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Investigating the Challenges of Financial Instruments in Iran's Capital Market

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Abstract

Pathology of the failure of the financial instruments of Iran's capital market due to the wide applications of these instruments at the governmental, corporate, and individual levels is an important but little-known topic in academic studies. In recent years, the treatments of examining the issues facing the development of financial instruments have taken a more comprehensive and data-oriented form. Still, most previous studies in this field have only dealt with the challenges of designing and publishing Islamic financial instruments, which will move away from its goal without considering the previous failures. Research outside Iran has generally addressed this issue from the perspective of innovation in the financial sector, and domestic research has often dealt with this issue from the perspective of structural and interfering problems in the Iranian market. One of the challenges of pathological study in this topic is the weakness of databases, the lack of a comprehensive database, and the conflict between existing databases, which hinders the analysis of trends and diagnosis of the causes and areas of damage. In the present research, the failed and unregistered financial instruments in Iran have been addressed. The discussion on financial instruments is broad and dynamic globally and has a rich history. Paying more attention to this significant and neglected topic in academic research is appropriate.

Keywords: Financial instrument, Iran's capital market, Failure, Innovation.

1 | Introduction

The history of financial instruments can be traced back to the invention of money (coinage and then paper money) and the prevalence of virtual currency[1]. An overview of instruments is presented in *Table 1*[2].

[1] The evolution of financial instruments and the legal protection against counterfeiting: a look at coin, paper, and virtual currencies.

[2] Wikipedia

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Table 1. Financial instruments.

Asset Class	Instrument Type			
	Securities	**Other Cash**	**Exchange-Traded Derivatives**	**OTC Derivatives**
Debt (long term) 1 year	Bonds	Loans	Bond futures options on bond futures	Interest rate swaps interest rate caps and floors interest rate options exotic derivatives
Debt (short-term) ≤ 1 year	Bills, e.g. T-bills commercial paper	Deposits certificates of deposit	Short-term interest rate futures	Forward rate agreements
Equity	Stock	N/A	Stock options equity futures	Stock options exotic derivatives
Foreign exchange	N/A	Spot foreign exchange	Currency futures	Foreign exchange options outright forwards foreign exchange swaps currency swaps

But the number of instruments in the world is much more than this. Expectedly, financing methods (the main purpose of designing instruments) are more limited in Iran's capital market. Not all these instruments are booming everywhere. Various challenges and obstacles can stand in the way of the spread of financial instruments and cause them to fail and not reach the goals they were designed to achieve. In this research, we intend to address some of these challenges. Financial instruments are one of the most important ways of financing and, perhaps more important than that, risk coverage for individual & legal entities. Studies on these tools have taken a more serious and systematic form since the 1970s, and today, industrial engineering and optimization methods are widely used in this discussion. In the rest of the article, we will start by reviewing the literature of studies outside Iran (generally the United States) and then articles related to Iran. Almost all foreign studies have looked at financial instruments from the innovation perspective.

What conditions increase innovation in the financial sector, what type of institutions show more interest in this work, and what challenges face the adoption and expansion of innovations (including legal challenges)? In Iran in the late 2000s and early 2010s, some studies were conducted on the risk of Islamic financial instruments. After that, the majority of studies have focused on the feasibility of using Islamic financial instruments from a legal and jurisprudential point of view. In recent years (early 2020s), examining the issues facing the expansion of financial instruments has taken a more comprehensive and data-oriented approach, but the number of research in this field is still very limited. The results of the interview with experts in the field of financial instruments in the Iranian market are presented below. This research aims to investigate the problems and challenges of financial instruments in Iran and to demonstrate some of the problems of this type of study in Iran.

2 | Literature Review

Studies related to Iran: Studies related to the risk of financial instruments in Iran have been very limited in number. The author found only three articles with limited research areas in this section. In an article, after introducing various aspects of rental Sukuk, researchers analyzed its risks and suggested ways to cover some of them. They also acknowledged that in designing any Islamic financial instrument, attention should be paid to the five aspects of jurisprudence: legal, financial model design, risk management, accounting, and taxation [1]. In another paper, researchers studied the operational model of Islamic mortgage bonds and their financial and non-financial risks from the perspective of investors and founders (banks and leasing companies) [2]. The risks of Muzarabah securities (Muzarabah Sukuk) have been examined with an emphasis on the Jafari [3] school of jurisprudence. In an article titled "Investigation of the causes of lack of acceptance and dissemination of innovations in Islamic financial instruments in the capital market of Iran," after categorizing the obstacles to the promotion of new Islamic financial instruments with a domestic design (establishment) approach, the introduction process, components and effects of a new financial instrument in the market Capital is investigated. In its conclusion, this research enumerates hindering factors in the success of innovation in Islamic financial instruments, such as structural barriers, legal barriers, jurisprudential challenges, policy barriers, market barriers, technical and specialized barriers, marketing and operational barriers [4]. In the paper "financial market regulation tools in Iran and England," a comparative study between the regulatory tools of the two countries of Iran and England, it is stated that despite the similarity of regulatory tools and methods due to the common and similar dual purpose (market control and reducing government interventions in the market), the difference in the political, economic, social and technical infrastructures and the lack of preparation for these things in Iran has caused the government of Iran to fall into an ineffective cycle (strengthening the financial market to provide capital for privatization - privatization to strengthen the financial market). The lack of preparation for the items above troubles the criteria for properly regulating financial markets, such as risk reduction, transparency, investment support, etc, [5].

