

ANALYSIS OF MODERN ISLAMIC FINANCE INSTRUMENTS (ATTORNEY SUKUK) IN OIL, GAS AND PETROCHEMICAL INDUSTRIES

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Abstract: Today the key role of oil, gas and petrochemical industry in the development of countries, increasing need of human societies to its products, has attracted the attention of countries to the construction of manufacturing factories and attracting investment into this industry. However, in the current situation in Iran and various sanctions by Western countries, investment in Iran is facing serious challenges; so the use of local resources, especially capital market capacities can be effective in financing the oil, gas and petrochemical industry. The present study, using the descriptive method is following to confirm the hypothesis that it is financially, legally and operationally feasible to design and issue the law securities as a new Islamic financial instrument in the oil, gas and petrochemical industry. Results of the study indicate that the proposed law securities model, in compliance with risk management strategies, is a useful tool for various financial needs in the oil, gas and petrochemical industries including the provision of working capital and financing the plan.

Key words: New tools for Islamic finance, Sukuk attorney, Oil, Gas, Petrochemical industries.

INTRODUCTION

The fundamental role of oil, gas and petrochemical industries in the growth and development of the country is not hidden to anybody and increasing human need to fossil fuel and oil products has attracted the attention of countries to itself. Despite the political and economic sanctions, investment in oil and gas and petrochemical industry is facing challenges. Therefore the use of local resources, especially capital market capacities can be effective in financing these industries. One of the most important features of these industries is its high value-added; meaning that with chemical and physical changes on fossil resources we can increase the value of the products as much as 20 percent. Other features of this industry are variety of Products and thousands of raw material supply for downstream firms; that in terms of employment, foreign currency income and dependence have fundamental role in the country's economy. Fortunately, because of the abundant resources (oil and gas) and other factors, production of petrochemicals in Iran has attracted special attention. Iranian petrochemical products worth has been about 13 billion dollars in 2011, that is predicted to reach \$ 28 billion in the year 2016 and it is expected that the value of exports amounts to

US \$ 21 billion. So in this situation the use of internal resources, especially the capacity of the country's capital market can meet the enormous need for financing these industries. With the approval of the securities market law and the development of tools and financial institutions law in 2009, the capital market has provided infrastructure necessary for the release of a variety of securities. In recent years, Islamic and non-Islamic securities have been proposed as an important tool. One of the types of securities, is the attorney securities that its main functions are financing of projects, liquidity and the supply of working capital in various industries including oil, gas and petrochemical industries. In the design of each Islamic financial instrument the dimensions of financial, juridical, legal, risk management, accounting and tax should be considered.

The necessity and importance of research:

Our country is one of the Islamic countries that with forming juridical committee in the stock exchange organization, has designed some Islamic instruments such as bonds rentals, murabaha, astsna, mortgage, etc. The most important functions of these tools according to the nature of their basis contract are financing, liquidity supply, conversing the assets into securities but as is clear, each of the tools has its

own special application. Nowadays, investment is considered as cash accumulation to start or continue a business, too. Governments and economic companies need to provide investment to start or continue a business. Recognition of the financing methods is important. Choosing the most appropriate method of financing, depends on the recognition of capital markets and the types of financial instruments. The status of long-term financing in the financial structure is so obvious that regardless of that, there is no possibility of financial planning. Financial managers in the design of optimal financial structure pay attention to the policy of financing. Various tools and techniques can be used for financing, that each of them has its own features, advantages and disadvantages and depending on needs, financial capability, the situation of enterprises and people diversification of investments and exposure to risk, these tools and methods are explained and applied. Undoubtedly, countries dependent into the world economy face with severe economic downturn in the meantime, countries like Iran with Islamic banking system adopted less impact of the West financial crisis. Nowadays, Islamic banking system is increasing dramatically worldwide and in most countries, this banking system is working in parallel with conventional banking systems. One of the main reasons for this trend among countries is the expansion of Islam in the world that according to economic principles and ideas of Islam, Muslims around the world tend to deposit their funds in the Islamic financial system and this factor itself caused a boom in Islamic banking. Among the features of this banking system we can refer to adjusting the earnings and equitable distribution of wealth between the depositors and production operators, increasing in efficiency, reducing the production costs, increasing in investment and production and going up the levels of employment and reducing the general level of prices, etc. This new tool is called attorney securities, which is in the financial instruments with expected benefit. Also outside of Iran since 2007 attorney based Islamic securities was introduced upon which various industries including oil, gas and petrochemical can use it to finance a variety of needs.

