resilience

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0: 7MTS is one of Europe's leading electronic fixed income trading markets majority owned by London Stock exchange.

Press Release MTS,

against the market challenges. As the countries are analysed in terms of actor, strategy and context, the chapter reveals that all three countries confirm the instrumental role played by both the public and the private actors. Nonetheless, there exists some qualitative variations to this role across the three countries. Indonesia and South Africa appear to have stronger public actors' role as reflected by its buoyant development of the DCM where government's bonds consume bigger shares of the market vis-á-vis the corporate and the private actors in general. Malaysia, on the other hand, shows a much stronger private-driven initiative owing to the regulatory leadership through its multi-pronged strategies. Although, it should be noted that all three countries clearly show initial government's role as critical impetus for further private participation in the capital market development.

The analysis once again highlights the presence of catalytic forces that affect the capital market development in Malaysia, Indonesia and South Africa. In terms of governance, all three countries reinforce the significance of putting in place a sound legal framework. While actors in all the three countries work to establish the most appropriate rules and guidelines, their efforts are conditioned by the different catalysts confronting their respective country. For Malaysia, the country fortunately follows a relatively smoother transition from pre- to post-colonial economic system. Furthermore, these transitions have been achieved in a relatively more peaceful and much stability. Such an environment has tremendously helped Malaysia to enjoy more progressive development stages that in turn has helped thrive capital market development.

South Africa has had to deal with some turbulent past with racial struggle that has left long-term impact on the country's socio-economic landscape. The apartheid regime had crippled South African productive resources including capital movement. This had further exacerbated social and political divide in the country. However, South Africa's position in the African region has somehow helped to revive this whole unfortunate past legacy. Making itself as Africa's economic dynamo, South Africa has successfully leveraged upon the continent's promising potentials to seize market opportunities that come from far and wide.

Indonesia also had to confront its tumultuous legacies of the past. Not only its colonial history, the country also had to reckon with more disruptive political economic realities of its post-colonial times. Going against extreme corruption has been Indonesia's long struggle and the intermittent political instability has made this struggle even more difficult. With its huge population, Indonesia presents immense potentials, but more often than not these potentials become Indonesia's weakness as it takes much greater efforts (and cost) to craft good economic policies in an effort to make the capital market work.

The key takeaway for the GCC region in this regard is to craft a DCM development path that accounts for each GCC economy's past, present and future. This seems straightforward but more often than not policymakers demonstrate a time-inconsistent behaviour that value the present more than anything else (present-bias). Indonesia and Malaysia, in this country, provide a good evidence as to how a bitter past has not necessarily led policymakers to discounting the future too heavily. Instead, Indonesia is determined to mobilize its assets- people and their talent – to strive for a better future. Plagued by various labelling; namely terrorism, corruption and political chaos, Indonesia is slowly acquiring its renewed national identity that is entrenched in the nation's vow for inclusive growth and development. Hence, developing robustness in its DCM development described earlier has materialized because the political leadership has convinced the people that development (infrastructures and facilities) is no longer centralized but decentralized. This is to include some of the remote areas in the archipelagic state implying that the narrative of debt is expressed within a positive development discourse so as to encourage ownership and accountability among all stakeholders involved.

Similarly, for South Africa, post-Apartheid was never conceived as necessarily an absolute victory for the black South Africans but for all South Africans. The nation struggled to construct its own national identity given its clamorous past. Moreover, South Africa then had to detach itself from the image of Africa being the lost forgotten region. Fortunately, South African policymakers, at least, managed to not fall into the present-biased trap and profited the select few at the expense of the many. A newly defined national identity based on national resilience; politically, economically and socio-culturally was formulated. Such a national resilience is indeed an expensive national project and South Africa required more than just the conventional way of doing things financially[18]. Arguably, it is such a drive for non-conventional way of doing things that has allowed DCM to flourish. It is finding such a common national identity (culture) in this country that will facilitate the development and the deepening of DCM. By concretely identifying such a national identity helps a nation to formulate an achievable national strategic plan.

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m/news-insights-events/insights/news/mts-and-jse-deliver-south-africa%E2%80%99s-first-electronic-government-bond-trading-platform" https://www.mtsmarkets.com/news-insights-events/insights/news/mts-and-jse-deliver-south-africa%E2%80%99s-first-electronic-government-bond-trading-platform.

financial market is not a guarantee to an equitable economic opportunity. It takes more than sound financial and economic policies to tackle inequality and extreme poverty. But to use this as an excuse not to develop and deepen local financial market is analogous to not pursue formal education for there is no guarantee of such a formal education providing decent or materially rich life.

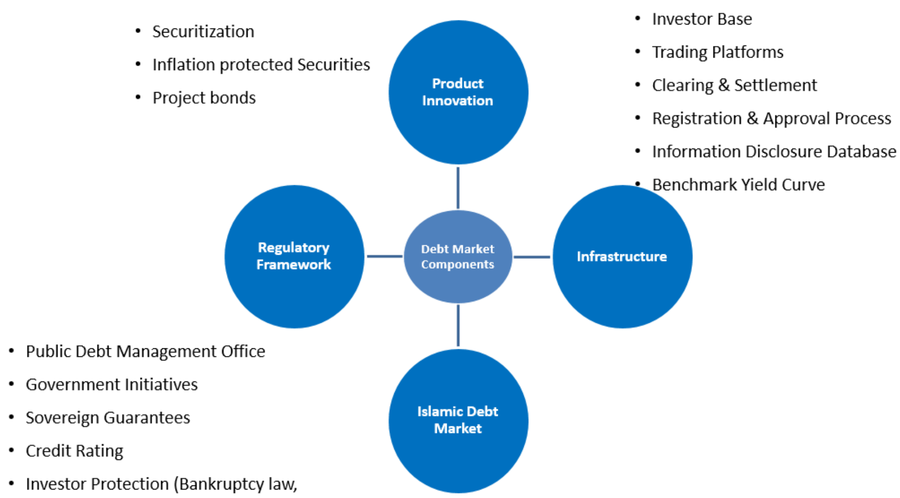
6.7. Conclusion

In examining the degree of development in the GCC countries as compared to Kuwait specifically, we can notice that such developments are much slower or coming later in case of Kuwait. That demonstrates two main issues; firstly, the financial needs are not extreme or pressing on the government's budget and secondly, the lack of political will, vision and commitment in public policy is undermining the gravity of market reforms that is being required. A more comprehensive development plan and framework along the lines of the diagram below will be examined and discussed in Chapter 8.

All in all, the three countries provide a convincing argument that capital market development does not rest with good policy pronouncement and intention to become a modern and sophisticated economy. While actors' strategies to accommodate global and regional opportunities and challenges are necessary for developing a capital market that is competitive, national development needs must be appropriately addressed and incorporated in such capital market development strategies. This is where actors, at least as the three countries has shown, remain cognizant of the strong interplay between power (authority-legitimacy), culture (historical and social legacies) and governance (rule of law) that will continuously facilitate, complicate and fail (in worst-country scenario) their efforts.

The next chapter forms the heart of this dissertation, we will be looking closely on issues affecting the development of DCM in the GCC region. It will examine the underdevelopment of capital market in the GCC region in a comparative perspective by directly referring to financial infrastructure and structure, legal framework and regulative environment as well the role of the political institutions.

Figure 20: Framework to Develop DCM in Kuwait



Source: Markaz, (Raghu, 2016b)

Chapter 7: Locating the Factors Hampering the Development of Debt Markets in the GCC: Empirical Findings

7.1. Introduction

This chapter highlights issues affecting the development of DCM in the GCC region. It examines the underdevelopment of capital market in the GCC region and directly compares and contrasts the financial infrastructure and structure, legal framework, regulative environment and the role of the political institutions. It draws on the comparisons with other examples of emerging markets discussed in Chapter 6 for Malaysia, Indonesia and South Africa, as well as the focus group outcome in Chapter 8 and the Appendix. Finally, we discuss the significance of development of capital markets in the GCC region and how the decision process can be influenced and how to implement persuasion mechanisms with the different stakeholders.

7.2. Current Impediments to Further Market Development

By many standards, GCC has a stable and favourable business environment. Nevertheless, features of the regulatory and legal framework place GCC countries at a disadvantage in relation to their neighbours. This reduces attractiveness and a hurdle for foreign investments. This section identifies and discusses some of these deficiencies. Therefore, it focuses on "legitimation" to understand the impediments that are affecting the development of the DCM in GCC region.

7.3. The Public Sector Challenge

A challenge for GCC countries is to overcome the lack of political will to shift the financing burden from the public purse. There are "ideological biases" of senior government officials and their "vested interests" in the traditional economic cycle, these may prove an impediment to economic reform, particularly in the absence of democracy. In GCC countries with all power vested in the political elite senior circle, the implementation of an efficient DCM rests on the political will of the ruling elite. Along with the influence of oil rent inflow, the GCC governments' reluctance to depart from traditional practices and relinquish some degree of project control to private actors, may prove harmful.

7.4. Marginal Secondary Market

Despite the establishment of the *sukuk* market trading platform on the Tadawul (the Saudi stock exchange) and Nasdaq Dubai and the recent surge in issuances, the GCC bond market remains "highly illiquid" (Bourland, 2009). Under this system, trades are negotiated off the exchange and treasury departments of local banks. For the whole of 2008, there were only 85 trades executed with a value of SR1.3 billion, (12 years later its only 205 trades for the year) compared to 52 million share transactions worth SR2 trillion over the same period. This also indicated that investor's objective was to generate yield by holding the instrument to maturity as opposed to using a secondary market. The illiquidity of the instruments must be surpassed by an attractive discount for investors.

This cyclical impediment to an illiquid secondary DCM does limit access to a much-needed alternative source of private financing in the GCC. The inadequacy of private channels of finance will ultimately prove detrimental to the implementation of efficient, market driven DCM in the GCC. In fact, secondary market liquidity is considerably more difficult to achieve than placement of debt instruments in the primary market. It requires constant cooperation between stakeholders and a regulatory and legal framework, to meet best international practices (Saidi et al, 2009).

7.5. Investor Base and Awareness

Implicit to the ongoing discussion is the need to further deepen the debt markets through a broader investor base. A broader investor base does not only mean investors by multiple geographical origins (foreign participation) but equally important are multiple investor types. The logic being that; the depth of the markets depends on trading volumes, and trading volumes can be increased with more investors actively participating in the markets.

Table 6: Growth of Deposits vs Total Securities in the GCC

GCC's Key Conventional Banking Assets

	Conventional Banks							
	(Percent of Assets)							
Deposits	2008	2009	2010	2011	2012	2013	2014	Average
Bahrain	50.9	50.3	52.3	60.5	60.9	63.9	65.0	57.7
Kuwait	62.4	59.1	61.9	62.0	62.7	63.0	59.4	61.5
Qatar	56.5	58.8	61.9	61.0	62.7	65.3	62.3	61.2
Saudi Arabia	73.1	75.1	74.9	75.7	75.1	75.9	76.4	75.2
UAE	61.8	62.9	65.4	65.1	66.0	66.7	67.4	65.0
Simple Average	60.9	61.2	63.3	64.9	65.5	66.9	66.1	64.1
	(Percent of Assets)							
Total Securities	2008	2009	2010	2011	2012	2013	2014	Average
Bahrain	12.6	15.4	20.7	21.7	24.3	28.5	27.4	21.5
Kuwait	13.0	16.3	19.4	19.6	18.6	18.2	17.0	17.4
Qatar	8.9	13.2	17.8	21.1	22.2	22.3	16.7	17.5
Saudi Arabia	28.3	25.6	27.9	27.1	25.6	26.1	27.8	26.9
UAE	7.9	7.4	7.8	9.2	9.0	9.4	10.7	8.8
Simple Average	14.1	15.6	18.7	19.7	20.0	20.9	19.9	18.4

CAGR 1.4%

CAGR 5.9%

Source: Basu, Prasad and Rodriguez, 2015; Authors' calculations

The GCC region still has very concentrated players in its debt market as demonstrated by its sovereign securities. The banking sector was (and still is) the main investor for these sovereign securities. Available data on the share of total assets of the banking sector shows clearly that banks are the captive domestic investor. The banks are required to hold much of the government securities partly due to the high liquidity asset ratios requirement imposed on banks. Table 16 shows that while deposits made up the biggest chunk of the total banking assets, the CAGR for securities outperformed deposits between 2008 and 2014.

Institutional investors were still very much underrepresented in the GCC region. Pension and insurance organisations– Saudi Arabia and the UAE have the most sizeable insurance markets which made up 43% and 34% respectively of the regional total in the GCC. Although by international standards this is small with their private-sector counterparts being of marginal significance.[19] Such lack of long-term investors with different types of investment appetite further hamper the potential deepening of the GCC DCM. However, there were initiatives being undertaken to reform the pension systems.

7.6. Standardization of *Sukuk*

Although the discussions between Islamic financial institutions and regulators continue to improve, the lack of *sukuk* standardization across the global marketplace has restricted the development and growth of the Islamic debt markets. The AAOIFI standards provides guidance on *sukuk* but are not universally endorsed, with discrepancies between the models of Malaysian and GCC *sukuk* on complicated cross-jurisdictional trade. As the Islamic debt markets become increasingly accustomed to *sukuk* issuances, transaction costs associated with a standard offering will decrease, simplifying issuance and improving supply.

Regulators are starting to recognize the market and the need for regulation that enables market growth and establishes legal frameworks. In turn industry codes and standards have been established by AAOIFI and IFSB for the *sukuk* market and a host of market related reforms that provided socio-political legitimation (Hsu et al, 2009).

Introduction of bond and *sukuk* indices and incentives to foreign investors including assurance on investors protection, are among the efforts that can increase greater participation from foreign

[19] Deutsche Bank, GCC Financial Markets Report, 2012.

investors. The GCC economies can also explore ways to increase Asian investors' participation in their capital markets.

As *sukuk* issuances and tradability are scaled up, the liquidity improves. The increased supply of DCM instruments will encourage holders to trade prior to maturity, and the prevailing high transaction costs associated with *sukuk* issuance will fall as the process is streamlined. Thus, incentivizing borrowers to issue *sukuk* and could prompt the desired market cycle, deepening the GCC DCM and may secure new ways of alternative financing streams in the GCC. In addition, investors' confidence and rating agencies play a key to the legitimation process.

7.7. Lack of Benchmarking Issuances

As of 2010, despite the high growth of sovereign issuances, the GCC region did not have the sovereign benchmarks. This was due to the absence of regularity in the issuance of sovereign bonds in the four largest GCC economies (Saudi Arabia, the UAE, Kuwait and Qatar). Again, the huge fiscal surpluses from oil revenue implied little need for government borrowing and logically explains the lack of sovereign issuances. The exceptions were Bahrain and Oman where their sovereign issuances were at much regular intervals making benchmarking more feasible. Hence, it was not surprising that the GCC region had a negligible representation in global benchmarks or indexes. Although this began to demonstrate some changes beginning in 2015 onwards, the region's allocation in global indexes, e.g. Bloomberg Barclays Global Aggregate Index and JP Morgan Emerging Market Bond Index (EMBI) Global, is extremely low compared to other regional markets. Since 2017, this has changed. As of 2019, the GCC now has a significant weight in the EMBIG at around 15% of index evident in allocation of the GCC bonds (see Graph 50, Markaz, 2019d).

Graph 49: GCC poor representation in global indexes hampers benchmarking

Source: FactSet. The Bloomberg Barclays Global Aggregate Index measures global investment grade debt from 24 local currency markets and includes treasury, government-related, corporate and securitised fixed-rate bonds from both developed and emerging market issuers. The JP Morgan Emerging Market Bond Index (EMBI) Global is an index of US dollar-denominated sovereign bonds issued by emerging market countries.

7.8. Political Will and National Strategic Plans as Catalysts Driving the Journey

Financial sector development involves not only financial regulators, but also many other stakeholders e.g. tax authorities, related government agencies, services, private sector and institutional investors. Political will from top leadership is important to drive relevant stakeholders into the planned direction. Countries like Malaysia and Indonesia both have strategic master plans that underline a 5-year or 10-year plan to ensure efforts are directed to achieve identified objectives (SCM, 2011). Another key observation is the importance for leadership or regulatory bodies to play their advocating role in driving this agenda. Impact and transformation of the GCC capital market is also dependent on its leadership at the government level to spur greater involvement by the private sector and international participation.

7.9. The Debt Capital Market Ecosystem

The GCC economies scored highly on key indicators of good political and economic governance albeit significant variations across the region. Nonetheless, these scores were still far behind the best international standards. Graph 50 compares four indicators namely government effectiveness, regulator quality, rule of law and control of corruption. The World Bank Governance Index indicates Saudi Arabia and Kuwait lag behind in effectively managing their economies despite having made some progress earlier in the decade. Most GCC countries (except the UAE) saw their governance scores declining after 2010 with Kuwait seeing its scores deteriorating by 2017 into the negative territories for government effectiveness, regulatory quality and control of corruption. An overall positive score was observed for application and enforcement of legal requirements across the GCC region. The UAE witnessed great strides in its overall standing of governance albeit falling far behind the scores of advanced economies like the U.S.A, Japan and Germany (World Bank, 2018b).

Graph 18: World Bank Governance Index 2010 - 2017

More specifically on laws related to the DCM, all the GCC economies do have specific laws governing their respective DCMs (see Table 19). All GCC economies with the exception of Kuwait have long been full members of the International Organisation of Securities Commission (IOSCO).[20]

We will now examine the key aspects of the ecosystem that are essential to the GCC region for ensuring long-term competitiveness of its DCM. At this point, it is evident that the need for a developed DCM in the GCC region is paramount to ensuring sustainable liquidity in the markets, a shared goal for many of the GCC economies which have long experienced liquidity abundance due to their buoyant oil revenues. Development of a robust and effective functioning debt market demands the involvement of various stakeholders and components because a financial market is fairly integrated and requires a value chain that will support an efficient and comprehensive system.

