

# The ambivalent Indonesian Islamic capital market

Indonesia’s Islamic finance landscape is developing very slowly. One of the country’s biggest weaknesses is in its corporate Islamic capital market. When looking at raising funds, companies overwhelmingly turn to conventional bonds. However, MARC ROUSSOT finds that this may be gradually changing.

The Indonesian Islamic capital market is either vibrant or lifeless depending on which side you choose to look at. On the governmental side, the Republic issues Sukuk twice a month under its Sukuk series SPN-S. Since January, Indonesia has raised IDR87.31 trillion (US\$6.55 billion) and had sold IDR111.47 trillion (US\$8.36 billion)-worth of Islamic papers in 2016.

On the corporate side however, it is a completely different story. Between 2007 and 2016, company Sukuk issuances per year ranged from IDR100 billion (US\$7.41 million) to IDR4.32 trillion (US\$323.94 million). So what are the reasons for this tremendous gap?

Eva Muis, the senior director of business and relationship management at Fitch Rating Indonesia, points to the weak demand for Sukuk. Hendro Utomo, the director of Pefindo Credit Rating Indonesia, on the other hand believes this is due to the very conservative or traditional profile of Indonesian investors. “Corporate bond investors are mainly pension funds that are not very keen in understanding new products and types of instruments,” he shares.

“Moreover, in a country where Islamic banking assets account for a mere 5% of the nation’s total banking assets, is it surprising to see such a subdued corporate Islamic capital market?” asks Hendro. “Even though Indonesia is home to the largest Muslim population in the world, the level of Islamic finance penetration is very low,” he says.

The lack of interest from investors could have been palliated by higher yields for

Sukuk but returns for bonds and Sukuk are pretty much at par, according to Indonesia Bond Pricing Agency’s data.

**“ Last year, the government decided to remove the income tax on sovereign Sukuk proceeds. This measure should be extended to corporate Sukuk ”**

## A slow growth

From an investor’s perspective, besides the fact that the demand for Sukuk is weak and that Islamic papers are as expensive as bonds, the complexity to structure a Sukuk facility makes it less attractive as it extends the time to market. Also, Sukuk and bond ratings are at par. Hence, Sukuk have no comparative advantage over bonds.

That being said, the amount of Sukuk issued since 2015 has been growing in value and in numbers. From IDR920 billion (US\$69.07 million) in 2014, the amount issued jumped to a whopping IDR3.27 trillion (US\$245.49 million) in 2015, IDR4.32 trillion (US\$324.31 million) in 2016 and IDR3.17 trillion (US\$237.98 million) as at the 26<sup>th</sup> May 2017, while on its way to establishing a new record.

The election of Joko Widodo as the president in July 2014 seems to be key, given that “nothing changed on the regulatory side,” according to Irwan Abdalloh, the head of Islamic capital market development at the Indonesia Stock Exchange.

“This increase is a consequence of Widodo’s administration. Given the good business climate due to a certain stability, the fight against corruption and Indonesia’s growing economy, companies are keener to raise debt via Sukuk,” believes Abas A Jalil, CEO of financial advisory firm Amanah Capital.

Also, state-owned and government-linked companies are encouraged by the current administration to tap the Islamic capital market. As an example, in May 2016, Otoritas Jasa Keuangan (OJK) called for 53 out of 119 state-owned firms operating in the infrastructure sector to auction Sukuk. However, it has yet to materialize.

Another key factor is that companies are more familiar with Shariah securities as corporate Sukuk have been floated for more than 10 years already, setting the precedent for the private sector to raise funds in an Islamic manner.

## Calling for reforms

Even though companies appear to be bolder and keener to auction Islamic papers since 2015, the Indonesian corporate Sukuk market remains extremely small in comparison with its conventional counterpart. The issuance of Shariah securities represented only 5.45% in 2015 and a mere 3.86% in 2016. Nevertheless, this would likely change with the current government, and more precisely with OJK that is pushing its agenda to create awareness of Islamic finance and simplify the issuing process.

But even that may not be enough; the government should think of implementing incentives and tax exemptions, according to Farouk Abdullah Alwyni, CEO of Alwyni International Capital. “Last year, the government decided to remove the income tax on sovereign Sukuk proceeds. This measure should be extended to corporate Sukuk,” he says. Double taxation issues are also not fully settled. In 2009, an amendment addressed Murabahah transactions, but not Ijarah.<sup>(5)</sup>

Table 1: Corporate issuances per year (IDR trillion)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Corporate bonds	30.35	11.65	28.64	35.8	45.64	65.66	55.29	47.82	60	111.86	40.01
Corporate Sukuk	1.03	2.45	1.78	0.8	0.1	1.98	2.20	0.92	3.27	4.32	3.17
Ratio	3.39%	21.03%	6.22%	2.23%	0.22%	3.02%	3.98%	1.92%	5.45%	3.86%	7.92%

Source: OJK (2017 figures as at the 26<sup>th</sup> May 2017)