Research questions:

-Do tools and techniques of modern Islamic finance (Sukuk), have justification for these industries?

-Can Sukuk compared to other methods of financing increase the productivity of capital in the capital markets of these industries?

-Can Sukuk be a proper context for optimal use of existing favorable investments in the energy sector?

Hypothesis of the research:

-From financial points of view, it is possible to design and issue attorney securities as a modern Islamic finance tool in the capital market (for oil, gas and petrochemicals).

-From Juridical points of view, it is possible to design and issue attorney securities as a modern Islamic finance tool in the capital market (for oil, gas and petrochemicals).

-From legal points of view, it is possible to design and issue attorney securities as a modern Islamic finance tool in the capital market (for oil, gas and petrochemicals).

-From operational points of view, it is possible to design and issue attorney securities as a modern Islamic finance tool in the capital market (for oil, gas and petrochemicals).

MATERIALS AND METHODS

This research is based on the applied research purpose and in terms of the way of collecting and analyzing data is a descriptive research. Since, such papers have not been published in Iran, so there is no quantitative research method for these papers thus, according to the research aim, qualitative research methods were used to evaluate the attorney securities.

The research background:

- Mesbahi Moghaddam, Rahimi and Kavand(2010), in an article with legal and juridical investigation have reached the conclusion that partnership securities of the legal dimension are the legal relations based on the law and Islamic Jurisprudence, that in some cases legal strategies have been devised to compensate for the weaknesses. Issuance process of these papers of the legal dimension has no defect and its implementation mechanism, is legally adjustable. We can use legal sanctions and binding the parties to do the obligations by applying the rules and law, To implement the foregoing securities.
- Musavian, Kavand and Radadi(2010) In an article entitled "Partnership securities, suitable tool for the

development of Iran's exports" considered partnership securities as a new way to finance exports and of the legal and juridical as well as economic points of view, have considered these tools as useful in terms of the export financing.

- Bazvkar (2010) with a thesis entitled Astsna papers in Iranian law and Imamia Jurisprudence with a comparative study of public Jurisprudence, at first has raised generalities about sukuk, Astsna contract and papers then has legally and juridically reviewed two main models of Astsna papers issuance including parallel Astsna papers and also Astsna papers and hire-purchase.
- Divandry and et al (2004) in the article "Designing a model to predict in the liquidity management of financial institutions within the framework of lucre-free banking system using neural networks "have used sources and uses approach as operational research models. Then they have designed operational research model referring to the laws and lucre-free banking system regulations.
- Simon and Knight (2007) in an article entitled British government Sukuk issuance, world Sukuk market and the growth of recent UK policy on this matter, have reviewed structure of the types of governmental Sukuk including partnership Sukuk and explained their operating models (quoted from Naieb Yazdi and Mehrasa, 2012).
- Geert Bossuyt (2007) in an article entitled structuring the Islamic financial products, with the introduction of products species, presents operational models for Sukuk types including partnership papers and offers operational strategies.
- Omar Qoqa et al (2008), in an article entitled Sukuks : introduced the start of new Islamic finance, Islamic finance and its components such as the prohibition of lucre etc. and Islamic financial products including investment-oriented products, fee-based, etc. , then presented a report on the distribution of types of Sukuk. In the end, he investigated the types of sukuk including partnership sukuk, operational models for them, related risks and their distribution statistics in

different parts of the world (quoted from Naieb Yazdi and Mehrasa, 2012).

Concept of SUKUK

Sukuk includes the securities that with involving specific physical assets and the establishment of contracts such as leases and partnership , are consistent with lucre-free banking law. Corporate Audit and Inspection of the Islamic financial institutions defines the Sukuk as: "Certificates with the same nominal value that after completion of the underwriting, represent the payment of the nominal amount set forth there by the buyer to the publisher and its owner will own one or set of assets, the benefits of the property or will be the beneficiary of a project or investment activity."