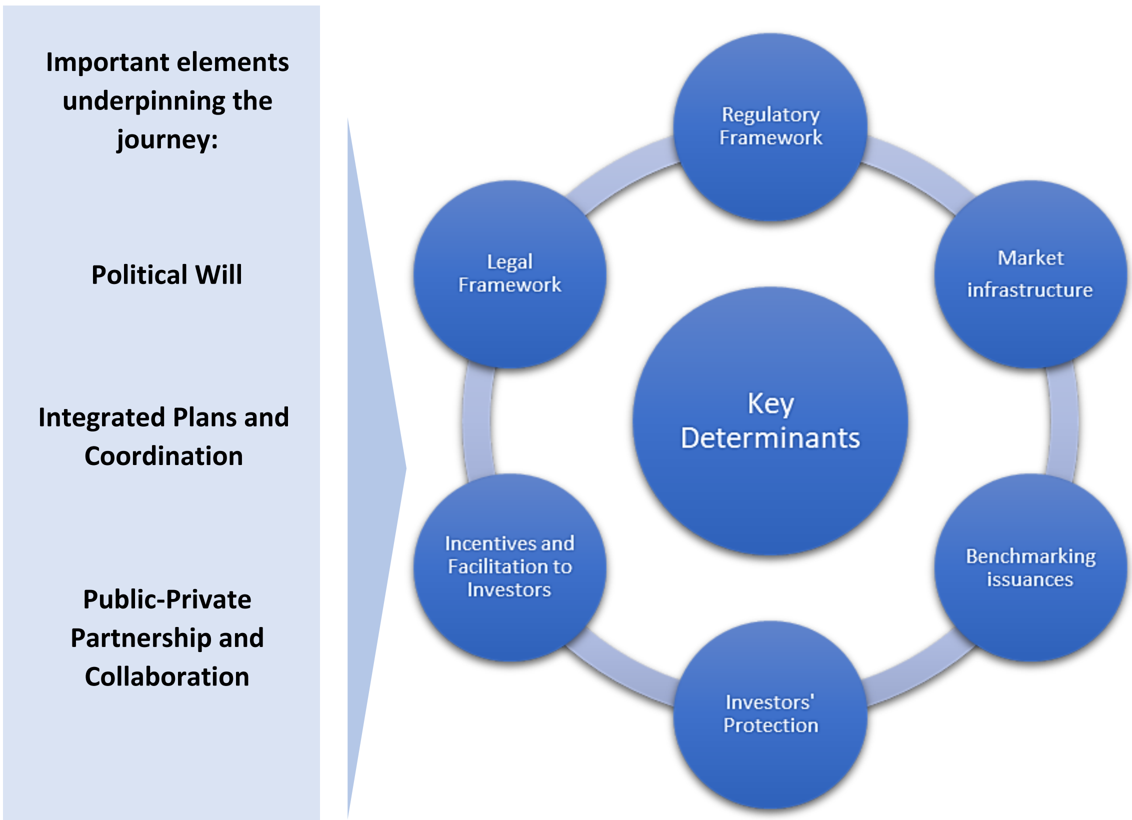
[20] Kuwait only joined IOSCO in 2017.

7.10. Towards an Efficient Debt Capital Market

There are a number of key building blocks that are pertinent in the ecosystem of the capital market (see Figure 20). Amongst them are top-down leadership, clear coordination amongst key stakeholders and the role of the private sector. Also, to consider is the social aspect by supporting the development of Islamic finance and *sukuk* issuance market in developing a persuasion and change policy plan in the GCC. An increasing DCM appeal is also required for the investors both locally and internationally.

Timely change and well-planned execution to implement such measures or policy also play an important role. However, these determinants evolve to meet conditions and different phases of development of each country.

Figure 21: Key building blocks in building a comprehensive GCC debt market



Considering both conventional and Islamic finance as the main focus, Figure 20 above outlines key important building blocks in the development of the GCC debt market.

7.11. Political Commitment

Political will and national strategic plan are key catalysts in driving the journey. Financial sector development involves not only financial regulators but also many other stakeholders e.g. tax authorities, related government agencies, services, private sectors and institutional investors. Political will from top leadership is important to drive relevant stakeholders into the planned direction. Countries like Malaysia and Indonesia both have their own strategic master plan that underline their 5-year or 10-year plan to ensure efforts are directed to achieve identified objectives.

Another key observation is the importance of country leadership or regulatory bodies in driving the agenda. Impact and transformation of the GCC capital market is also dependent on government leadership as this will encourage greater involvement by the private sector and international participation.

7.12. Public- Private Sector Collaboration

Private sector is an important stakeholder in the evolution of the DCM, as it is also expected to be a key driver and user. A sustainable DCM is dependent on the active contribution and participation of the private sector. A bond or *sukuk* market will also prosper as the government alone will not be able to create a dynamic system. As such, the GCC must put emphasis on this synergistic approach.

7.13. Holistic Approach

The Malaysian experience as discussed (see case study, Chapter 6) provides a good example of a holistic approach to reform and develop the DCM with positive outcomes. In developing a robust *sukuk* and bond market, Malaysia has taken various efforts to support the evolution of *sukuk* in its bond market. With the launch of the Capital Market Masterplan (CMP) on the 22nd of February 2001, a number of recommendations were implemented as part of the efforts to enhance the Malaysian bond and *sukuk* market with the aim to establish a deeper, broader and more efficient corporate bond market. These include; development and establishment of liquidity in benchmark issues, expanded access to trading on the OTC market to a wider range of participants, encouragement of international financial institutions and multinational corporations, to issue ringgit bonds and implementation of full disclosure-based framework for the issuance of corporate bonds. In the recent years, effort in broadening its capital market in sustainability has also been implemented. In 2014, to facilitate the financing of sustainable and responsible investment initiatives, the Securities Commission Malaysia (SC) launched the Sustainable and Responsible Investment (SRI) *Sukuk* framework. This has resulted in issuances of SRI *sukuk* and green *sukuk* in Malaysia and this marked an important milestone in the global *sukuk* market.

As another example, we can draw similar lessons from the legislative reform of Germany's capital market. Deeg (2001) and Thelen (2012) demonstrated how the global shifting towards universal banks prompted a strategic transformation of regulatory bodies to accelerate change. German banks gradually switched from low cost credit provision towards a US investment banking model based more upon well-developed security markets. They formed a pro-reform coalition with the related regulatory bodies to promote stock market development. These reforms included the establishment of "Frankfurt Coalition" in 1984, amended Stock Exchange Law in 1989, the introduction of IBIS electronic trading system and the first of three Financial Market Promotion Laws in late 1989. While 1980s reforms emphasized lower trading cost and financial innovation, later reforms "extended and expanded upon prior efforts" (Deeg, 2001, p. 26). The impact of a deep reform of the traditional regulatory system had positive impact on the financial market development, both from the regulatory efficiency of stock exchanges and transparency of listed companies that had significantly improved. Deeg (2001) observed "all these omnibus laws contained numerous and wide-ranging statutory additions and amendments intended to stimulate the supply and demand of securities" (p. 25). Hence, a coordinated comprehensive plan and approach to develop the market is essential.

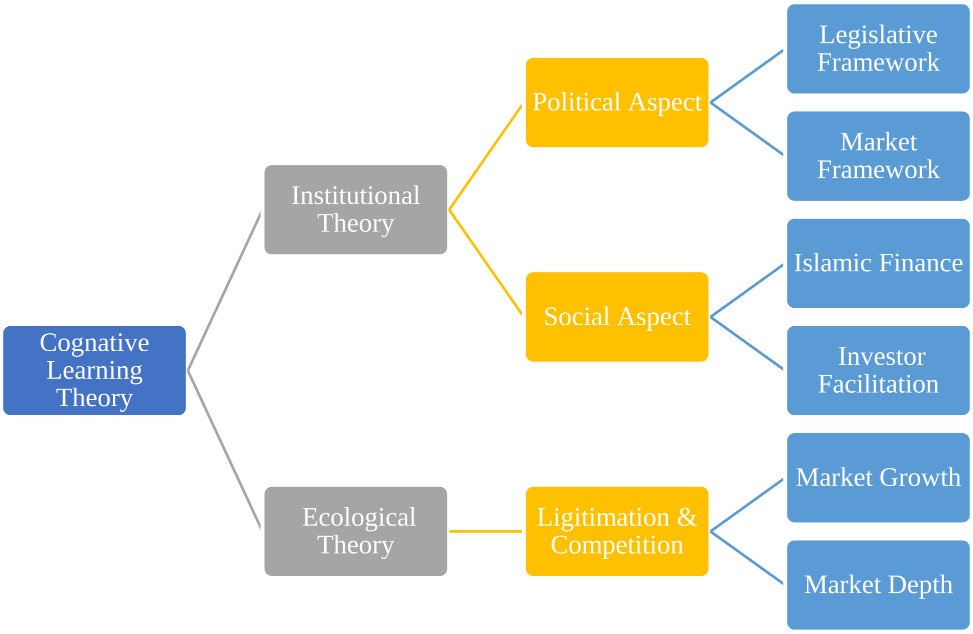
7.14. The Key Determinants

As discussed in Chapter6, development of a well-functioning capital market is reliant on the various determinants that we will discuss in detail and are as follows:

Regulatory Framework	**Market infrastructure**
Legal framework	Investors protection
Benchmarking Issuances	Incentives and facilitation to Investors

Drawing on our theoretical framing discussed above (Figure 21) both the public and private sectors actions have a causal relationship that frames social movement studies, use of ecological organisation to explain social movements and more importantly the political will to develop both the market and legal frameworks. This will be discussed in more details in the building blocks of the GCC DCM.

Figure 22: Theoretical Framework to Develop DCM



Further learning points from the country studies can be segmented and summarized according to the various determinants mentioned in earlier (see Figure 15). We will discuss in more detail each of the building blocks for a comprehensive DCM in the GCC.

Table 7: Key Determinants from Country Cases

Components/ Determinants	Analysis from country studies
Legal and Regulatory Framework	• Overall, all regulators put emphasis on stability and sustainability of its capital market. All regulators gradually review their policies to comply with international standards and strive toward achieving good governance and market integrity. • A distinctive area is on regulatory measures for Islamic debt securities. Both Malaysia and Indonesia capital market regulators issued guidelines related to *sukuk* to provide clarity to the market. Both markets have growing size of *sukuk* vis-à-vis conventional bonds over the years. Meanwhile, South Africa is yet to have policy measures of issuances of *sukuk* or *sukuk* related framework although its Government has issued a sovereign *sukuk*. • All regulators have embarked on SRI/green related measures as part of its developmental aims to support growth of this emerging segment.
Market Infrastructure, Benchmarking and Price Discovery	• Market infrastructure for development of a well-developed bond market emphasizes of the need for secondary trading, clearing and settlement, information platform as well as stock exchanges. • Market makers play an important role and regulators may instigate intervention in the early stages to support the role of market makers. As the market grows, formation of primary dealers driven by industry players is a more feasible approach. • Secondary market for private debt requires more intensified efforts compared to government bonds.
Investors' Facilitation and Protection	• Respective regulators or agencies must provide comprehensive information on relevant laws and regulations.

7.15. Regulatory Framework

The regulatory framework provides the basic structure for DCMs in general. A competitive and efficient DCM structure can be characterized by low transaction costs, resulting in a robust and safe market infrastructure, lower levels of fragmentation, and greater heterogeneity among market participants (World Bank /IMF, 2001).

Effective cultivation of governance mechanisms depends on the extent of adaptation to the pre-existing economic and social characters of the "importing" body. In other words, simply importing Anglo-American corporate codes, or another market-based model, is not necessarily viable for developing countries, especially where that model assumes a well-developed capital market and legal infrastructure. In the case of GCC DCM, reform and consistency between different institutional features suggests that "it would probably not make much sense to mix the outsider and insider control system and to combine those elements that appear to be particularly valuable in each of the two types of systems so as to create the overall optimum" (Schmidt and Gerald, 2002, p. 324).

As discussed, adopting a holistic policy framework that encourages the participation of the corporate sector is essential to support private sector's fundraising activities through bond and *sukuk* market and creation of liquidity instruments for the financial sectors. Roles of financial regulatory bodies, both the central banks and capital market authorities are principal in this agenda. On the regulatory side, although some institutions only draw upon the existing laws and regulations without legislation of new laws, enhancement to processes and clarity on regulations are provided to support a more efficient process for market participants. The Table 18 below summarizes the existing regulations, settlements and clearing systems and availability of secondary markets.

Table 8: Summary of Regulatory Framework for the GCC Economies

Country	Market Authority / Regulator	Legal Regime	Clearing and Settlement Mechanism	Secondary Market Trading
Bahrain	Central Bank of Bahrain	CBB and Financial Institutions Law 2006; Commercial Companies Law (Number 28/1975)	• T+2SSS (government securities) on real-time basis • Central Securities Depository (private securities)	Available
Kuwait	Ministry of Commerce and Industry; Capital Market Authority	Capital Market Law 2010	SSS; T+10	
Oman	Central Bank of Oman, Capital Market Authority of Oman	Capital Market Law (Royal Decree 80/98); the Executive Regulations (Ministerial decision 4/2001)	T+2 (bonds); T+3 (equities)	Available
Qatar	The Qatar Central Bank, the QFC Regulatory Authority and the Qatar Financial Markets Authority	Qatar Financial Markets Authority Law 2005 (amended in 2007)	T+3	Available
Saudi Arabia	Capital Market Authority, Saudi Arabia Monetary Agency	Capital Market Law by Royal Decree M/30 in 2003	T+0 (equities); T+2 (bonds) SSS; T+0	Available (stringent requirements for foreign investors up to 2017)
UAE	Central Bank of the UAE, Securities and Commodities Authority of the UAE	The UAE Securities and Commodities Exchange Law 2000	T+2	Available (Dubai)

Source: Author's research

What is noteworthy is the holistic approach for development of the Saudi capital market that witnessed major reforms between 2014-2017. In 2014, the CMA developed a comprehensive strategic plan to nurture capital market development, promote investor protection, improve the regulatory environment and enhance its role. The reforms that have taken place can be summarized in four areas: organisation/operations, regulations/regulatory frameworks, infrastructure, and corporate governance and investor protection (Ben Latifa et al, 2018).

7.16. Market Infrastructure

The market infrastructure is viewed as an ongoing process in which sustained financial sector and macroeconomic stability are vital to build efficient markets and establishing sovereign issuer (of debt securities) credibility. Stable and credible governments are required for establishing an efficient securities market as well as effective infrastructure (legal, tax, and regulatory), sound fiscal and monetary policies, smooth and secure settlement arrangements and a liberalised financial system with competitive intermediaries.

The government's lack of enthusiasm for borrowing before the oil revenue drop of 2014, might have continuously undermined the development of adequate market infrastructure for the smooth functioning of DCM in the GCC region. In the absence of an efficient market infrastructure linking the various parties involved in the securities transactions, DCM development is unlikely to flourish. Furthermore, a slow and inefficient securities settlement system (SSS) also affects secondary market development as it raises settlement and operational risk.[21]

One of the key elements in the SSSs is the presence of central counterparties (CCPs). The Bank for International Settlement through its Task Force on SSSs (in collaboration with the Technical Committee of the International Organisation of Securities Commissions) already in 2004 put forth a recommendation for comprehensive standards for risk management of a CCP. A well-designed CCP with appropriate risk management arrangements reduces the risks faced by SSS participants.[22] Observations made across the GCC region post-global financial crisis between 2010 and 2016 shows that CCP remained highly debatable across the GCC region. The Saudis allowed foreign investors to use an independent global custodian model if they so desire.[23] The UAE in early 2016 already circulated a draft regulation on CCP for review by its lawmakers. The establishment of CCP is indispensable to attract inward investment and creates confidence, especially among foreign investors, to participate in local capital markets.

7.17. Legal Framework

In general, legal framework is highly lacking and fragmented in the GCC. Institutional responsibility for banking regulation and supervision is well-established in the various central banks, however the supervision of the nonbank financial sector is either fragmented in the case of capital markets and institutions or lacks governance and is less developed.

[21] IMF paper on settlement for secondary market development

[22] See Bank for International Settlements and International Organization of Securities Commissions, Recommendations for Central Counterparties, 2004.

[23] Saudi Arabia Capital Market Authority announced in 2015.

The GCC legal framework lacks sufficient provisional elements to facilitate the issuance of fixed income instruments, including a securitisation market for asset backed *sukuk* and securities. As we have seen the case of Kuwait, there is also a need for Trust and Special Purpose Vehicle (SPV) laws; property rights, insolvency laws and clarity on references for dispute resolutions (Sole, 2008).

As the GCC credit market is starting to show some signs of difficulties in the aftermath of the impact of the global financial crisis, the debt market started to gain legitimation as an alternative for longer borrowing. Another major challenge is the enforceability of contracts for establishing credibility of the emergent debt market (Ainley et al., 2007). There was also concern over the uncertainty in the rules and regulations with regard to *sukuk* holders' rights to the underlying assets and whether they are a preferred creditor or part of the general creditors. This was apparent after the global economic crisis; some regional *sukuk* issuers either defaulted or restructured their obligations.

As the regulators have recently intensified efforts to develop the debt market, it is necessary to stress the importance of harmonising the legal process in the GCC. Regulators need to look at the legislative sources to build a solid legal infrastructure to anticipate any legal risk and uncertainty in the local *sukuk* and debt market (see Figure 22).