In a study, the passive susceptibility of the capital market to the government's method of managing its debts and not using Islamic financial instruments has been criticized in detail [6]. In the article "development model of new financial products in the capital market of Iran," an attempt has been made to present a comprehensive picture of the development of new financial products and instruments in Iran's capital market using a marketing approach. Using the grounded theory approach and by asking experts, this article has extracted the concept categories related to this issue: intervening conditions, causal conditions, strategies, contextual conditions, central phenomenon (stages of financial product development), and other [7]. In the article Classification of compound financial instruments based on Accounting Standard 36", the answer to the question Is the distinction between compound financial instruments (with debt and equity characteristics) important?" was researched. It was concluded that the requirements of accounting standards affect the choices of companies regarding the structure and financial instruments as well as the classification of investors' decisions [8].

Studies unrelated to Iran: The development of financial instruments originated in the real sector. Expressing that the research on innovation in the financial sector has not been done much compared to the real sector, Ben-horim, and Silber predicted by using industrial engineering tools (linear programming) that the increase in innovation had a direct relationship with the increase in shadow prices. In other words, the driver of innovation was considered to be the opportunity to earn a profit [9]. By examining the data between 1990 and 2002, Lerner [10] concluded that small and unprofitable institutions make the absolute majority of financial innovations, but over time and with the introduction of innovations, the profitability of innovators increases. Lerner and Tufano [11], referring to the Islamic Sharia law in areas such as Saudi Arabia and the Persian Gulf, point out that no innovation can be used systematically and widely unless it is first widely and fairly accepted. Khalator et al. [12] examining 39 countries (including two developing countries, Ukraine and Moldova), have reached the same result as previous research at the country level. In 2018, Ukraine ranked first in one of the innovation indicators. These financial innovations are a way to expand cooperation and sustainable economic growth. Callens has addressed the relatively new-fashioned phenomenon of cryptocurrencies and examined the legal definitions and theoretical framework of classifying these phenomena concerning the laws of the European Union. He regarded them as a liability (debt) similar to traditional assets [13]. Dan Perbankan [14] presented an alternative to external debt using Islamic financial instruments in a case study of Indonesia's budget deficit policy. By examining empirical data, Gentsoudi [15] has investigated the impact of effective management on the financial instruments of the Greek public sector. Therefore, the literature on the subject can be summarized as follows. In the developed countries' studies, the subject is discussed from the perspective of innovation in the financial sector and the comparison of different companies concerning it. On the other hand, the Iranian market is examined from the perspective of structural and legal problems and interfering factors.

3 | Research Method

This research is mixed (quantitative and qualitative) regarding the data type. In the quantitative part (which was not helpful, as it will be shown), real data from Iranian capital market authorities and unstructured interviews with experts have been used in the qualitative part.

4 | Findings

When searching for numerical data, we faced some serious challenges. First, the data on every financial instrument is not easily available, and the researched websites do not show any interest in disclosing failed instruments. Secondly, there are conflicting results between the references of this endeavor. For example, the website of financial information processing of Iran[1] shows the number of funds as 391. The website of the Tehran stock exchange[2] has listed about 50 funds in one entry and a much smaller number on another page[3]. Tehran securities exchange technology management Co's website[4] has also presented its own unique and different categories. In the current research, an effort has been made to use the most complete and comprehensive source. It should be said that these conflicts, inconsistencies, and lack of information troubles research on trends, causes of success and failure, and analysis of external factors' effects. Since the quantitative data of Iran's capital market was not ideal and analyzable, a list of problematic instruments was extracted using several unstructured interviews with experts in risk and financial and money markets. The presented list is in the two columns of failed instruments and unregistered tools in *Table 2*.

Table 2. Failed and Unregistered Instruments.

#	Failed Instruments	Unregistered
1	Gold coin futures	Foreign currency securities
2	Gold coin certificate of deposit	Swap
3	Saffron certificate of deposit	Interest rate instruments
4	Real estate investment trust	
5	Project fund	
6	Partnering project	
7	Mixed fund	
8	Leverage fund	
9	Convertible bond	

The above table needs to be completed and reviewed in various ways. The failed tools section can be highly expanded, and the unregistered instruments are just a few examples of the tools that have been rumored and promised (except for interest rates) but have not come to fruition. Investigating the causes and factors of each unregistered failure requires a dedicated study of that instrument. The literature review showed that many tools have problems and legal or jurisprudential issues. Some tools also face legal problems. Infrastructural and technical challenges can also prevent a number of tools from working properly. Larger policy-maker (or political) actors also play an interventionist role in their place. Finally, market and marketing challenges can also be mentioned as an important factor.

5 | Conclusion

Scientific studies on the risk of financial instruments in Iran have been very limited in number. This phenomenon has led to the lack of progress in risk hedging methods and the lack of effective prevention of the failure of various tools in recent years. Most of the last two decades' research has been on Islamic financial instruments and exploring the obstacles to developing indigenous products. According to the authors' research, there has not been any significant research in pathology on the failure of tools in Iran. One of the challenges of pathological study in this topic is the weakness of databases, the lack of a comprehensive

[1] https://fund.fipiran.ir/mf/list
[2] https://tse.ir/MarketWatch-ang.html?cat=etf
[3] https://tse.ir/listing.html?cat=etf&section=alphabet
[4] https://tsetmc.ir/Loader.aspx?ParTree=15

database, and the conflict between existing databases, which makes it difficult to analyze trends and diagnose the causes and areas of damage. We hope that with the improvement of databases and the increase of studies in this field, we will witness the presentation of more solutions to deal with the failure of instruments in the market, as well as the increase in diversity and the development of proper usage (risk coverage instead of profiting from fluctuations). For future research, it is suggested that solutions be found to collect different data, identify all obsolete tools, and, more importantly, combine this topic with risk literature.

Author Contribution

The authors have equally contributed to this study.

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Data Availability

The authors will supply the supporting information upon request.

Conflicts of Interest

The authors declared no conflicts of interest regarding this work.

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