Islamic financial instruments (SUKUK)

Islamic financial instruments (sukuk), are the securities with the same monetary value and can be traded in financial markets designed based on one of the Islam-approved contracts and the holders of securities will jointly own one or set of assets and their profits (Mousavian, 2012).

The difference between Islamic financial instruments (sukuk) and bonds (fixed-income usury securities):

1. Sukuk represents the ownership of a determined asset, while bonds are only indicative of debt obligations. This means that the relationship between the issuer and the bond buyer is the relationship between the lender and the borrower that the loan interest rate is fixed and this is the same as lucre.
2. The assets of the issuance of Sukuk papers must be legally proper and licensed. While in the case of the bond, assets are not accepted in Islam can also be backed of securities.
3. The validity of the bonds depends on the issuer credit and is measured by that, while the Sukuk credit does not depend on the publisher but depends on the value of the backing asset.
4. Sukuk sales in the secondary market, is the sale of ownership of an asset but the sale of bonds is the debt sale.
5. In Sukuk it is possible to increase the asset and therefore increase the value of Sukuk sheet itself, while it is not possible to increase the debt in bonds.

Advantages of using Islamic financial instruments (Sukuk)

Sukuk has several advantages and in some experts opinion, this type of securities is a bridge between money and capital markets. Some of the major benefits of Sukuk are as follows:

1. Increase in founder liquidity (financer by the issuance of sukuk) 2. In case of issuance of Sukuk backed by low liquidity assets or non-cash assets, these assets will be removed from the balance sheet and cash will substitute. 3. Although a portion of the assets is separated of the founder company, yet again, the sponsor can use the asset. 4. Since the sukuk is issued backed by asset it is less risky and also reduces the cost of financing. 5. Support the development of the capital market by providing the possibility to convert assets into securities. 6. If a secondary market is provided to trade these securities, the possibility of liquidity of these securities will increase.

Development Act of new financial instruments and institutions to facilitate the implementation of general policies of article 44 of the constitution

Article 83

- A. The central bank is allowed to, in the framework of the annual budget law to finance developmental and infrastructural government projects proceed to disseminate participation bonds and different kinds of Islamic Sukuk in international markets.
- B. The state corporations and municipalities are allowed to, in the supply of foreign exchange for their investment projects, after the approval of the Ministry of Economic and Finance Affairs and the Central Bank, issue the participation bonds and different kinds of Islamic Sukuk. Guarantee of principal and interest of these securities is by mentioned companies and municipalities.

Therefore, in accordance with paragraph (A) of Article 83 of the Fifth Development Plan Act, the Central Bank can, within the constraints of that article, proceed to disseminate participation bonds and different kinds of Islamic Sukuk in international markets. The Central Bank is the issuer of these securities and since these bonds are released directly by the Central Bank and in the framework of the budget Act and exclusively on international markets, getting permission from the organization is not needed. The state corporations and municipalities are allowed to, in the supply of foreign exchange for their investment projects, after the approval of the Ministry of Economic and Finance Affairs and the Central Bank, issue the participation bonds and different kinds of Islamic Sukuk. Guarantee of principal and interest of these securities is by mentioned companies and municipalities and participation bonds and different kinds of Islamic Sukuk issued merely as mentioned in paragraph (B) of Article 83 of the discussed law

do not need a permit from the exchange organization.)

2. Article 97

In article 97, according to paragraph (23) of the general policies of the Fifth Plan communicated by supreme leader, Money and Credit Council is obliged to, during the program, do the following:

- A. reform of administrative, accounting and finance procedures in the banking system in accordance with the purposes and provisions of lucre-free banking
- B. Promote the use of new Islamic financing instruments such as Sukuk to help to Islamic finance for the country banks

(In paragraph (b) of Article 97 of the Plan Law, merely promote the use of instruments of Islamic finance such as sukuk is permissible and it is obvious that only rejecting or proving "promotion" does not imply the central bank trustee for Sukuk. Meanwhile, the final phrase in this paragraph referring to "contribute to the Islamic financing of the country banks" also makes clear that purpose of promoting is only the proliferation of Sukuk in the banks. Also in this case, merely the participation bonds issued by banks are exempt from registration by the organization (paragraph 2 of Article 27 of the market Act). In other words, promoting the use of Sukuk does not imply the nonconformity of the Sukuk emission provisions and issuance of these papers is possible only within the framework of subject laws and regulations and the security that its publication according to the rules, is not exempt from registration by the organization, must be supplied with the necessary licenses to be offered.)