Figure 23: Sources of PDM Legal Framework

Sources of PDM Legal Framework

Supranational
- *Treaties of Monetary Union Members*

Constitutions
- Distribute political and fiscal powers and basic institutional arrangements, establish broad public finance arrangements including the authority to borrow and pay for debt related costs and expenses, and requirements for audit and reporting;

Primary Legislation
- ***PFM legislation***—Include budget laws, public financial management/administration laws, fiscal responsibility laws; and establish the framework for budget preparation and execution, cash management, public debt, accounting, auditing, and reporting;
- ***Dedicated debt legislation***—Include public debt management laws, Government loan laws, treasury securities laws, or others, which provide more specifically for mandates, institutional, and operational matters relating to public debt management; and
- ***Others***—Include other relevant laws such as Central Bank laws. Central Bank laws typically provide for Government borrowing (if any) from Central Banks, and the central bank's role as fiscal agent to Government.

Secondary Legislation
- Regulations
- Rules, Circulars (e.g. Government Securities Market Rules or Circulars, etc).

Source: (Awadzi, 2015)

GCC countries have increased efforts to introducing new capital market laws (Saudi Arabia, Bahrain and Qatar) and establishing new regulatory bodies (the UAE, Saudi Arabia, Qatar and Kuwait) thus enhancing corporate governance and easing restrictions on foreign investors. As noticed from Table 19 there has been several regulations which were either issued or amended post financial crisis of 2008. Primarily directed towards the equity market rather than the debt side. Sound public debt policies and debt management practices require strong legal foundations.

Table 9: Bond Laws and Regulations in the GCC

Laws and Regulations relating to Bond and *Sukuk* issuance in the GCC States

Kingdom of Bahrain	**Issued – Amended**
Central Bank of Bahrain Law	**2006**
CBB Guidelines for Issuing, Offering and Listing of Debt Securities	**2004**
Commercial Companies Law	**2001-2016**
Kuwait	
Kuwait Law of Commercial Companies	**1959-2016**
Kuwait Law No. 7 of 2010 Capital Market Authority	**2010**
Sultanate of Oman	
***Sukuk* Regulation**	**2016**
Qatar	
QFMA Rules for Offering& Listing of *Sukuk* and Bonds	**2005-2018**
Qatar Commercial Companies Law	**2005-2015**
Qatar Exchange Rulebook Admission & Issuers Obligations	**2012-2015**
Saudi Arabia	
KSA CMA Offers of Securities Regulations	**2003**
KSA CMA Listing Rules	**2017-2019**
United Arab Emirates	
UAE SCA Decision 93R on Listing of Islamic Bonds	**2005**
UAE SCA Decision 94R on Listing of Debt Securities	**2000**
DFSA Rulebook – Offered Securities Rules	**2007**
NASDAQ Dubai DFSA Requirements and Procedures Debt Markets	**2004-2010**
NASDAQ Dubai Issuers and Securities Rules October 20 2011	**2011**
SCA Decision No (16) of 2014 Concerning the Regulation of *Sukuk*	**2014**
SCA Decision No (17) of 2014 concerning the Regulations of Debt Securities	**2014**
DIFC Markets Law No.1	**2012-2014**
NASDAQ Dubai Admission and Disclosure Standards for Issuers	**2012**
DFSA Rulebook – Market Rules	**2006-2010**
DFSA Rulebook – Islamic Finance Rules	**2010-2012**
DFSA Rulebook – General guidance	**2016**

Source: IMF

7.18. Benchmarking Issuances

By benchmarking of government bonds across the yield curve in all developed capital markets provides a reference for the corporate debt market sector as well as for securitised issuances. Without such a benchmark it is difficult to measure the risk that is attached to an issue and a comparable price quote (Woertz, 2008). Therefore, each of the GCC countries are encouraged to increase the issuances with different maturity profiles to enable the drawing of the risk-free yield curve and a measure to deepen the DCM.

We have started to see such recognition and legitimation from the market audience with the influx of foreign investors as we will see in the next section. Starting from January 2019, J.P. Morgan has added GCC countries bonds to its Emerging Market Bond Index (EMBI). GCC countries, which are expected to have a weightage of 13.8% with Saudi Arabia having the highest weight of approximately 3.1%, whilst Kuwait's weightage is just below 1%. As a result, expected increase of demand could range anywhere between US$30-45 billion through passive investment by index-tracking funds which are about 30% of the value of outstanding GCC sovereign issuance (Markaz, 2019b).

7.19. Incentives, Facilitation and Protection of Foreign Investors

Foreign investors participation plays an important role to build a wider investor base for the financial system to flourish. In the GCC region, although restrictions on foreign investors have eased recently, the degree of liberalisation is still low compared to other financial centres. A report by the IMF [24] stated that in 2017, foreign investors held between 2-8 percent of market capitalisation in GCC economies. The recent liberalisation taking place e.g. in Saudi and Oman must be supported with clarity on regulation and process for foreign investors to take part in the GCC financial system. The GCC markets must also investigate gaps in financial instruments that are essential to foreign investors, e.g. hedging instruments. For example, to increase private sector participation in the capital market, access to potential investors must not be restrictive, and market data and information should be efficient and timely to ensure transparency about key decisions as well as active engagement with potential counterparts. Similarly, clarity on regulation and barriers imposed by financial regulators is needed to avoid any potential issues and challenges.

At present, the GCC countries share is approximately 14% of the total outstanding emerging market debt stock. The Addition of the GCC countries to EMBI is expected to widen the investor

[24] How Developed and Inclusive are Financial Systems in the GCC? Benlatifa 2018

base, leading to increased liquidity of GCC bonds and *sukuk* and lowering the spreads of the outstanding sovereign issues. Using a weighted approach, the EMBI gives less relevance to larger issuers relative to their amount outstanding. Large issuers such as Saudi Arabia and Qatar will have relatively smaller share in terms of percentage-of-debt outstanding, whilst smaller issuers like Kuwait will benefit. It is expected that flows could amount to nearly 50% of Kuwait's outstanding external bonds (Markaz, 2019b).

In recent years, the GCC bond market has witnessed both an increased interest from foreign investors and clear trends in USD issuances, as mentioned earlier. It was reported, more than 75% of the issued bonds, mainly sovereign bonds, in 2017, were comfortably absorbed by non-GCC investors[25]. For example, in the issuance of US$750 million bonds by the National Bank of Kuwait, 33 % were US investors, 37% European, 20% Asian investors and only 10% MENA investors. Leveraging on this trend, it is poised for the GCC economies to explore efforts to sustain and further increase the trends. A wider investor base, as discussed above, has a multiplicative effect on the debt market’s growth. Introduction of bond and *sukuk* indices, incentives to foreign investors and assurance on investors protection are among the efforts that can increase greater participation from foreign investors. The GCC economies shall also explore on ways to increase Asian investors’ participation in their capital markets.

In summary, there is taken-for-granted way to organising this market, and there is an established identity code used by outsiders to evaluate whether institutional form qualifies as a legitimate alternative funding source.

Using organisational ecological approach which is interested in population led studies and how they make sense of the environment places emphasis on the concept of “Legitimation” of the DCM or market recognition with:

- Increase in the market depth by the increasing of the number of issues traded both in the primary and secondary market and volume of trading
- Increasing number of issuers and investors

[25] https://thepeninsulaqatar.com/article/01/10/2018/GCC-bond-performance-fuels-foreign-investors%E2%80%99-appetite

7.20. Capital Market Development

What we learned from the country cases is a key driver was a strategic approach placing emphasis for the development of Islamic capital market. Malaysia's emphasis on the development of its Islamic finance since early 1980s has resulted in equally emphasized development in the and Islamic financial system. This has resulted in a well-established ecosystem covering legal, regulatory, arbitration and market infrastructure that are well-catered to support the evolution of its Islamic capital market. As a result, the country has positioned itself as the leading Islamic financial market globally, where Islamic banking, *sukuk* and Islamic fund management are thriving.

Although Islamic finance has gained its foot in Indonesia through Islamic banking since early days, Indonesia's Islamic capital market started to thrive in the recent years. Recent emphasis on the development of Islamic finance has started to increase its momentum and began to stimulate its Islamic capital market growth. In South Africa, the country has issued a US$500 million sovereign *sukuk* as part of its aim to signal its aspiration to become an international financial hub that is able to raise and to widen its investor base. South Africa's approach is to cater for broad capital market users rather than creating parallel eco-site for the Islamic capital market.

In the case of GCC, the region may explore the approach undertaken by Malaysia and Indonesia about its policy evolution in integrating bond and *sukuk* market in the region, as the region has a natural position to develop its *sukuk* market in parallel to its overall bond market. In recent years, developments have shown that the approach by the UAE in reaping the potentials of Islamic economy including Islamic finance has borne fruit. This has resulted in greater awareness across various industries on the potential of Islamic trade and economy and the use of Islamic finance in supporting national economic growth.

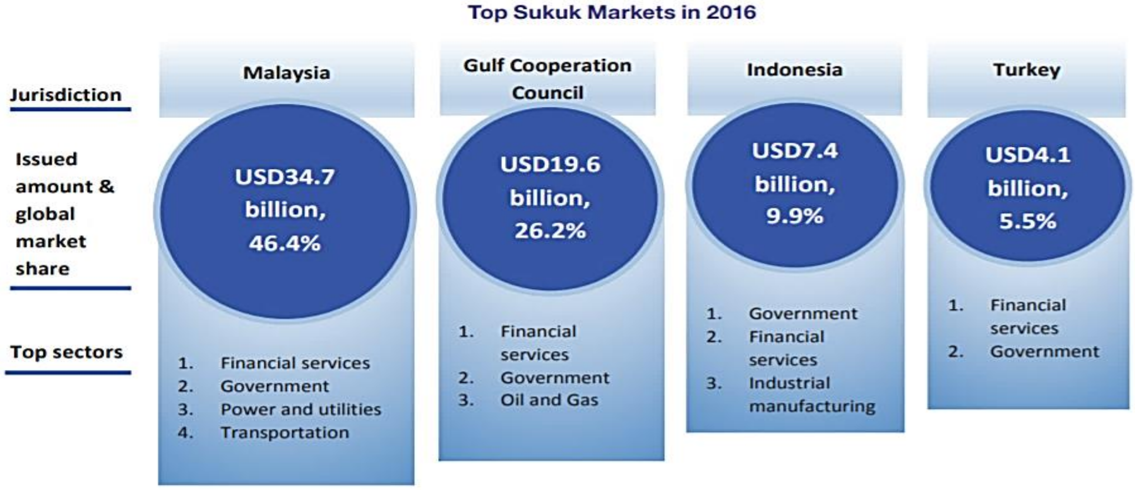
In addition, to increase private sector participation in the capital market, access to potential investors must not be restrictive. Furthermore, market data and information should be efficient and timely to ensure transparency about key decisions and active engagement with potential counterparts. Similarly, clarity on regulation and barriers imposed by financial regulators is needed to avoid any potential issues and challenges.

7.21. Islamic Finance Considerations

Another facet that should be a factor in the development agenda is how Islamic finance could play an essential role, as this segment has now evolved into the mainstream global financial system.

Many countries have expanded their bond markets to include *sukuk*. Malaysia is one of the countries that has the largest *sukuk* market followed by Saudi Arabia and UAE.

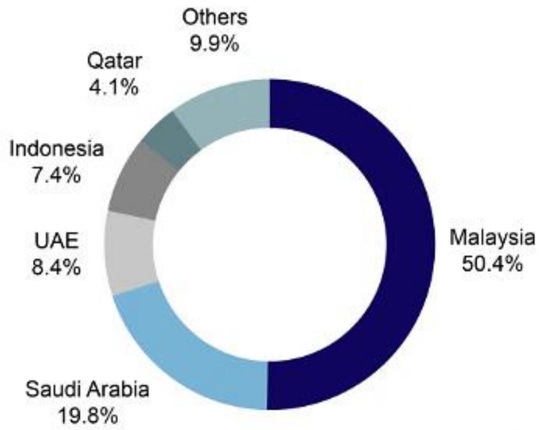
Figure 24: Top *Sukuk* Markets in 2016



Source: MIFC

As we saw in Chapter 6 *sukuk* now plays an important role in fund raising for government and corporates in Malaysia. The Malaysian financial sector, infrastructure, and property & real estate sectors are benefitting from the strong growth of the bond markets. Malaysia's outstanding and issuances of *sukuk* in 2017 commanded a global market share of 51.0% and 36.2%, respectively. Figure 25 illustrates the current state of the *sukuk* market as of September 2018 where Malaysia held 50.4% global share.

Figure 25: 2018 Global *Sukuk* Outstanding by Domicile, %



Source: MIFC

Therefore, this research does not only see macroeconomic volatilities as the key trigger to poor presence of other debt types in the GCC region. In fact, the other important factors namely market infrastructure and regulatory framework equally deserve a deeper investigation. Furthermore, the encouraging growth of the sovereign debt issuances could have been made more robust with a more innovative market ecosystem and sound regulatory framework.

Table 10: GCC Regulatory Bodies

GCC Regulatory Bodies by Country
Bahrain. The Central Bank of Bahrain is responsible for regulating and supervising the whole of Bahrain's financial sector, including the retail and wholesale banking systems, the insurance sector, investment firms, brokers, investment advisors, the Bahrain Stock Exchange, finance companies and other financial services. As regards credit information, in 2005, the Benefit Company (owned by seventeen commercial banks in Bahrain) launched the first phase of a Credit Reference Bureau that deals with personal credit. A future phase will deal with corporate credit. Finally, Bahrain has a deposit insurance scheme.
Kuwait. The Central bank of Kuwait (CBK) regulates and supervises banks, financing companies and domestic exchange companies. CMA regulates and supervises the investment companies (ICs), mutual funds, the securities market and the Kuwait Stock Exchange including the primary securities market (the issuers) and securities secondary market. While supervision of the small insurance sector rests with the Insurance Department in the Ministry of Commerce and Industry (MOCI). A credit bureau, Ci-Net, owned by 17 banks and ICs, operates a retail registry in Kuwait since 2002. With so many bodies, the regulatory environment is fragmented.
Oman. The Central Bank of Oman regulates and supervises the banking system, investment and merchant banks and the leasing and finance of companies. The Capital Market Authority supervises the Muscat Securities Market regarding listed securities, but not government securities. Insurance supervision is conducted by the Ministry of Commerce and Industry. Oman has a private credit bureau, the National Bureau Commercial Information, which was established in 2008, and collects retail and corporate information. Similar to Bahrain, Oman operates a deposit insurance scheme.
Qatar. The Qatar Central Bank (QCB) regulates and supervises the banking sector, ICs, finance companies and mutual funds. The Doha Securities Market (DSM) regulates the stock exchange and its participants, mainly listed companies and brokerage companies.

Responsibilities for the supervision of the securities market are therefore fragmented between the QCB and the DSM. The Qatar Financial Centre (QFC) is regulated by the QFC Regulatory Authority. The QCB maintains a registry with only partial credit histories to which commercial banks have access. Commercial banks, retailers, and finance companies are collaborating to launch a private credit bureau with QCB encouragement, which should allow more comprehensive collection and sharing of data on SMEs and individuals.

Saudi Arabia. The Saudi Arabia Monetary Agency regulates and supervises the banking system and the insurance sector. The capital market authority regulates and supervises the securities market. A Saudi retail credit bureau, SIMAH, was established by the Saudi commercial banks in 2004.

UAE. The CBU regulates and supervises the banking sector, investment funds, ICs, investment advisors, brokers, money changers and finance companies. The securities market in the UAE consists of the Dubai Financial market, the Abu Dhabi Securities Market and the Dubai Gold and Commodities Exchange– all regulated by the Emirates Securities and Commodities Authorities. The insurance sector is supervised by an Insurance Commission under the Ministry of Economy. The Dubai International Financial Centre (DIFC) is regulated and supervised by the Dubai Financial Services Authority, which is an independent regulator. An independent credit bureau for both retail borrowers and corporates, EM credit, was established in 2006 and is licensed in the DIFC.

Source: (IMF, Khamis et al.,2010)

7.22. Conclusion

We have comparatively examined the underdevelopment factors of capital market in the GCC region by directly referring to financial infrastructure, legal framework, and regulative environment and the role of the political actors. This chapter has analysed key important aspects of the ecosystem that are vital to drive a robust and comprehensive debt market in the region. These key points are establishment of legal and regulatory frameworks, widened investor base, benchmarking of issuances for bonds and *sukuk* and the incentivization to facilitate foreign investors. In addition, the preceding discussion brings to the foreground one critical factor that needs further analytical treatment: pragmatic and visionary leadership. Building a robust capital market is a prime agenda of all the GCC economies. In diversifying economic development and expanding the region's sources of funding to fuel the economy, the GCC governments should have a strong motivation to expand the intermediation roles of its financial system. Therefore, political will coupled with strategic development efforts from the financial regulators is essential.

With the aim of gaining deeper understanding from the interview data with three senior executives/pioneer practitioners operating in GCC region in the financial sector. This will help us understand the reasons behind the lack of development of the DCM. The semi-structured interviews are used to evaluate the prospects and challenges of DCM. We can then develop our set of recommendations and predictions for implementing DCM in the GCC.

Chapter 8: Conclusions and Reflections

It is evident that the fall in global oil prices in mid-2014 resulted in GCC states running budget and fiscal deficits for the first time in 20 years. This prompted once surplus rich countries to reform their local laws to issue debt locally and abroad. The markets need the regulators involvement in creating the platform and environment for the debt securities market to grow. This in turn requires focused effort and persuasion on the value proposition that DCM would bring to the overall welfare of the various stakeholders.

As discussed in Chapter 2 applying Cognitive Learning Theory (CLT) brings two lines of argument together; institutional theory and organisational theory. CLT focuses on learning as the outcome where active thinking about a problem or situation is based upon known facts and reactions are therefore more objective and oriented. It recognizes that a person learns the meaning of objects and events and learns the response according to the meaning assigned to the stimuli. This theory debates learners form cognitive structures in their memory and store organised information about the events that occurs (Wood & Bandura, 1989). Cognition defines a person's ideas, thoughts, knowledge, interpretation and understanding about themselves and the environment.

In Chapter 6 we analysed three country studies that highlighted various learning points in creating a well-functioning debt market. In this chapter we will reflect using the CLT approach on lessons learned from the country case studies and insights into the development and challenges of the DCM, with predictions and recommendations. Based on the nature of the evidence thus far, we use institutional theory and legitimation in both political and social aspects with aim to reach a framework and a development plan in this chapter.

The three country case studies highlight various learning points in creating a well-functioning debt market. In this section we will discuss the key lessons learnt in the developments of capital markets in Malaysia, Indonesia and South Africa, and the key considerations that the GCC region may emulate in their plans to advance capital market developments. Although the three countries have different approaches and market characteristics, there are key observations pertinent to their policy objectives and success factors.

Malaysia's emphasis on its Islamic finance development since the early 1980s resulted in a balanced development between both conventional and Islamic financial systems. This led to a well-established ecosystem covering legal, regulatory, arbitration and market infrastructure that are well-catered to support the evolution of its Islamic capital market. As a result, the country has positioned itself as the leading Islamic financial market globally, where Islamic banking, *takaful*, *sukuk* and Islamic fund management are thriving.

Indonesia's Islamic capital market has only begun to thrive in recent years. Recent emphasis on the development of Islamic finance has started to increase its momentum and began to stimulate its Islamic capital market growth. South Africa has issued a sovereign *sukuk* as part of its aim to signal its aspiration to become an international financial hub that can appeal to a wider investor base. South Africa's approach caters to broad capital market users rather than creating a parallel eco site for the Islamic capital market.

In the case of the GCC, the region may explore the approach undertaken by Malaysia and Indonesia concerning its own policy evolution. The GCC is in a natural position to develop in parallel both the *sukuk* and bond markets and therefore suitable for integrating into the region. The UAE approach has in recent years reaped the potentials of an Islamic economy including Islamic finance by implementing sound strategies. This has resulted in greater awareness across various industries on the potential of Islamic trade and economy as well as the use of Islamic finance in supporting national economic growth.

8.1. Findings

Mr. Khan has articulated key factors that need to be considered for the development of the DCM for sukuk and bonds in the GCC. First, harmonisation of directives and standards between the industry regulating bodies such as AAIOFI, IFSB and other related industry entities. Followed by endorsement, obtaining the acceptance of regulators and rating agencies both in the GCC and internationally. This would lead the way for clear regulations being set for the DCM stakeholders.

Mr. Albahar's view relates to regulatory bodies in that "democracy does not build a market. A better way to do it is to create regulatory bodies [but] that are independent" in nature, meaning its governing body is composed of a "mixture of international, regional and some government substance" in "a competitive environment".

Initially, the issuance of *sukuk* in the GCC has proven to be challenging. *Sukuk* issuance was considered a costly instrument due to the lack of legal and regulatory frameworks to facilitate Islamic financial products that hindered the use of such an instrument.

According to my interviewees, the market population is divided into the following categories:

1. International banks with regional presence that are securing the major sovereign and corporate issues.

2. Regional banks with regional distribution capabilities working alongside the global players.
3. Local banks and investment companies that find it hard to compete with regional and international banks when there is a locally denominated currency security issue.

Some GCC countries such as Kuwait lacked *sukuk* and Trust laws as well as regulations covering the establishment of special purpose vehicles. These are typically incorporated by companies to issue *sukuk* and need to be set and implemented to encourage firms to issue *sukuks*. In addition, the development of a viable secondary market is crucial to render *sukuk*s and bonds as desirable instruments in terms of their tradability and liquidity.

Which begged the question of legitimation and whether the market players and the regulators were starting to recognize such efforts as viable and a serious source of alternative funding to the bank? The argument was to let the market play its competitive forces, and only establish the initial set of successful deals so that the market would grow exponentially. The regulators would then need to address regulating the growing side of the market. In addition, there is a need to establish both investors' confidence and the rating agencies understanding and acceptance of the *sukuk* market. This leads us to the importance of the government's vision, leadership and commitment towards the development of the DCM for the greater good of the economies of the region. This can be done, according to Mr. Stokely, by developing the right "political climate" by positioning the key players such as supranational entities (e.g. International Finance Corporation (IFC)) and major international banks which can bring recognition to the DCM and play a key to the legitimation process.

One of the fundamental challenges for the development of the DCM according to Mr. Khan. "in front of these reforms stands a huge lobby of influential [bank] shareholders, who have created for themselves a really very beautiful business model, you cannot lose in this business model. In good times you take all the profit and in bad times the state is there to bail you out. You have privatisation of profits and socialisation of losses in the West". It is a broken [Western] model versus a profit and loss Islamic model. The solution is for a model with reforms to both the banking act and land ownership laws which is inclusive of "the people who stand on the way of reform they also should have brought in so as you can continue to be the shareholder of the Commercial Banks. But as the new order emerges, you can be part of it".

Overall, all my interviewees were positive about the market growth and expected a surge in the flow that would provide the issuers both sovereign and corporates with an alternative financing platform; to grow and to seek new funding opportunities. In addition, liquidity in the local currencies market provides an avenue to develop local issuance and it is expected that corporate *sukuk* issuance to flourish. They agree that *sukuk* was gaining international recognition as a tradable debt financing instrument with a growing global appeal, that was evidenced by the international banks' involvement and foreign investors investing in the GGC DCM.

All the participants acknowledged the need to increase the volume and scale of the local debt market to issue *sukuk* or bonds to increase the depth and breadth of the market. Also, the market needed more transparency in the regulatory framework and more completion in terms of the number of the market players, whether; issuers, agents or trading platforms (stock exchanges), these can lower costs of debt issuance. In addition, they raised the issue of a lack of standardization of the *sharia* interpretation of risk amongst the scholars as a factor that could deter investors.

Many of the participants thought it essential to standardize the process of *sukuk* issuance with reference to accounting and *sharia* standards in order to create an efficient process for tapping the local debt market and to activate the secondary market.

Mr. Stokely believes that "the Saudi Arabian *sukuk* market is perceived to be the biggest potential *sukuk* market in the region because of the economy size and increasing demand for financing and for government deficit and corporates needs".

Table 11: Interview Findings

Components/ Determinants	Analysis from interview Findings
Legal & Regulatory Framework	• Harmonization of Islamic Finance (IF) standard setters in the DCM. • Overall, all regulators gradually review their policies to comply with international standards for IF and strive towards achieving good governance and market integrity. • A distinctive area is on regulatory measures for Islamic debt securities. Capital market regulators to issue guidelines related to *sukuk* to provide clarity to the market. • Tax reforms for level playing field for *sukuk* issuers. • Bank act and structural reforms may be required.
Market Infrastructure, Benchmarking & Price Discovery	• Government vision, leadership and commitment is required for reforms and development of the DCM. • Market makers play an important role and regulators may have its intervention in the early stage to support the role of market makers. As the market grows, formation of primary dealers driven by industry players is a more feasible approach. • Market infrastructure for development of secondary trading, clearing and settlement, information platform and stock exchanges. • Increase of volume scale and currencies of sovereign issuances with medium to long-term maturities to establish yield curve for corporate issuers. • Secondary market for private debt requires more intensified efforts compared to government bonds.
Investors' Protection	• Rating agencies buy-in and understanding of the Islamic debt capital market. • Respective regulators or agencies must provide comprehensive information on relevant laws and regulations. • Local knowledge coupled with international expertise are key for the development of the market. • Market education about the benefits of the DCM.

8.2. Interviews' Reflection

The semi-structured interviews have given a valuable insight into the interviewee opinions on different issues relating to the GCC DCM structural issues and challenges. During the interview, verbal discussion with semi-structured questions were raised for focused feedback from interviewees.

The interviews were conducted with open-ended questions and ensuing discussions with each interviewee was dependent on their perspective and area of interest, giving an opportunity for a more constructive outcome. The interviews explored different facts and areas of interest in which many observations were raised and addressed.

The established questions in the semi-structured interviews for investigation were to stimulate a constructive dialogue, to target specific aspects of the DCM and this led to further opportunities for spontaneous questions. The outcomes suggested by the interviewees based on their practical experience has confirmed to a large extent the learning outcome derived from our research on the GCC market.

My research focused on academic and practical issues relating to the underdevelopment of the GCC DCM. To reach a point and scale to establish itself as a viable source of funding both for sovereign and corporate issuers. This involved understanding of; the market ecology, the process of persuasion and legitimation and the impact and benefit on various DCM stakeholders in the GCC region (regulators, banks, investments companies, rating agencies, investors and the public). The aim was to develop a change plan, methodology and approach for DCM development.

Using organisational ecological approach, which is interested in population led studies and how they make sense of the environment, it places emphasis on the concept of "Legitimation" of the DCM. Legitimation of an organisation is defined as "the generic fit with the schemas and a low frequency of observed schema-violations lead observers to take for granted the behaviours that fit the schemata" (Hannan, M. 2008). The consensus of the audience for membership grade within the class of category can be observed by the increasing acceptance of the audience. In the case of DCM, the audience would be expected to react in the following manner:

- Increasing number of issuers and investors
- Increase in the market depth due to increasing number of issuances traded both in the primary and secondary market as well as the volume of trading

We observed regulators starting to recognize the market and the need to regulate in a manner suitable for the market growth and establishment of the legal frameworks. This in turn has established industry codes and standards by AAOIFI and IFSB which provides socio-political legitimation.

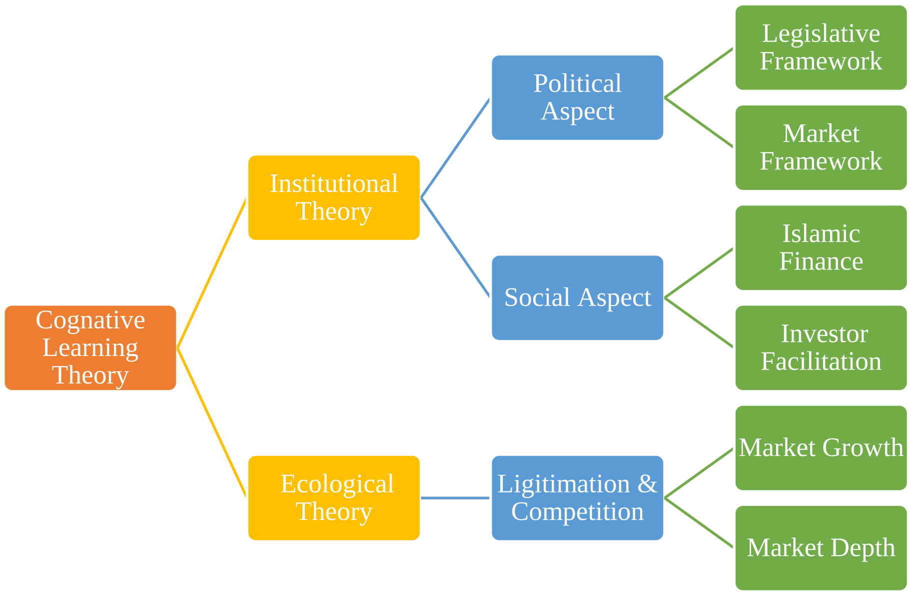
Therefore, we focused on the aspect of "legitimation" to understand the impediments that are affecting the development of the DCM in the GCC region.

8.3. The Challenges Facing the GCC Market

The key issues and challenges that were impeding the growth and development of the securities market were studied using experiences from the emerging markets. The challenges faced were primarily associated with poor liquidity of the market and bank lending dominance, which saw little benefits of debt capital and asset monetization. In addition, there was a lack of commitment by the banks to act as market makers, as this could result in an additional cost from capital adequacy. Moreover, there was little confidence with the quality of the local credit rating agencies and its risk assessment ability.

Corporate debt issuance is considered a relatively recent phenomenon in GCC region. Several instruments were being progressively installed, most notably the Islamic bond *sukuk*. A significant advantage of *sukuk* over corporate bonds is its *sharia*-compliant feature. The increasing investors' preference for Islamic products renders *sukuk* an attractive instrument, more so than conventional corporate bonds, which satisfies the social aspect. For purpose of economic diversification, Islamic financial instruments can play an important role in delivering an alternative source of funding and investor base. We have seen how *sukuk* as a tradable Islamic financial instrument was used extensively for this purpose. In the last 10 years *sukuk* has been used by over 20 sovereign governments from around the world, Muslim and non-Muslim alike, to raise over US$1.2 trillion of funding for projects and initiatives across; Africa, Asia, Europe and the Middle East. *Sukuk* not only helps institutions raise funding and deepen capital markets but also helps governments build infrastructure and provide support in achieving sustainable development goals (AlHashel, 2018).

The *sukuk* market was still considered in its early stage with numerous uncertainties regarding its potential. Politically, several factors need to be developed before establishing a market for *sukuk* bonds. First, the development of a viable secondary market is crucial to render bonds as desirable instruments. In addition, clear regulations and regular transactions are required for companies to exploit these sources of capital. Harmonization is also required of directives and standards between the industry regulating bodies such as AAIOFI, IFSB and other related entities. This in turn requires focused effort and persuasion on the value proposition of what the DCM would bring to the overall welfare of the stakeholder. Socially, the promotion of Islamic finance and development of the *sukuk* market as a grassroots alternative mode of funding is closer to cultural norms and beliefs. In addition, it protects and facilitates investors and brings us to the theoretical framing of our research as illustrated below (Figure 22).



8.4. Potential Contribution to Literature and Practice

The financial system was put through the test during the financial crisis of 2008, as financial institutions started to become less prudent with their financing criteria, risk management and dissemination of risk (Jobst, 2009). Moreover, as we have seen, in Chapter 4, following the drop in oil market prices of 2014, GCC countries were under financial and budgetary constraints or under huge social and political pressures to reform. Hence the need to establish and develop a platform and legal environment for the DCM in the GCC region.

There is growing need for the GCC to finance their expansionary budgetary policy that targets industry, energy, infrastructure and security and social needs. The governments of the GCC region need an accessible and efficient DCM. The research addresses Financial Policy decisions and options covering regulation, supervision and oversight of the financial systems. This includes markets and institutions with the view to promoting financial sustainability, stability, market efficiency and consumer protection. This will impact DCM evolution and growth. It is examined how Islamic DCM techniques could positively impact the global DCM industry by offering alternatives for interest-based assets. The direct contribution of research in the DCM will lead to the establishment of a framework for the development of capital markets in emerging and GCC areas in particular. The potential contributions of the proposed research can be summarized as:

- Gives a geographic focus on the GCC region, as an unchartered area
- DCM is at an early-stage and it is important to learn the lessons from other emerging markets
- Organisational ecology approach is a growing area of research and the initial literature review revealed a gap i.e. a lack of research on at DCM using organisational ecology
- Develops a change plan, methodology and approach for capital market development with impact and benefit on stakeholders (regulators, banks, investments companies, rating agencies, investors and the general public)

8.5. Market Predictions

In Chapter 6 we analysed the learning outcomes of our country case studies of Malaysia, Indonesia and South Africa. The key drivers of the ecosystem for a robust and comprehensive debt market in the region are establishment of legal and regulatory frameworks, widened investor base, benchmarking the issuances of bonds and *sukuk* and incentivization and facilitation of foreign investors. In addition, our discussion thus far raises one critical factor needing further analysis; that is pragmatic and visionary leadership. As such, our prior discussion has already touched upon the uniqueness of the GCC being ruled by monarchies that have strong leadership founded on pragmatism and vision. Monarchs are known to rule by virtue of their sovereign quality or divine rights. With pragmatic and visionary leadership, the monarchs may have to be adaptable to fundamental reforms– some of which can lead to political power reconfiguration between the monarchs and the rest of the political economic factors and this leads us to the politics of Institutional theory. The theory can lead us to predict the shape and form of these reforms, and these may include, but are not limited to, regulatory framework, political practices, market education, investments and taxation.

The immediate consequence from undertaking these reforms is a more empowered civil society. This is often overlooked when discussing fundamental market reforms. As the economy becomes more sophisticated, participants naturally demand for transparency and accountability. What this means politically for leaders is that checks and balances are continuously assessed. Leaders' privileges are no longer given but linked closely to the ability to discharge leadership responsibilities to satisfy the rights of the people.

Developing the DCM should be part and parcel of discharging such leadership responsibilities. As demonstrated earlier in the Chapter 6, a well-developed DCM allows for broader investor participation. It can provide capital access to those SMEs hence potentially elevates the socio-economic wellbeing of the rest of the society. A transparent and orderly DCM can help allocate economic resources more efficiently, thus eliminating waste or mismatch of financial and economic resources.

All these impacts are important for economies stability. In the case of GCC countries, DCM can even help strengthen the state's position by making it more relevant through necessary political economic reforms. When the state together with large corporates realise that a developed and functioning DCM is an important function of their survival, then changes to taken for granted will send strong signals to the rest of society about the importance of DCM legitimation.

The importance of development of the DCM in the GCC will have a direct impact on improving the efficient mobilization of resources and allocation in the economy. Thus, providing liquidity management tools for both short term and long-term objectives and finally developing a benchmark on the income earned on government issues as risk free return. The development of the DCM would benefit various stakeholders, issuers, investors, regulators and customers.

Sukuk issuances in 2018 the international debt market accounts for approximately 20% (up from 15% in 2016) of the total GCC issuances and is on the rise, as issuers seek to develop the Islamic debt market and diversify their funding mix. Even though around US$45 billion worth of *Sukuk* were issued over the past 3 years in the GCC, the challenge of is still to balance debt sustainability with the need for public expenditure.

As discussed in Chapter 7, there are two options to bridge the budget deficit gap without upsetting the social fabric, either to draw on the general reserves or borrow. Different countries in the GCC took steps to remedy the situation with proactive financing strategies and plans, while others were slower in following suit.