3- Section 224

Also, the article 224 of the Law of the fifth plan is as follows:

- The adjustment law of the Government Financial Regulations adopted in 2001, and its subsequent amendments and additions with the following corrections and additions will be implemented for the Fifth Plan period:

To provide the foreign exchange resources needed for the plans with technical, economical, financial and environmental feasibility, the state-owned enterprises are allowed to, limited to the figures provided in annual budget rules, accordingly issue the Islamic sukuk papers or partnership exchange bonds in domestic and foreign financial markets in compliance with the regulations of the Central Bank and the ceilings stipulated in Article (81) of this Act. Issuance of the mentioned securities subjects to the approval of the Central Bank and the Deputy and the repayment and guarantee of principal and interest of these securities is by related

companies. Issuance of partnership bonds or Islamic sukuk with incentive profit is subject to the approval of the Council of money and credit.

The current status of Islamic securities (Sukuk) in Iran

Finally, after many attempts in Esfand 89 rental papers were published. First rental papers experience was related to Mahan Air Company that could fund about 30 million tomans in a few minutes. After Mahan, Saman bank and Omid Investment Company also used this tool to finance. Mahan also, with respect to the attractiveness of this method of financing, used this tool for the second time. As I know by early June 2011, there was about 9000 million tomans demand for the release of this tool, but nothing about this amount has been published so far. Of this demand amount, about 5000 million tomans was related to the banking system. Among the reasons of failure to publish this amount of securities by now (despite the high demand), we can mention bank guarantee limits to act as guarantor in the process of issuance of the lease, too much bureaucracy in the corporate office to make accurate and timely decisions, problems related to the company's assets documents and so on.

In addition to the rent papers, at present the regulations of the Interest free loan and Murabaha securities are also almost finalized and will be released in the coming days. Mortgage securities, although designed to finance the banking system and since 2008 we were following its publication, and also the Central Bank had promulgated regulations for that in 2008; finally after several negotiations with the Central Bank is almost finalized. A new tool called oil Salaf is newly designed and the oil ministry is following to publish it which seems to have numerous and complex problems.

History and Statistics of Islamic financial instruments publication (sukuk)

The Islamic Republic of Iran in 1994 prepared the regulations governing the issuance of participation bonds and Tehran Municipality as a publisher, published the first participation bonds to finance the martyr Nawab Safavi highway project. Due to lack of Islamic finance Researchers information about this invention, the idea of using Islamic financial instruments is attributed to early 1997 that is 3 years after the approval of the administrative regulations of Iran publishing participation bonds. Therefore, Iran was the first country to design and publish such tools. Of course, development and design of various types of financial instruments is done by other Islamic countries especially Arabic countries and Malaysia. It is worth noting that

from 2001 to January 2013 it has been published about 7/472 billion Sukuk in the world that about 36/394 billion dollars has been for domestic Sukuk and about 33/78 billion dollars for international Sukuk. The value of sukuk issued in Iran until January 2014 has been more than 15,000 billion rials. The total issued global sukuk according to the regional division from 2001 to January 2013 has been with a value of 472,684 million dollars.

Description of assumptions

Hypothesis 1: It is financially possible to design and issue advocacy papers as a modern Islamic finance instrument in Iran's capital market (for oil, gas and petrochemicals).

In terms of financing, oil, gas and petrochemical industries have diverse needs that the most important ones are:

1. Financing Projects

Oil, gas and petrochemicals due to the nature are project-based industries. Hence these industries for the financing of medium and long-term projects such as the construction of petrochemical, refining plants, etc., can use some kinds of Sukuk;

2. Financing for the purchase of capital and consumable assets

Many industries such as oil, gas and petrochemicals need financial resources to purchase their required equipments. In many cases, limited internal resources make companies finance from the sources outside of the company such as banking system; however, resource constraints in the banking system, in some cases, funding to purchase equipments for the profitable and strategic projects in petrochemical sector such as the building refineries with small, medium and large sizes, faces problems. To tackle this problem, high capacities of capital markets can be used to finance;

3. Providing the working capital for these industries

Short-term or working capital financing have the same meaning. Although there is no single definition of short-term financing, but the main difference between short-term and long-term financing, is the cash flow time. Short-term financial decisions typically involve cash input and output flows that occur in one year or less. With this description, the various economic sectors, including the petrochemical sector, to finance their short-term needs, can use publication of Islamic securities such as Salaf or

representing securities. Representing securities and how to use them to provide working capital will be explained in the following research sections.