8.6. Kuwait Reform Recommendations

The two main prerequisites for reforms are trust and partnership between the public and the private sectors. Facing serious shortcomings of its long-term economic stability, Kuwait has a dichotomy of reforms versus being one of the last GCC countries to be affected by oil price volatility. Kuwait budget with a recurrent non-productive spending; institutional efficiency is unsustainably low and the ease of doing business is one of the GCC's lowest (Alhajere, 2016).

Notwithstanding these deficiencies, the Kuwaiti authorities have taken steps to correct some of them. There are two important laws being currently considered by parliament, namely, the Sukuk Law and the Public Debt Law. The approval of this body of legislation would greatly enhance the legal foundation of the financial sector by developing the tools and the right environment for local and international issuances.

The Kuwaiti Islamic finance market is a nascent but developing segment of the country's financial sector. While Islamic banking retains a significant market share, other segments, particularly about the capital market have significant room for development and growth. Kuwait has the regulation and tax neutrality to enforce Islamic finance structures but lacks the holistic regulatory framework for Islamic finance of other developed Islamic financial markets.

Whilst the issue of DCM issuances is increasingly becoming academic and standardized, the risks due to Kuwait's learning curve cannot be underestimated. The availability of human capital and institutional excellence in managing the strict deadlines remain the prime risks. Such a process can undoubtedly be highly critical for all stakeholders involved, ending with mature institutions such as the Kuwait Investment Authority and the CBK.

There should be a debate to articulate key risk in the start-up of Kuwait entering the international sovereign debt market with questions required to bring clarity to crucial such as:

Will Kuwait continue to see the same budget anomalies in the post debt budget?

- Can the country keep up with the scrutiny of international capital markets to address the anomalies? And through what governance framework?

- How can Kuwait use sovereign bonds and sukuks, as a factor of stability and investment diversification, not as a crowd out threat to the private sector?

Once a governance framework is put together involving the relevant national and international stakeholders, sovereign bond and sukuk issuances can take place. This will represent an opportunity for Kuwait to introduce a new type of scrutiny from international capital markets to the sustainability of its budget.

8.7. Market Recommendations

A government's credibility as an issuer relies on sound and prudent debt management. The framework of a sound debt management in many jurisdictions is based on having a clear debt management objective, proper coordination with monetary and fiscal policy, a dynamic risk management framework, an effective institutional framework, and a robust operational capacity enabling efficient funding and sound risk management practices.

Some experts (Oh and Park, 2006; Park and Rhee, 2006) have suggested a package of three policy measures to develop regional bond markets. Namely, regional; credit guarantee agency, securities rating facility and a clearing and settlement capacity. Combined, these elements are the necessary infrastructure components upon which to build a regional securities market. Development of a robust government securities market in developing countries will often lead and aid the development of a private sector securities market. At the same time, private debt markets need other elements to be successful, most importantly; a disclosure system, a credit-rating system and bankruptcy laws. Regulators should also avoid possible crowding out and legal restrictions that inhibit private sector securities market development.

Finally, as discussed earlier, the establishment of an efficient DCM will have a positive impact on growth and spill over on other markets as a result of the required upgrade to the market infrastructure. Below is a comprehensive list of recommended courses of actions given by the World Bank and are grouped as follows (World Bank & IMF, 2001):

Legal and Regulatory Framework
Establish a legal framework and improve enforcement of securities laws and the judicial system.
Ensure the protection of investors and reduce systemic risk.
Auditing and accounting best market standards.
Proper securities supervision and enforcement.
Eliminate transaction taxes

Developing a Government Bond Market
Establishment of a sovereign debt management office with appropriate governance structures. To oversee manage and coordinate government financings. Professional staff in the debt management functions should operate it.
Improve supervision and regulation of financial institutions.
Proper separation between asset management and investment banking.
Linking insurance and pension fund reforms towards building government securities markets.
Promote retail investor interests through new distribution channels, including mutual funds and automated trading formats.
Encourage a trading culture in the market through professional associations, primary dealers, entry of foreign institutions, and codes of behaviour.

Issuance Strategy and Debt Management
Establish a strong political commitment to develop toward market-based government financing using tradeable securities sold at market price and a proactive approach to market development.
Develop a broad and transparent government funding strategy with clear risk management objectives.
Establishing a risk management framework.

Primary Market Structure
To reach the targeted investor base, requires financial system development, and efficient distribution channels for securities should be established with the structure of intermediaries (auctions, underwriters).
Create new channels for securities distribution leveraging on technology.

Secondary Markets
To improve liquidity in the government securities market, promoting repo and money markets.
Prudent regulations for governing trading practices.
Develop market makers system.
Introduce borrowing and lending of securities and short sales.
Eliminate taxes and hindering securities transactions.
Start automated trading systems to facilitate access by onshore and offshore investors for settlement and custody (connections to EUROCLEAR, Clearstream).

Securities Settlement
Develop credit information infrastructure, including credit ratings, basic credit information and related infrastructure.

Instruments and Yield Curve
Use standardized simple instruments with conventional maturities.
Develop the Treasury bill market.

Investor Base
Reform the pension system and insurance sector to allow participation of private sector nonbank institutions to expand the investor base.
Improve information and financial disclosure requirements for institutional investors.
Expanded and facilitate for foreign investors to tap into the local market
Evaluate the benefits of encouraging foreign investors, such as eliminating withholding taxes on their investments.
Sponsor investment funds specializing in government securities.

8.8. Final Remarks

S*ukuk* hubs such as Kuala Lumpur and London have so far struggled due to a lack of Islamic financial infrastructure, limited populations of domestic Islamic investors and domestic issuers that will chase the best pricing and bypass conventional bonds. But it will not happen soon and will never truly rival conventional bonds. Most issuers seeking light covenants, favourable pricing, deep pools of liquidity and diverse bases of investors will continue to look past Islamic *sukuks*. Market participants need to work diligently on establishing; global standards for *sukuk* issuance and investment, structures to make them appealing and easy to transact and finally deepening of the market to include as much liquidity as possible.

Over the next three years, I believe that the GCC can develop plans to become a global *sukuk* market place. Growth in the GCC *sukuk* market in terms of market depth and width makes sense due to the increased need for borrowing. *Sukuk* looks set to remain decidedly niche, and the GCC is well positioned to become a hub with an increasing appeal as an emerging market with fixed income and growth with future market and legal reforms. Moreover, if other Muslim majority emerging nations such as Turkey, Bangladesh, Egypt and Pakistan find stable paths to development, then the Islamic capital market could find a long-term growth potential. The world's Muslim population is approximately 1.8 billion and growing at a faster pace than China the most populous nation in Asia with the largest and most widely touted emerging market.

The GCC growth model is based on an oil renter economy that has created jobs in the public sector for nationals and resulted in positive economic and social gains in the past. However, with the declining relative importance of oil, its price is expected to persist near present levels and the growth performance expected to be hindered by fiscal consolidation. Therefore, the development of an efficient DCM will boost the growth and fulfil the need for economic diversification and sustainable growth in the non-oil sector.

Appendix 1

Interview Questions

1. Can we have a brief background about yourself
2. What is your definition of debt capital market both Islamic and conventional in the GCC region?
3. Who are the major players? and how would you categorize them?
4. In your view what is the current status of the Market? and why?
5. Would you consider it as a niche market?
6. What are the key challenges that are facing the market?
7. How do you see the role of regulators in developing the market?
8. If you are part of a think tank and you were asked to put a set of recommendations for developing the market over the next 5 years, what would be your recommendations?
9. Any other final thoughts?

Appendix 2

Interviewee Profiles

1. Mr. Iqbal Ahmad Khan:

Chief Executive Officer - Fajr Capital- DIFC, Dubai

Mr. Iqbal serves as the Chief Executive Officer of *Fajr* Capital and was previously the Founding CEO of HSBC *Amanah*. He built the business and team at HSBC *Amanah* over 8 years to become the fastest growing and most successful emerging businesses in the HSBC Group. Mr. Khan was a member of the Boards of Directors of HSBC Bank Middle East, The Saudi British Bank, and HSBC Investment Bank (Saudi Arabia). He reported directly to the HSBC Group Holdings Group CEO and now Chairman, Stephen Green. Mr. Khan has been associated with the launch of leading Islamic finance institutions such as Meezan Bank, Citi Islamic Investment Bank, and IDB Infrastructure Fund, and has overseen a wide range of business lines, including retail banking, corporate finance advisory, treasury and risk management, wealth management, private banking, and private equity. He is active in a large number of Islamic finance institutions industry initiatives, serving as an advisor to Islamic Financial Services initiatives of governments in the UK, the UAE, and Malaysia. Mr. Khan has received a number of Industry commendations, including a special award from Euromoney in 2006 for his "Outstanding Contribution to Islamic Finance."
(Fajr Capital Website: https://fajrcapital.com/management-team/).

2. Mr. Simon Stockley:

Director, Catalis Holding PTY Ltd., South Africa

Mr. Simon has marketed, established, and managed the Townhouse Group of Companies over a 10-year period. He Researched alternative funding mechanisms in 1998 for the South African mortgage market and in January 1999, in association with venture capitalists, he established South African Home loans. He became first Chief Executive Officer in 2000 to 2004 and remained instrumental in raising initial venture capital to establish the enterprise and subsequently he negotiated equity participation in the company with The International Finance Corporation, JP Morgan and Standard Bank. Whilst CEO of SA Home Loans, the mortgage portfolio grew from a zero base to over

R20 billion (US$3.5 billion) and also led the team that first brought residential mortgage backed security issue to the market in November 2001 to South Africa. Subsequent to this issue, he was intimately involved in the structuring and marketing of 3 Thekwini bond portfolios. As the first private sector residential mortgage backed security issuance outside of Europe, Australia, and the USA, the Thekwini DCM program represents an international benchmark for Emerging Markets. After stepping down as CEO, Simon consulted exclusively to SA Home Loans for one year, and since November 2005, he has been retained by Kingdom Instalment (a loan finance company in Saudi Arabia) as an advisor to the Board. He successfully launched, during this period, the Gulf's first *sharia* compliant mortgage DCM program (KSA MBS) and executed a strategic alliance on behalf of the company with Arab National Bank and the International Finance Corporation. This will recapitalise KIC in excess of US$550 million, making it the largest specialist home loan finance company operating in the GCC. The merger of his investment and advisory company under Catalis Holdings Pty Ltd in March 2007 has allowed him to now consult to both national and international clients. Catalis has recently acquired a private equity stake in a mortgage start-up operation in South Africa. In addition, Simon acts as Non – Executive Chairman to a specialist mortgage finance company in Ghana, Ghana Home Loans

(Catalis Website: Source: http://www.catalis.co.za/simon-stockley/)

3. Mr. Adnan Abdulaziz Al Bahar:

Chairman & Managing Director –The International Investor, Kuwait ("TII")

Since 1992, Adnan A. Al Bahar is the Chairman and Managing Director of The International Investor, Kuwait a regional investment bank. He holds a BA in International Business from the American College in Switzerland and began his career at KFH during the period from 1980-1990. There he built his career until reaching the post of General Manager. Subsequently, he pursued his career in London for two years as the Managing Director for Al Rajhi Bank of Saudi Arabia between 1990-1992.During his career Mr. Al Bahar served on many national and regional Boards & Committees.

He has served as Advisor to the Finance Committee of the Kuwait Parliament, and as a Director of the Kuwait Investment Authority, Kuwait Stock Exchange and Kuwait Higher Planning Board.

(Adnan Al-Bahar Website. Source: http://www.adnanalbahar.com/about)

Appendix 3

Interview with Mr. Iqbal Khan

Issam Al Tawari: This is a telephonic interview with Mr. Iqbal Khan, The Chief Executive Officer of the Fajr Capital and a Pioneer of Islamic Finance.

Iqbal, the title of my dissertation is **What Factors are affecting the development of the Debt Capital Market in the MENA Region.** That's a broad title also I'm going ask you few questions, you know and you just feel free to answer them the way you see fit So we just start by basically if you could give a brief introduction about yourself?

Mr. Iqbal Khan: I think you've already made the introduction, so first and foremost I'm delighted to assist you as a very, very close friend or dear brother over a long period of time. And I think you could have not chosen a better university as well.

Mr. Issam: Thank you so much. My first question to you is just, what's your definition on Debt Capital Market in the MENA Region from your perspective, I mean how do you view the Debt Capital Market in that Region both Islamic and Conventional?

Mr. Iqbal: I think from my perspective what I have seen is this that the debt capital market have gradually evolved in the region and obviously the evolution first and foremost took place in the conventional market space, simple because they had ready-made models of conventional instruments which were already being practised in the last and when they came out it was easy to replicate them. Therefore, the Bond market and the Euro-Bond Market, the money markets all of them kind of came first in the conventional space and its only when Islamic Finance started growing, and we were all part of that industry as you remember, that the journey towards Debt Capital Market began. So, in the region there is conventional, which is still I believe, the majority of the instruments which have been used in the region that are conventional. Interestingly, the Islamic instruments are finding acceptability. Issam, I wanted to ask you when you said Debt Capital Market, are you talking about Equity instruments in the capital markets or just the debt?

Mr. Issam: Just about the Debts, mainly the *sukuk*, the bonds, the debt convertibles as well, the structured products let's say, that could be any debt capital markets.

Mr. Iqbal: Sure, So I mean, I think clearly, the sovereign who were the ones issuing early in the Islamic finance in the conventional space and they all issued is initially who kicked others but the conventional debt instruments. So, from my perspective, the market started with conventional instruments it moved towards Islamic over period of time gradually and more and more issuers are realising that they can tap a wider group of investors both Islamic and conventional through the various Sukuk structures. And of course, more and more people are familiar with *Sukuk* Al *Ijarah* but you know other Sukuk like *Sukuk* Al *Musharaka* or *Sukuk* Al *Modaraba* or *Sukuk* Al *Salam* are less known to issuers and *Sukuk* Al *Istisnaa* or *Sukuk* Al *Morabaha* or *Sukuk* Al *Astithmar* you know all those are less known to investors and hence less in usage area. But your question was that what is prevalent.

So of course, for all the conventional forms of these instruments specially the bonds, the commercial papers and others are prevalent in regions as you know, the Islamic are evolving and more are being used excessively in the region.

Mr. Issam: And where do you see securitisation, asset securitisation as in within this sort of bigger picture?

Mr. Iqbal: In terms of the assets securitisation as you know in the region has taken place or some of the asset type companies like Airlines has tried to tap these Assets in securitisation markets, But the main focus in the Islamic space of course has been the *Sukuk* Al-*Ijarah*.

Mr. Issam: OK, who are the major players and how would you categorise them?

Mr. Iqbal: The major players from an origination perspective, structuring perspective and distribution perspective, those 3 categories if we take them, the major players would obviously be the large multinational banks with regional presence and the large regional banks within the regions. So, the large multinational banks will be like The Sub Citibank, like Sub HSBC, Deutsche Bank, UBS and others who have bought regional distribution as well. And then of course they are the regional distribution as well. And then of course there are the regional players from the regions as well like the sub GIB, ABC and then there are national players. More and more Sukuk issuance, if I talk about Sukuk say, is becoming in local currency rather than just foreign currency alone. In local currency you will find local players with balance sheet appetite to underwrite to warehouse, playing a much bigger role and those who don’t have that appetite.

Mr. Issam: Where do you see Niche players within the sort of these markets or is this the market that is strictly for the big boys?

Mr. Iqbal: Well I think as the market evolves and we get into the issuance of the corporate Sukuks, the key factor which influences the ability to give certainty to issue us that on a book building basis this Sukuk will be well underwritten, well covered from investors and you will get duality in terms of the type of investors you are targeting and for that in the local markets if there are local currencies issues the local niche firms with the distribution market will play an important role. But once that comes to international distribution, local firms will find it very hard to build a reputable distribution network internationally.

Mr. Issam: So, for Debt Capital Market to grow it needs you main players in terms of distribution, origination & structuring of course.

Mr. Iqbal: Absolutely.

Mr. Issam: Ok. In terms of volume where do you see the current market? I mean the debt capital market, the Islamic debt capital market. Now let's just be focusing on Islamic debt cap market v/s the general capital market, the conventional market.

Mr. Iqbal: Well you know that we had an issue in this Sukuk market after the credit crunch which impacted the debt markets all across. There was issue of standardisation in the market and the AAIOFI statement in Feb 2008, that created a concern thought there was repeated clarification, the market doesn't seem to have registered the clarification. They have focused on the grey and then of course the high profile Sukuk default by the originators has created concerns on structural challenges and most of the Sukuk defaults which took place were in particular market you know and they were in a Dubai based institutions but also you find that you know, the different types of structures. One is of course the credit risk inherent which is both standard for conventional and Islamic. But the non-recourse nature and the ownership nature of the Sukuks and those structures pose additional challenges for investors. So, you would remember that you know they've been shift towards Islamic securitisation in true sales securitisation by Abu Dhabi based, I think it was *Sorooh* Real Estate Company they had this securitisation which they went for true securitisation. So, I mean, Sukuk defaults then let to more authentic structures being thrown by issuers and of course people have now got much more clarity on the *sharia* side.

Now that the markets are getting much more active, and you saw only yesterday the Malaysians trying to tap the Middle Eastern markets by doing a sovereign *sukuk*. The challenge is that in the region this whole issue about these standstill agreements of 2008-2009 created certain challenges and regulators are very concerned about cross-border exposures taken by the banking community. The non-banks which are the pension funds and others they are more targeted towards their own country. *Sukuk* issuance for example institutions like GOSI like Public Pension Funds, ___________ of Arabia what initially focus on putting their money out in Saudi Riyal denominated local currency *Sukuk*s rather than investing abroad, however good the issuer may be. So, the challenge is that due to the crisis this market is becoming much more local rather than regional or international.

Mr. Issam: So basically, in your view the challenges are structural in nature, this market has to address, so in this case in your view what is the role of regulators?

Mr. Iqbal: I think basically the role of the regulators is that first and foremost is the standardisation of the *sukuk*s, so that we can have more tradability. We can focus more on the corporate responsibility of the manager of the issues, the permissibility of the reserves account which are created on their structure. The purchases of assets whether they are *Musharaka* structure, *Modaraba* structure, *Wakala* structure should be at their net where they have nominal value because there have been some cases where there is a net value, where there is a nominal value. And we need to standardise that because then you can have more tradability. You are comparing the like for like. And of course, the duty of the *sharia* Scholars is to oversee the implementation of the funds and investments are still in a compliant manner and their involvement should not end at the issuance of the fatwa alone. So, the ongoing involvement would also help. So, I think the standardisation and using the AAIOFI platform, so that would certainly help.

Mr. Issam: Brother Iqbal, you are now basically a member of a think tank that is basically putting together proposals to develop the debt capital market over the next 5-10 years. OK, what would be your proposed recommendations for the market? I know that you've touched upon these points while asking some of these questions, but now I mean just to put interest in a sort or concise manner for just putting things forward for the market for the expanded capital market in this case in the MENA region, what would be your recommendation to improve the Debt Capital Market?

Mr. Iqbal: I think the recommendations could be in categories and I'm just kind of thinking loud as you're asking these questions. So, I have no kind of particular framework of prioritization. If I was to say is. First and foremost is the harmonisation of the standards both amongst AAIOFI, IFSB and other industry building organisations. So there are number of these institution IFM, LMC, AAIOFI, IFSB one would like to see the harmonisation of its standards amongst them you know to make sure that they have brought the right terminology, right standards for the entire framework of the debt capital market whether it is for the securitisation or for the different types of *sukuk*s and then after that once they have this they've created the framework they should be accepted by the regulators of the Central banks in these markets and the International Organisation Of Securities Commission (IOSCO) which you know has been looking at the *sukuk*s over a period of time. I remember the IOSCO has a taskforce on Islamic Capital Market, Taskforce it was established in 2004 and I had represented to them in 2004 and 2005 in Kuala Lumpur and these kind of recognition by industrial bodies, by central banks and then by rating agencies. But if we have a consensus amongst them, then for the issuers and the investors they can get on with their lives. The lack of consensus is holding back the industry. So this will be my first focus is get all the Islamic governing bodies on one page on the basic rules and regulations and simple things like is it market value or nominal value on structures and then once we have them and the rating agencies on the same page then allow the market forces to get on with their work and they will meet the demand of supply in the best possible way where there is capital surplus, it will find its way to the issuers who have got businesses to find and businesses to grow. And Islamic finance always have been and should continue to be a private sector phenomenal. I personally believe that, you know there is a huge potential for the *sukuk* market to play an important role, both for the rated institutional and for the non- rated ones.

Mr. Issam: Brother Iqbal I want to argue on one point here which is, which comes first is it the regulators facilitates and opens up the market or is it the practice where basically the originators and the arrangers come together they basically try to struggle to put the structure together, they bring the first deal then the regulators they find out about good series of transaction and say ok, I mean we don't want to have chaos here lets regulate. Because there is a phenomenon that is regulations/regulators are or they tend to be at this term kind of lazy, they cannot regulate what they don't know, they only regulate what's out there. What is your thought on this sort of an idea?

Mr. Iqbal: Well I think the entire Islamic finance industry has been based on the premise, there is less work under interesting regulations, let's work with what we have and try to do role model transaction. And the industry has evolved, but my view is this for the *sukuk* industry we need to get on, first and foremost part is that we have got a number of industry building organisations, IIFM, LMC, IFSB, AAIOFI they need to get on the same page and issue one guideline which can then be rooted to organisations like IOSCO.

As I said earlier, there's already an emergence consensus on what we need to be done. The question is, how quickly can we do this? The role model transactions, the market is doing it the market has, to within a framework and that framework, if there's uncertainty, if this a __________ on that principles itself or what constitutes a *sukuk* structure is most definitive term and the fear is this that these structures could be challenged in the court of law in the future. This is holding the market back in a very big way. so I think while and you know these current restructuring that are going on in the Middle East, every restructuring from a problem perspective, as well as a solution perspective has to have *sukuk*s as part of the agenda, But the difficulty with people who are doing these restructuring are finding both the for solving the problem and for finding the solution is the lack of a definitive framework. So, to me that's a big limiting factor we need to face it.

Mr. Issam: Do you have, I mean I've come to basically end of my questions, just the last thing is that if you have any further thoughts about this subject that you'd like to be added? Any last sort of thoughts that you have.

Mr. Iqbal: Yes, you know, my fundamental thesis in the current environment is that the Islamic countries may need to relook at their financial services regulations and divide the banks into 2 categories: The commercial banks, we should do nothing but safe keeping basic banking and let the market go in for Investment Banking Financial Intermediation, Asset Management and it is this site the financial intermediation, the asset management, merchant banking, investment banking which will be issuers, structurers and investors in *sukuk* that they will create a vibrant market.

The problem happens when the banks gets involved into the investment banking space and then they look at everything from a risk weighting perspective and, of course they then tend to stay with the high-quality risk, as they should, because they are also controlling the payment system. Therefore, the Central Bank has responsibility towards them. But what it does is, it starves money away from the issuers which are non-rated, emerging issuers, you know potentially future high-quality issuers that whole market is starved of funding and capital because of this regulatory, normally which is really a legacy of the colonial era and colonial mind set. And unless and until we correct this anomaly, we will not be able to sort out the problem inherent on our region and in the Islamic finance industry.

And I know I've probably been stepping away from your research, but fundamentally if you look at it, the structural fort lines which created the financial crisis are still in place. The dichotomy between you know which was tried to be created by Frank- Dodd [Wall Street Reform and Consumer Protection Act], this new act, has not happened. The previous act Glass-Steagall Act was demolished. As a result, commercial banks have become universal banks and a result we are controlling the payment system and we have made a banking model which is really broken. You have privatisation of profits and socialisation of losses in the West. I mean it's a broken model and the current crisis was a great opportunity to fix it, but nobody had the guts to do it. In America they tried it through Paul Volker’s principle, you know through Senator Frank and Senator Dodd’s bill, which in my view it’s a still birth because it wasn’t implemented and the lobbyists have worked against it.

Our banking system in our part of the world, is very much you know, taken from the West. So, we have instead of taking their best we have taken their kind of worst situations, and unless and until we decide that we are going to take a new folk on the road, implement Glass - Steagall, implement Frank- Dodd Act in letter and in spirit, in our countries even before those people could do it in their home markets. But the trouble which we have, Brother Issam, is this that the shareholder lobby of the banks both in the West and in our part of the world are too strong. Nobody can be in reform unless and until we have that dedication and commitment to do the right thing in the long run for our future generations.

It’s a matter of time this cannot continue this current model of universal banking, and this is in many ways, holding back the development of genuine authentic debt capital market in the region. To me this is a big challenge; everything else is tinkling at the edges, rules, regulations, everything else. But unless and until, we decide to do this. There are 2 types of banks, one which are the Narrow banks, they keep your money safe, they provide the basic custody services for you. And there are the investment banks, merchant banks, asset Managers, structuring Advisors, all kind of people, these guys have no protection of the central bank, they are under the supervision of central bank, in terms of know your customer rules from your fiduciary guidelines, but if they go bust, they go bust.

This will allow the market forces to develop the debt capital markets in an orderly manner and in an effective manner. But this reform is all easier said than done, because in front of these reforms stands a huge lobby of influential shareholders, who have created for themselves a really very beautiful business model, you cannot lose in this business model. In good times you take all the profit and in bad times the State is there to bail you out. And in good times you got to all the excesses possible under the sun and in bad times when everything goes back to hunt the roast, they turn back to the tax payers, governments and get bailed out.

So to me this is the challenge, and this is the challenge I believe, the Islamic finance industry when we look back in our history, we know, there were 2 folks on the road, one was shall we go or shall we wait for the ideal regulation or something in which you mentioned or shall we start the industry. I think there the founders were right, we were all part of it that we were hoping that the regulations will catch up and they did to some extent. But there was another folk, a smaller folk and a more important one that was, shall we go to the root of the Asset Management, Merchant Banking, Investment Banking or should we go to the root of Commercial Banking, Because the regulations had defined commercial banking much better and because the market understood Commercial banking better. The founders chose commercial banking model and therefore started the whole bank, Islamic Banking Phenomena rather than the Islamic Merchant Banking, Islamic Investment Banking, Islamic Asset Management, Islamic Corporate Finance, the whole advisory side didn't take off as it should have. So, to me behind this challenge is this particular big mega picture issue. This is if he can fix this as a think tank, and I've been an advocate for this since last 20 years saying we should go for a model which focuses the banks, big banks, Islamic Banks and Commercial Banks in the region into a narrow defined area and then we should let down market forces to create a whole range of opportunities, but manage them very well by educating their investors on the best profiles and everything else. Unfortunately, that is may not be possible, neither in our part of the world, more importantly it's not quite possible in the West. so, I think after having gone over one of the biggest financial crises, the mother of all crisis, we still haven't taken those steps.

Mr. Issam: Very interesting brother Iqbal, you said in order to resolve these you need the dedication and the commitment. Ok, my question is that dedication and commitment by whom you are referring to the regulators, the politicians, the banks, whom were you referring to?

Mr. Iqbal: Well I think we need leadership; I think the people who make the rules who run our governments, our policies, they have to take a fair sighted view of the future saying that a current financial service model imported from the West is non- workable. As it is proven in the west and proven in our part of the world as well. Many of our countries which survived the crisis, survived not because they were wise or they were smart, they survived because they were lacking behind the curve, because of their own limitations in imitating the West. So, their countries which were really protected and they are happy to pay, but their reality is that they were happy because they were going on that root. If they had their wish they would have been there as well, but they were not there not because they were genius but because they were lacking behind and thank God that was the case. So, I think the leadership has to come from the people who make the roofs, implements the roofs at whatever stage. You cannot expect this from the management of the banks or from the shareholders of the banks or the boards of the banks. because they will fight it. But we, I mean most of us, people like us who have the opportunity to work in large institution but also to see things as are gone wrong in the West and are gone and will continue to go wrong.

We should be articulating this kind of system which we call the case for narrow banking and you know, Brother Issam, there's a lot of literature now on that for your research. People like Vein Angel, are saying the same people like Governor Paul Volker is saying the same thing, that we need to fix the structural fault lines which have created this crisis. Whichever stood in the way of reform on the real estate ownership laws, so they stand the lobby of land owners who do not want land ownership to be opened up by the wider market, on whatever pretext. But You know You can’t have liberal debt capital markets, if the one asset which fix it more naturally, the earth and the hotel bill on the earth cannot be sold to foreign buyers, to global buyers and will be sold only to local buyers by definition the debt capital market will be local. How do you get people from outside to come and invest, you can’t do that. So, the more local the more pro-local you’ll make our laws the more local and pro-local will be our market, this is a logical thing to take from it.

Mr. Issam: My Final question Brother Iqbal is that, if there is a lobby that’s trying to protect its interest which is understandable then what would be the instruments on the ways of influencing the decision to counter the power of the lobby? Practitioners like you and me who have got ideas of how to basically introduce or suggest or recommend reforms, how can we basically get that into action?

Mr. Iqbal: 1. By demonstrating a model which will run in the long run for all in a balanced manner that model. We need to see where does it exist in the world. Can we take the best practices from there and bring it to our local and regional markets?

2. By advocating this in the media, getting people to understand that we do have a structural frontline and reform has to come. In the West they are very fortunate that they have land and properties and the other structural reforms, ownership laws are much more open than we have in your part of the world. We have the double challenge of reforming our land ownership laws which to me is fundamental to opening of the market and reforming the banking act and this is really a campaign and I think the people who stand on the way of reform they also should have brought in so as you can continue to be the shareholder of the Commercial Banks. But as the new order emerges you can be part of it.

But challenge is this once you have got used to a system where your profits are yours and your losses are somebody’s else, it’s very hard to convince such people. So, how do you convince somebody that look I’m going to give you the Profit/loss sharing model away from the current model which is you know profits are yours to keep but losses are for us to share, that’s a hard one.

Mr. Issam: Very interesting, Brother Iqbal that’s been quiet enlightening, I really appreciate your feedback, it was really interesting and I do appreciate your time. Once I put down together all the tape together, I’ll send you a copy to see what are other people thoughts as well.

Appendix 4

Interview with Mr Adnan Al Bahar

Mr. Issam Al Tawari: This is a telephonic interview with Mr. Adnan Al Bahar Chairman, Managing Director of The International Investor. This is a mini assignment for my thesis and the title of my thesis is **What Factors Affecting the Development of Debt Capital Market in the MENA Region.** This is a semi structured kind of discussion; we'll just open the issues and I'm just interested in hearing your views about the subject. I mean let's just start with just the brief questions about if you describe yourself and your background briefly in a minute or two.

Mr. Adnan Al Bahar: Ok. Well I am Adnan Al Bahar, 55 years old, Chairman & Managing Director of the International Investor started in Investment Banking 1992 was set back that's making. Since 1992 and before that in retail and commercial banking in 1978. Career that started at Burgan Bank ended up with Kuwait Finance House where I was General Manager of Kuwait Finance House the leading Islamic bank in Kuwait. I left KFH in 1990 and started the_ International Investor and I sat on a multiple of committees such as the National Planning and Economic Committees and was on the board of Kuwait Stock Exchange and Kuwait Investment Authority and other Regional bodies.

Mr. Issam: That's quite impressive. Thank you very much. Let's just kick off with the questions and my first question to you is, what is your definition of Debt Capital Market under the MENA region whether Islamic or Conventional?

Mr. Adnan: Well, Debt Capital Market, my definition is state of debt i.e., listed and created with secondary market trading some sort of liquidity and pricing globally. But, regionally dominated debt. Now, because not only currency but for regional players they want more and more of it, but the main is 3rd debt of 5yrs years and over that has secondary market.

Mr. Issam: Ok. So, and how do you see the similarities between Islamic and the conventional or the difference between the two?

Mr. Adnan: In terms of debt capital Market the difference between Islamic and conventional is mainly the structure by which the future receivables are created and the future cash course are committed on that paper are generated further to be conventional. Any commitment on paper binding revocable on a corporate work by which the corporate commits the stream of future cash flows in basis to create a great conventional debt because as long as that paper can be created at a price which represents the current discounts, today's discounted value of that special fraction.

Coming to Islamic for that paper for debt to be created you need to have used. Islamic rules accepted in transaction to generate that stream of future cash flows. Meaning, however, if the paper one which says Islamic means, its Islamic compatible on the books of the enter key the corporate that carries the obligations is committed to pay the future obligations and this Islamic be acceptably traded by the buyers of that paper, meaning the buyers of that paper can buy it and hold it as the Islamically acceptable debt and trade it. And then the future cash flow needs to have been generated through, by merely anything in fracture because in Islamic it's not just the stream of the future cash flow you are buying you are also ownership temporarily or permanent or by assets that is generating that future stream of it. Because I know I say that why, because to trade that paper you are trading that underlying assets and not the stream of future cash flows and to determine the present values of that asset based on the stream of future cash flows that we are on. So, the paper, the bond, the capital market, that instrument needs to present a share in the asset which entitles the owner of that paper to a share in the future cash flow and hence most traded Islamic. So-called Corbonds or capital market instruments that are traded not that those are brought and held on the books of/or held by the original buyers/ first time buyers or those that are brought and traded by conventional players. Those that are traded as the Islamic instruments by the buyers of those instruments are mainly securitised at least you are acquiring a bit of the lease which means a bit of an asset and owning a bit of that least asset entitles you a bit of corresponding amount a percentage of the future cash flow generated on that asset and you may rate it based on the quality of that state of cash flow so that's the main difference.

As that describes you now, I described the 3 forms of the conventional which could be any because that generates that future cash flow and it must be an asset involved. An Islamic generated debt that is on paper, but the debt after its been generated can be traded in the common conventional market although the original borrower is Islamic. And may even be the first time buyer, let's say the borrower can consider the transaction as Islamic but, where the debt is after that its traded in conventional market, and here the contractor of the first payment sale by the spot sale payment, metal trade can generate that stream of future obligation and the owner of that future obligation may trade them in the conventional market and the 3rd is where the borrower and the buyers of that paper intend for it to be Islamic and it is there that what is been actually traded is the underlying asset and you price the assets based on the quality of the obligation, the party that is committed to pay the cash flow and based on the full value of that future obligation.

Mr. Issam: Ok. Very good Thank you very much. How would you describe the Islamic debt capital market, the current state of debt cap market from your perspective?

Mr. Adnan: At a very early stage, the whole world has seen a very interesting development over a last few couple of years because regional sovereign borrowers are, sovereign have started to use it and some major regional corporates. So, it was started well and nicely but has suffered now, the recent global financial crisis and the impact of that on regional corporates and on regional sovereign borrowers. So, it has suffered cause of that, it will take some time to rebuild that confidence back.

Mr. Issam: Who are the major players in your view in this market? And how would you categorize them?

Mr. Adnan: The major players are usually the Sovereign and the sufficiently rated corporates.

Mr. Issam: No, I'm talking about the major players not the issuers.

Mr. Adnan: Players meaning those that buy and trade that paper.

Mr. Issam: Yes, originate, arrange and trade that paper.

Mr. Adnan: Well the largest players have been international financial institutions and so because that papers sorted issues in that capital market are made underwriting and commitment, book them and distribute them in the market and basically because the difference between, you know, in mainly Islamic and conventional is structuring. Normally, what happen is the global players in the game dominate normally. We were seeing a small role for the regional corporate and investment banking in the issues of underwriting and issues of that paper. But they've limited by their fellow cheated capability to add their right. And so, I think personally that the largest players in the market will always be the larger global players and who can underwrite the largest sovereign and corporate that can be distribute it in more than one country and in more than one region. The demand for Islamic paper will at the end also come from funds operated regionally and globally and so I feel that the market will always be dominated by ______________________ state by those players. Smaller issues by the regional corporates might be an area where regional and investment banks may play larger role. That's why I mean if you look back and look at the largest, the most of the papers issued during the better days in that market for the crisis, the larger players back.

Mr. Issam: How do you describe your own experience in trying to tap the debt capital market For DoCar Company in Turkey?

Mr. Adnan: Well because our attempt today to tap that market, that started after the crisis has been difficult. And in Turkey, there is usually to develop the problem called *sukuk* and Islamic debt that's an issue also. In many countries unless you solve because of tax fractures or _______________ of others, otherwise the structuring of transaction of Islamic may cause unit burden of tax. Since all transaction may intake the ownership of asset or a lease, But Turkey has lately amended its tax clause to allow for *sukuk*s, Islamic that is. So that is what hurdle for Turkey that was involved. The next cause was waiting for our corporate to reach a level that would allow. Second the problem of causes what told was to take an issue, the total issue was fined to be and that with all the market you know accepting problem you know for it to be affected. Now I would like to go back and the tax structure has been solved in Turkey But the issue of opening total fresh market and fresh starting, so no need for more __________. But we are, I think we will be able to do something which makes us over the next 3 to 4 months in Turkey. It will take; will be in a position to take. For e.g. Our Subsidiary in Asia, Singapore and Malaysia was just before the crisis, the main issue Islamic *sukuk*, securitised both problems. But the born market the securitised both market because that generates consumers receives that writes off as a result of the crisis you know ad the problem with the securitised receivables. So, you know the market but I know the early stage capital market they also suffer both of the crisis but have not been able to recover yet.

Mr. Issam: If you sit back, and basically you sit on a high building and have a bird's eye view of debt capital market. How would you describe it in terms of different sorts of players in the market meaning in terms of when you look at regulators, investors, arrangers, issuers, how would you describe this market just sitting from up a top of a building?

Mr. Adnan: Well at early stage the problem of other issue with it is that are not enough quality problem issues you know but a lot of for example Dubai___________ and hence that created, but the other things to remember is, there are in countries like the US for example ____ there is US government that provokes that really developed a lot of the paper at the market such as more rich banks, securities.

Mr. Issam: Which basically created a lot of problems?

Mr. Adnan: There are no such instruments in our part of the world yet and governments in legacy for example don’t use the regional sovereign markets as primary stocks for debt.

Mr. Issam: Why?

Mr. Adnan: For example look at countries like Kuwait, Qatar either they have capital generating subsidiaries these days and so you need a government that is primarily borrowing also, the when the government creates an issue then they are primarily concerned at doing very large transactions, a couple of biding and which you know the bid may be of private sector advertising that may be too much for it. Remember the banks are already buying treasures from the central bank in countries like Kuwait, Saudi Arabia. And so, as a secondary market trading loss between them and the central bank. So that has taken the bank of sovereign debt out in most markets because they have enough they have much treasures as they want for short term majority a debt other liquidity from the central bank. This leaves ______________________________is mentioned by the corporate and part of them to play. I think one of the issues is also the Government have to you know, you want to develop a market you know you agree not to the pricing initially at least in terms of fees because you going to do a smaller issue and you are going to.

The Government has to be interested in taping that issue of Islamic [*sukuk*] So far, the government that have attempted to do that, Bahrain and Inter mid of Dubai. I didn’t See many by that hopefully showing sources by other sovereigns, may be Oman. But the Government were just starting to use that market monetarily until the crash and you know _______________________.

So, it’s been there are not many programmes, the government sponsors program that use regional capital market or capital market generally. So, government were just trying to explore taping that market but the crisis happened so that’s the bad luck, other reason have to wait monetarily until the crash, so it will come back I think. And so, my current stating is look if there were programs under which government would use those obligations because they wanted to encourage that first time funding like you know like years back was mortgaging which is basically [Riyadh’s] government initiative to help smaller borrowers, smaller buyers, find housing buy it and find the right type of debts. Those program helps government borrowing from those markets helps and then which generates.

Let me put it this way you need volume, constant volume of high rated debt instruments to generates to feed that infrastructure that is needed to service the generation then they start to at the back of that lubricated infrastructure service small or medium sized of players and lower and different levels of operated debts and smaller issues. If issues of the paper is very specific you know it comes up high volume sometimes and it ties up new issues with others It doesn’t support to terminate the strength of fractures. And hence, you normally need to bank on international and global infrastructure that has global volume servicing it to handle your regional business the tender regional business has to be certain minimum global rating and a certain minimum size the transaction, for that global capital market infrastructure to be interested in it. If you want a regional infrastructure which will then be able to handle issues at volume size or regional that are lower than what the global market is interested in handling or regional rating of debt you know manifestly to global rating and more customized local currency issues and stuffs like this then we need to generate enough regional issues volume that would allow that cause that is regionally constant. The space for the existence of that infrastructure and then that infrastructure could service up you know the instant periodic increase volume of issues that are not constant. So, a multiple program by sovereign on corporate, or sovereign that borrowing program in the market, they create that quality regional volume and needs ________________. But you know government of Kuwait comes and issues a bond today and then issues another bond in next 2 years, what will the original issuers do in between you know. You need a stream a consistent stream and you need it and you need which will require a government with a vision. Government that wants to use developed regional borrowers and local borrowers which you see too is running also where it generates which allows some programs that it works to support for example Housing, it’s about thousands supported in most of the countries. Not through capital market initiative on which the government taxes it but does not handle it. In the Gulf for housing, the government borrows directly and manages its directly and builds it directly and distributes it directly and if the debt to the receiver of the more and collects from it, so it leaves very little for the debt capital market.

One of these instruments, so it requires a vision of government that says we want to do things where there’s a minimum amount of involvement and responsibility administratively on government and we won’t allow the private market to play and this is our intention to help in development of local or regional capital market and either to make those market affective and cost efficient to those who want to borrow program and to do that we have to earn a portion of our program our needs through that so you need that intensive strategy and not many happen, I haven’t seen an Asian with that objective running its all national program.

Mr. Issam: How about Malaysia for example?

Mr. Adnan: Well there are countries that are little bit, one example is Malaysia and one e.g. is Bahrain, Bahrain is too small in itself and all its programs are too small. Dubai was starting to use that and was helping but then you know Dubai itself had problems. Malaysia started to do that but remember that Malaysia is itself a capital performing internally and have no problem in government borrowing itself but they had not enough government sponsors the program but I would say that in all cases Malaysian capital market was one of the most interesting to look at in terms of local currency market that was slowly developed and the Malaysian government was helping and had a lot of support but they didn't have any concentrated program of saying that I am going to run the following mortgage, debt securities program and help people borrow from the market by making secure the smaller borrowers or by running a certain minimum amount of annual government issuers that focus on government or corporate issuers. They would do something or start to, but they did not have that commitment. I'm not saying look that's my program over the next 5 years of my needs that I'm going to run through this market and these are my entities program and I'm going to initiate the following housing programs that I would have government backing of debts that so you need to make a commitment, an announcement of that nature for the market, say you know it's interesting let me build a structure to service them, the minute the government are saying yes I'm interested in the growth of market I'll do something, I'll root something, but not a public sort of. My view is market would develop sooner or later as markets and economies develops. But if you want to do it faster and help it happen faster, you could do it by doing, by government intending to help our market and see it developed. And it's supposed to take its own time.

Mr. Issam: How about its been noticed that although there's scarcity in liquidity in the market in the major currencies there has been noticeable increase in the level of liquidity in local currencies. What are your views with regards to issues in local currency? Where do you see this one direction the market could be going to or is this something that might be interesting to watch over the coming period, I mean what are your views?

Mr. Adnan: My views is that, I mean look I think the local currency is the primary place where the government should rule and you know should commit program and the local currency program which has very little issuance through it were a bulk of private savings are _____________ and it is where a local program or a regional program could develop running, doing and local government borrowing in dollars or Euro is basically issuing a global debt instrument by our regional borrowers, so a portion of it could be distributed in trading with the regional investors. But it's the global issue and I think the biggest storm is the regional investment, if I'm trying to, my intention is that only to have regulators. It's not just only to make sure that debt from the economic development needed for a common debt is available, and is available also in the form of capital market because that allows increase, why do we need to encourage capital market? Because it basically allows for a larger volume of long-term debt but creates the liquidity on the interest. Since all investors that were willing to, their own borrowers were all with long term debt were only able to place it with the buyers of that debt that would buy it and hold it for 10-12 years or for 20 years of life. The number of buyers will be much smaller. When you create liquidity for the debt instrument in order that a larger percentage because more of the short-term money will go into investment into that long-term debt because it has to have liquidity. Similarly, why are capital market for shares, equity, stock markets important? Because they take a long-term investment in the capital of a company and convert into liquid instruments which means you could more of your total savings as an investor in it, because there is liquidity behind it. When the liquidity behind the stock market disappears, the investors disappears. So, the most of what is everybody is trying to encourage capital market, is to encourage a larger form of long-term available funding in both local and international. But the real local savings in dollars and in Euro are a part of the global flow of money and there is very little regional or local characteristic to it. You know and hence the local currency is important and not only that it also helps the development of the regional investment banks and the investment banking players because those with the inside issues in the local currency to those players that are best suited to handle it. And where the multinationals don't mind find what the bond the size sufficiently interesting in the currency. The other thing of course is if we move into a single currency in this stream that would also help because then all the Asians, Saudi, Kuwait or Oman whatever would deal in that currency. Today we are talking about KD issuance it's all in KD and primary holders of KD are Kuwaitis, individuals or corporate you know, so you have to in a country like Bahrain the local currency is too small and Oman is too small. So you may only have enough foods and employees in Saudi and Kuwait, if have permanent job and apart that the local [codes] are too small and the local currencies are just developing and this is why all those rated borrowers regionally borrow in dollars or in euro even if they want to distribute it regionally, coz you have one currency where regional investors are wanting to all change, but you know how many would want to change to Kuwaiti Dinars or Saudi Riyals in regional terms other than Saudi or Kuwait. So, the regional pools of local currency are small and could only ____________________. The Malaysian was stopping because, their currency was growing and was becoming reasonably resizable. But that's the problem with local currency unless those economy becomes larger and enough and also considerate those currencies into regional currency.

Mr. Issam: If you were to say what are the top 3 challenges that's facing the development of the Debt Capital Market in the MENA Region? What would those be?

Mr. Adnan: First on the basis of ok, these are emerging market and they then these markets are developed, they win what they have, what are the things that, what is it that can be done to speed up that, I would say 1. Government with a vision and commitment to see those market develop and hence arranging them program to use at the future and making a clear declaration of their future commitments under each program. Those government will initially sacrifice whether or not they are more effective issuances in terms of fight, structuring course or whatever, but they are accepting that because they want to achieve those markets develop and they know that somebody has to pay a little more of course and it would become better in the future. I believe its unifying regional currencies as much as possible which then creates room for a larger player in local currency. But I basically believe 1. A government intended target for themselves that happened declared as committed too. 2. I would say, if we vote for regional currencies it would help but the most regional currencies hedging techniques will be able to handle the techniques but the smaller market this will not happen. So, you see the markets primarily, in Egypt for example may be an Egyptian pound, one day when the economy returns to stability and it grows faster than enough, you see it in Turkey how it's with a much larger economy in Malaysia possibly but it will take time in other markets. But those markets could develop at least foreign currencies in other places if regional or local government commit to those to back them up. Thing would move faster and of course remember a nation that does a program like this commits to that infrastructure, commits to that banking, and to that issuers, will also benefit in another way. It would have an alternative borrowing and funding schemes for itself and its economy, through it will help develop a local industry or help domicile regional industry in its own junior. So, a country that creates a program issues it, commits to it and on the top may attract all the issuers, players, rating agencies, regional, to domicile themselves there because it is in that primary volume of that issuers based. And from there they concern their fathers around them and hence you know, if the Kuwaiti government would commit that market and that program and if that happen it may be able to be the regional destination based for those that handle trade regional debt. Why because they find enough regional issuers because the Kuwait government committed this percentage of it next 5,6/7 years borrowing program and to run for example mortgage back securities and take it out of the balance sheet of government or banks and supply that. So, also there is another thing that already benefiting in terms of better than regional then they get ability of creating a better room for regional and local players, issuers, corporates to fund themselves. But there's an opportunity to attract and gain an industry.

Mr. Issam: My next question is you've always probably been or its quite dear to your heart which is about the Regulators. In your view what comes first is it the Regulations and Regulators putting together all the frame work for the market or is it basically the business starting, evolving, establishing standards, and then regulators come and the regulate the industry within the context of the debt capital market what are your views? I mean since we know it's an industry, if infancy, early stage and we talking about how this market could be developed? So, the issues of Regulators or Regulations what are your views?

Mr. Adnan: Look Nobody normally practices regulations for the development, so normally when market develops then they require more regulations and etc, so too much regulations heading a market can't be that. The other thing is when the regulator has no benefits, definitely the key problem is to have the regulatory body, to have a government body, that regulators have no benefits in the success and the development of the market. So, it's just the government agencies, it can only be blamed for mistakes and if things are going well. So, one of our problem is we tend to create government bodies as regulators and that is as well in my view because it does create a democracy and democracy does not build a market. A better way to do it is to create regulatory bodies but that are independent meaning they are mixture of international, regional and some government substance. And the 2nd thing I believe they should be its best if they are regulating their own industry and in a competitive environment. So, for example when you have one stock exchange a monopoly and you create one government appointed to regulate. That body is all government appointed democratic, you know one guy from the ministry of commerce, one guy from central bank, one guy from, what are debt now you have at capital market that is owned by government so does not care to make money. 2 its run by democrat so its primary objective is to survive and avoid risk. so you not going to do great job developing creative instruments and creative rules, you are going to have that very conservative, very traditional, very heavy handling, very slow moving, one of the first objectives to get capital market to one, to encourage the existence of more than one because competition and competitive pressure is a very important moment and to have regulators that are dependant non- government , that regulates those sectors which possibly some government, but you know a lot of non-government takes. Now if you have two exchanges, each within its own privately ends in own or each seeking to survive and make money at the stock exchange. Then one if you have dynamic competitive players who wants to make money and have markets. Many have regulated a capital market a priority that is dependant which have ended in participation and then they left that market. Then still going to make mistakes but if you think you'll appoint only brokers so you are not going to make mistakes…

Appendix 5

Interview with Mr. Simon Stockley

Mr. Issam Al Tawari: We are … We're on tape now.

Mr. Simon Stockley: Ok

Mr. Issam: Ok Simon... I am doing an assignment which is a pilot study for my thesis for my doctorate with Durham University and the purpose of the pilot study is to first start basically gather sort of the main trends in the market about an issue and then basically from there my research will basically go deeper into the study. The title of the study is about "what factors affecting the development of the debt capital markets in the MENA region". This going to be a semi structured kind of discussion, and informal you just give me your views, your insights, your experience. I have a list of around 10 questions and we can take it easy the way you like it to be. Just for the records this is Mr. Simon Stockley. Mr. Simon let's just start by, just give me a brief background about yourself.

Mr. Simon: Sure … I am a lawyer by profession, and got involved in the capital markets in South Africa in round about 2000 and was responsible for the first securitisation in South Africa which was the first full planed securitisation done in outside of Europe, America or Australia. Being developed a sort of specialization in emerging markets, so I kind of concentrated on other capital markets and then ended up in the Middle East back in 2005 where I worked transactions for Dar Al-Arkan. A small pilot transaction which was securitisation of some Ijara leases then went back to South Africa and did a bit more work on the capital markets and then I'm currently back in the Middle East working on a structured finance transaction for Deutsche Bank.

Mr. Issam: Very good

Mr. Simon: So yes, I mean I now, I guess my specialization is emerging markets and then within the subset of the emerging markets I do have I guess 3 years' experience in the MENA region but predominantly Saudi Arabia, Issam.

Mr. Issam: Ok, very good. Thank you very much. Simon! What is your definition of debt capital market in the MENA region? I mean, whether it's was Islamic or conventional? I mean how do you define the capital market in the MENA region.

Mr. Simon: Well I think to define debt capital markets I think you need to include both Islamic and non-Islamic. If you're looking at MENA, I think within the subset of MENA you know there are specific markets like Saudi and to an extent Kuwait, where you can't talk about anything other than Islamic. But I don't think, you know, you can regard the whole of MENA debt capital market as Islamic. I think that would be a mistake, but within that subsets of MENA I think there are particular markets where you can only talk about Islamic, I mean you know, you have not got chance of or structure any kind of transaction inside of Saudi Arabia or outside of Saudi Arabia that is not just Islamic.

Mr. Issam: What sort of products are we talking about when we are talking about debt capital markets in MENA region?

Mr. Simon: I think my area of focus is obviously asset backed, I mean you know I tend to concentrate on residential mortgages. But kind of I've looked at consumer finance, you know auto loans, receivables, I haven't done much commercial. it's not the kind of asset backed. And obviously what has been the framework of Islamic structuring, I mean you know, they trying always to be the *sukuk* kind of nature. So yes, I think I concentrate on asset backed structure kind where I am right now.

Mr. Issam: Who are the major players in your view?

Mr. Simon: On a regional basis?

Mr. Issam: On a regional basis? and how would you categorize them as well?

Mr. Simon: Look, I think the charge was obviously led by Dubai pre the crash. And you know the major impetus was coming from the developers so people like you know Amlak, Tamweel was kind of where the trust was. You know that's you know first, the Dubai meltdown, you know, the whole market seems to have stagnated and the whole market doesn't seem to be you know, see any huge amount of activity. And having said that, I mean my overriding impression of the market here is people make the fundamental error of regarding it as a matured market because they get seduced by the size and the volume of the issuance as they try to make their way to the debt capital market. You know, by companies like SABIC or Dar Al-Arkan whom I did some work for, you know for me the fundamental understanding of this market is that it's an emerging market as well I mean yes there may be a huge amount of liquidity in the market but that liquidity disguises as the fact that this is an emerging market. And there have been relatively few transactions done. And I think people make the mistake of believing because you know the transactions are essentially big ticket in price that the market is mature and it's not. So you know, the market faces the difficulty that all emerging markets face of liquidity, investor confidence and need for education there is kind of huge liquidity sort of un-tapped.

Mr. Issam: How would you compare the current status of the market with your South African experience for example?

Mr. Simon: Yes, I think very similar, I think you know obviously the market in South Africa is smaller in scale and obviously does not have an Islamic component but I mean it was kind of pre the crisis. But it was all about establishing investors' confidence and building momentum and it was always you know the first 10 or 12 transactions but with difficult transactions once those transactions happen the rate of the acceleration and the expansion of offerings a cross kind of products classes from the pure asset backed classes to the synthetic happen remarkably quickly. You know and I think the MENA region was starting to get to the point of that kind of critical mass you know confidence was coming into the market, the rating agencies were getting involved and then you know the crash happened so I think going to have to start all over again, which is kind of hardly unfortunate. In South Africa, we kind of got to the point where there was critical mass and there was no I mean, the market sort of stagnated for a period of time, but did not actually impede it. So, you know there are now new issuance is coming back into the market, yes the spreads are wider but the market kind of maintained investor confidence and remained pretty much intact, where is I think MENA is going to start all over again and has not, faces a difficult period given you know what has happen kind of globally. But the fallout in Dubai with Dubai world is going to have a far reach in kind of impact. So, I think yes, the region will have some challenges.

Mr. Issam: Talking about challenges, can you elaborate more on the challenges that are facing the debt capital market in the MENA region?

Mr. Simon: Yes, I mean you know obviously you have to examine the region in relation to the product of the debt capital markets I mean no market is [] to global forces I think you know you start contextualizing the market in relation to what it happens to debt capital market kind of globally. I mean this is the first challenge.

And the second challenge Is that you know the MENA region pre-crash haven't reached that point of critical mass that I spoke about in terms of South Africa. So, it's almost going to start all over again then I think the Dubai experience some of the larger corporate defaults and some kind of frauds that has happened in Saudi Arabia. I've also wrote it in [] confidence so you know I think it's going to be you know the usual challenges one of establishing confidence, establishing transparency, establishing liquidity. But it's going to be, you know, harder than it would have been if the crises did not happen, but I don't think there are any specific issues, you know, the region faces that doesn't face any other kind of emerging markets being South Africa faced, being Australia faced and being what kind of America faced. And I think, having said that, there are some underlined kind of fundamentals you know if you look to population growth, you know liquidity in the market looking for [] investments opportunity, I think there are couple of factors working in the favour of the market but it's going to take time it's not going to happen over the night.

Mr. Issam: very good, Simon what do you think the rules of regulators or what will be the rule of the regulators in developing the market? I mean one would say that probably one of the reasons why the market hasn't developed is because there is no established legal framework for the debt capital market to grow or securitisation to happen. And one will argue what comes first is it the practice the transactions coming to the market and then the regulators will come to regulated or somebody else would say regulators known to be lazy they always come after the fact, it's always when something happens to the market then the regulators will turn their attention into it and start regulating it. What are your views?

Mr. Simon: Yes, I mean there was very much in my experience in South Africa when we wanted to do the securitisation, people said you can't do it because you know the is no securitisation regulations. And you know we were faced with the kind of the business decision that we wait the regulations or we actually proceed the structure and issue as best we could in the hope. That the regulator would catch up and you know that was the course of action that we followed. I mean we put together very large transactions you know it was significant enough but the regulator couldn't ignore it. We had significant shareholders, in that one of our shareholders was the International Finance Corporation another one was JP Morgan and the other shareholder was one of the largest local of retail banks. So the regulator was forced to take and we kind of launched the process in the press and said this is what we are going to do and we recognized the regulations does not exist but we are going to work with the central bank and we wanted to be regulated and we created the right, I guess political climate. And I am sure that they processed the regulation and they kind of caught up and that has been the message that I have tried to bring in my interactions to the Middle East. Because I think there is a tendency in MENA for people to sort of say that: we can't do that because you know the regulations does not exist. And what I have tried to be sort of pragmatic for the last five or six years in the region is no put together as put together the transactions take these transactions if they are significantly large and scalable to the regulator and the regulator will follow. I mean don't let the regulator lead, let the regulator follow I mean that was my particular, you know, view based on my personal experience.

Mr. Issam: Simon do you think that debt capital markets is a niche kind of activity where needs specialized institutions? or do you think this is again for the big players the global players to undertake and move forward? what you think I mean I am just going back to issue of who are the major players in terms of originating, arranging and placing?

Mr. Simon: I think yes it works best when you combine the skill sets, I mean you always need you know local knowledge and local specialization but you also need to reference kind of what is happening globally. So, I think the structures and the transactions that worked the best I mean if I look back to the I mean it was this small transaction it was US$28 million and the KSA transaction. I mean HSBC when I've arrived were working on it for about 3 years but they kind of been working on it from first London perspective. And I mean of course, that was 5 or 6 years ago in Saudi. I mean you know, with different kind of world. And early when I appointed South African Merchant Bank to assist to structure the transaction that experience you know operating on global skills but also had experience in kind of the emerging markets. But we were actually able to close the transaction because they kind of have the ability to take what was this practice in kind of London and New York and apply it to kind of local market conditions so I think the combination of both I think you obviously always reference what is international best practice. But you have to also take [] of kind of local market conditions but it doesn't help to say you know we need a trustee. I mean a trust company not exist it kind of its where your able to combine the two so I will argue the kind of pledge.

Mr. Issam: Very interesting, Simon imagine yourself part of a group of a think tank and you've been given the assignment of basically putting the recommendations to develop the debt capital market in the MENA region and to influence the different stakeholders with investors, issuers, rating agencies, regulators or the general public and putting it in this kind of context. What would be your recommendation and what would be the action plan for that to take effect?

Mr. Simon: My particular frame of references is always been, you know, commercial, you know, I am not a big fan of, you know, regulations and ¸you know, in creating the right environment. I think you develop the markets by finding a couple of transactions that make commercial sense and actually doing those transactions. And you know, it's through that process of doing and, you know. I can only recap my experience in South Africa, I mean you know, South Africa has a sophisticated banking sector, it has a sophisticated and mature stock exchange and, you know, up until 2000 nobody has done a securitisation transaction. And people kind of kept going well, you know, why haven't the banks done I mean if it's that straight forward. I mean, why I mean there must be a reason why it can't be done or you know [] you are kind of coming along when relaxed days and banks have worth billions and billions of dollars and haven't been able to put a transaction together. It really was just the function of not believing all of that and just doing the whole punch of transactions once they were done people kind of followed. You know, were regulator or where I was involved in a think tank, I would be trying to identify couple of players and try to assist them actually just getting a couple of transactions done because you know it's only in the doing that you educate the public, educate investors and educate issuers. You just got to get them done it's that simple.

Mr. Issam: And by doing that basically what do you think I mean what would be the benefit to regulators for example, what would be the benefits to investors, what would be the benefits to issuers basically, if this basically is developed.

Mr. Simon: Well look I still fundamentally buy into the theory of the debt capital markets, it all comes down at funding and to a variety of specialist originators and services it doesn't necessarily have the kind of required capital base, you know, it promotes competition. You know competition is fundamentally healthy. Competition drives down pricing and kind of ultimately low pricing benefits all kind of consumers, I mean I am still not with the standing experience in America, not with the standing the []. I still fundamentally by the fact that these are efficient mechanism, I mean yes you know. I mean unfortunately the Americans just developed the efficiency to the point where it was over engineered and over efficient. But properly structured, properly regulated you know these are efficient mechanism that provides competition and drop down pricing ultimately to the benefits to all consumers.

Mr. Issam: Simon, I mean was there a question that you wanted me to ask you and I have not asked you?

Mr. Simon: I guess the billion-dollar question is how long it is going to take to establish a meaningful kind of debt capital market in the MENA region and the honest answer to that is simply I don't know I mean I am glad that you didn't ask me the question.

Mr. Issam: I mean just to take this question one step forward. I mean how long did it take for examples markets like South Africa, like China and like Russia to develop to the level where they are today?

Mr. Simon: Its always I mean, it's the first 2 to 3 years that are the kind of difficult years and then like there been the market kind of accelerate and expands rapidly so I mean it's the period of getting to the []. The real shame about the MENA region is that it just with the starting and to develop and to starting look and feel like it could get to that [] and then the crises happened so it's kind of almost going to start all over again. So, if you ask how long I can't see anything of significant before 2014, 2015.

Mr. Issam: And if you have a crystal ball which market would be... will basically will lead the way in the MENA region?

Mr. Simon: It's going to be Saudi. I mean to me it's the real economy, I mean its 50% of the population, 50% of the []. You know there is a real economy here that has the right underlined fundamentals you know young population and yes it got some challenges in terms of work ethic you know overly regulated but I mean it is for me the engine that drives the MENA region that's my particular view. Sorry about Kuwait.

Mr. Issam: No, no don't think of it we are always taking it as GCC wide. But what about markets like Egypt and Turkey? I am talking about it is where we have more population basically?

Mr. Simon: I mean I think Egypt is going to have to work its way through you know a lot of political issues with the next coming years I mean I can't I think it's going to be a further inhibitor. You know Turkey is an interesting [] I visited I a couple of occasions, I've spoken in a few conferences there and you know it always seems to be a bad [] and I don't quite understand the reason for it. Now if I want to bit I think on Saudi its where the liquidity is and that would be where I will concentrate my efforts.

Mr. Issam: and where do you see North Africa I mean in the past three four years there were attempts to do securitisation in those markets. What are your views about North Africa?

Mr. Simon: I think North Africa is also now got some political issues that it's going to work through. You've got you know the added complications there of you know dealing with the you know a Napoleonic code. but I don't know North Africa markets particularly well so I would argue that like Egypt I think there is going to be like caught up in resolving kind of political issues over the next couple of years and yes, I don't see them [] well. Yes, you can't [] Turkey I mean I thing you're right you can't [] Turkey but I'm still biting on Saudi Arabia.

Mr. Issam: Simon one final question, OK, when you were talking about developing the market you said it needs building confidence and increasing volume and I also would like to quote a similar comment by another person who I have interviewed where he said it needs dedication and commitment. I mean by whom, who are you referring to here when you said it needs increasing the volume, I mean is it by southern issuers is it by corporates? By whom?

Mr. Simon: I think it’s by you know its pilot players in the market [] you know I always going to bring it back to my sort of personal experience I mean I did before I [] I think []
But I mean I see, I would see investors [] I would see investors, the fund managers, [] funds, [] funds, the money market funds. I would see them four times a year over the [] non deal specific just keeping you know investors, players to what was happening internationally and just keeping them contact just talking about markets talking about what we were doing you know are competitors are doing. And you know that kind of investment it takes time it takes commitment and it takes money but it kind of works out in a long []. I think you know my experience in MENA is been a little bit sometimes over short sighted and people are not been prepared to put in you know the commitments around investing educations, rating agencies education, they came on to concentrate on specific [] specific transactions. You know if you going to invoke in this sort of a program you need to start now and it will take you 3 to 4 years before you even in a position to place something. You know it takes a sizeable investment in terms of time, money, it’s not a short-term quick solution

Mr. Issam: Fascinating Simon. Thank you very much I’ll stop the recording.

Appendix 6

Glossary of Islamic Finance Terms

Amana: Deposit in trust; a widely applied term that refers to anything in the safekeeping of another.

Arboun: Down payment; an advance payment which is counted as part of the purchase price if the buyer decides to complete the transaction, but which becomes the property of the seller if the deal is not completed. Can be used as a form of short-selling.

Bay: Sale; an agreement between two parties in which ownership of an item is transferred from seller to buyer for a price.

Fatwa: Religious opinion under Islamic law - a formal response issued by an expert scholar.

Fiqh: Islamic jurisprudence; it provides supplemental legal reasoning in cases where explicit rules are not available in *sharia* law.

Gharar: Contractual ambiguity due to ignorance of an aspect of the goods, in which one or both parties stand to be deceived. Gharar should be avoided but there are different levels of it and only some of them are banned outright. The concept is cited to ban pure monetary speculation.

Hadith: Report of the sayings or actions of the Prophet
Mohammed.

Halal: Lawful, a deed permitted by Allah.

Haram: Unlawful, impermissible.

Hukum: Ruling. There are five categories: obligatory (*wajib*/*fard*), recommended (*mustahabb*), neutral/permissible (*mubah*), reprehensible (*makruh*), or forbidden (*haram*).

Ijara: Lease or rental arrangement; for example, one party leases equipment, buildings or other facilities to a client for an agreed rent. In a common form of *ijara sukuk*, the originator sells assets to a special-purpose vehicle which in turn issues *sukuk* certificates to obtain funding to pay for the asset.

Ijtihad: Decision-making in Islamic law by personal effort, independently of any school of jurisprudence. To be valid it has to be rooted in Islamic scripture and *hadith*, and there must be no established doctrine ruling the case.

Istijrar: Continuous purchase or supply contract; the supplier undertakes to provide a particular product on an ongoing basis at an agreed price with payment made in an agreed manner.

Istisna: Manufacturing contract; a type of sale, similar to *salam*, in which a price is paid for goods that are subsequently manufactured and delivered on a stipulated date. *Istisna*-based *sukuk* are commonly cited for use in infrastructure and project financing.

Kafala: Guarantee; a standard Islamic transaction in which a guarantor (*kafil*) agrees to assume responsibility for the debts of a creditor (*makful 'anhu*).

Khiyar: Option; power to cancel a contract. Jurists recognize different types including *khiyar* al *ru'yah* (option to cancel upon viewing), khiyaral'ayb (option to cancel if undesirable), *khiyar* al *naqad* (option to cancel on non-payment), khiyar alshart (option to rescind sale), and *khiyar* al *majlis* (option to cancel during the life of the contract).

Maqasid al sharia: The higher purposes of *sharia* law, which is believed to be built on three objectives: purification of the soul, upholding justice and protecting interests of all sides.

Maslaha'ammah: The public good or benefit.

Maysar: Gambling, which is impermissible.

Mudaraba: Investment management partnership; one party provides funds while the other provides expertise and management (the *mudarib*). Any profits are shared between the two parties on a pre-agreed basis, while losses are borne by the provider of the capital. *Mudaraba* is a common structure for *sukuk*.

Mudarib: Investment manager.

Murabaha: Cost-plus sale; a financial institution agrees to purchase merchandise for a client and the client promises to buy it from the institution at an agreed mark-up. In a common form of *murabaha sukuk,* a special-purpose vehicle is set up to raise funds from *sukuk* holders and purchase an asset, which the SPV will in turn sell to the originator at a mark-up. The originator takes delivery of the asset and makes periodic payments to the SPV, which flow to *sukuk* investors.

Musawama: A negotiated sale, in which the price of a commodity is negotiated without overt reference to the price previously paid by the seller.

Musharaka: Investment partnership. In a typical *musharaka* agreement, two or more parties agree to provide capital towards the financing of a commercial venture, share profits according to a stipulated ratio, and share losses on the basis of equity participation.

Qard: Loan; X lends Y some wealth to be repaid after a specified amount of time, but which can be reclaimed at any time. It is legitimate for a borrower to repay more than the amount borrowed as long as that is not stated as an obligation in the contract; some Islamic banks cope with this constraint by charging servicing fees on loans. A "*qard hasan*" is a loan in which no additional amount is repaid.

Rabb al mal: Owner of capital, investor.

Riba: Interest; any increase in a loan or sale that accrues to the lender, seller or buyer without the provision of an equivalent counter value to the other party. *Riba* is impermissible; the term encompasses various types of illicit gain, of which banking interest is one example.

Salam: Deferred delivery sale, the sale of fungible goods to be delivered in the future for a price to be paid in the present. It resembles a forward contract in conventional finance.

Sharia: Islamic law originating in Islamic scripture, as defined in practices and explanations by the Prophet Mohammed.

Sukuk: Islamic investment certificates; a term used to describe equivalents to conventional debt issues such as bonds. In contrast to debt issues, *sukuk* holders are the legal and/or beneficial owners of the underlying assets, sometimes through a special-purpose vehicle. As such, they receive the equivalent of a coupon from the performance of the yielding asset.

Sunna: The actions, deeds, endorsements and characteristics of the Prophet Mohammed.

Takaful: Islamic insurance, an alternative to conventional commercial insurance based on the concept of mutual support. It provides mutual protection of assets and property; the *takaful* company oversees a pool of funds contributed by all policy holders, but does not necessarily bear risk itself.

Tawarruq/tassiyeel: Monetisation, to convert something to cash. One party purchases an asset on credit from a second party on a deferred payment basis, and then sells it on to a third party, receiving instant cash. Used by some Islamic banks to provide cash financing to customers (also known as "commodity *murabaha*"). In "organised" *tawarruq*, the first party does not take material ownership of the asset; this is controversial among some scholars.

Wa'd: Unilateral promise; the primary difference between this and a contract is that the promise is binding only on the maker of the promise, whereas a contract binds both parties.

Wakala: Agency; a standard Islamic practice where one party acts as an agent (*wakil*) for another. In a *wakala sukuk*, certificates are issued by an originator to purchase specific assets, which in turn are given to a *wakil* for management (who charges an agency fee, which can include a performance fee). The originator undertakes to buy the assets at maturity at an agreed price.

Waqf: Charitable trust, an endowment set up for Islamic purposes (usually for education, mosque building or the poor). It involves tying up a property in perpetuity so that it cannot be sold, inherited or donated to anyone.

Zakat: Zakah tax, the third pillar of Islam; obligatory alms giving. Every Muslim who has wealth above a prescribed amount is required to give money to the Islamic authority for distribution to the poor and the needy.

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