Hypothesis 2: Legally it is possible to design and issue the advocacy securities as a modern tool of Islamic finance in Iran capital market (for oil, gas and petrochemicals).

A careful study of Islam teachings shows that not only Islam, has not confined Muslims within certain contracts and considers all rational contracts in compliance with the standards and terms appropriate; but also beyond this, by providing outlines calls the scholars to think and design innovative financing tools and devise contracts tailored to their age and time.

Economic system formed from a number of related institutions will have coordinate of the components, if the components work in order to achieve a single goal. General and current principles can define and determine this single purpose. Bank also, as one of the main institutions of the economic system should be the benefit of a single set of principles for coordination.

Using the general and main framework provided in Islamic jurisprudence, it is also possible to comment on the types of institutions used in this system such as innovative financing tools (Mousavian, 2010).

Hypothesis 3: Legally it is possible to design and issue the advocacy securities as a modern tool of Islamic finance in Iran capital market (for oil, gas and petrochemicals).

A) Legal and practical application

Practical steps to identify potential of Islamic financial instruments for the implementation of infrastructure projects

Thorough identification and analysis of infrastructure projects with all the details and invite the Islamic banks and other Islamic financial institutions to finance and invest in those projects.

Identify the appropriate financial instrument or instruments of the project or projects.

Develop a secondary market in this field.

In Islamic finance, there is a strong emphasis on the communication and link between the real and financial sectors of economy, and priority of the former (the economy) over the latter (financial). This link is more obvious in financial investment service field.

B) The regulations of Islamic finance

1- Article 83

• A. The central bank is allowed to, in the framework of the annual budget law and to finance the developmental infrastructural projects of the government,

proceed publishing partnership bonds and various Islamic Sukuk in the international markets.

• B. State companies and municipalities, to supply foreign exchange for their investment projects and after approval of the Ministry of Economic and Finance Affairs and the central bank, are allowed to issue the partnership bonds and various Islamic Sukuk papers. Guarantee of principal and interest on the securities and companies mentioned municipalities. Guarantee of principal and interest of these securities is by mentioned companies and municipalities.

2. Article 97

Article 97, according to paragraph (23) of the general policies of the Fifth Plan communicated by supreme leader, Money and Credit Council is obliged to, during the program, do the following:

- A. reform of administrative, accounting and finance procedures in the banking system in accordance with the purposes and provisions of lucre-free banking
- B. Promote the use of new Islamic financing instruments such as Sukuk to help to Islamic finance for the country banks

3. Article 224

Also the article 224 of the Fifth Law is as follows:

Adjustment law of part of government financial regulation adopted in 2002, and its subsequent amendments and additions will be validated with the following amendments and additions for the Fifth Plan period:

To provide the foreign exchange resources needed for the plans with technical, economical, financial and environmental feasibility, the state-owned enterprises are allowed to, limited to the figures provided in annual budget rules, accordingly issue the Islamic sukuk papers or partnership exchange bonds in domestic and foreign financial markets in compliance with the regulations of the Central Bank and the ceilings stipulated in Article (81) of this Act. Issuance of the mentioned securities subjects to the approval of the Central Bank and the deputy and the repayment and guarantee of principal and interest of these securities is by related companies. Issuance of partnership bonds or Islamic sukuk with incentive profit is subject to the approval of the Council of money and credit.

Hypothesis 4: Operationally it is possible to design and issue the advocacy securities as a modern tool of Islamic finance in Iran capital market (for oil, gas and petrochemicals).

In the advocacy securities based on the contract, the holder of securities is on the investor position and founder and on the capital

applicant position and the attorney manages the basic assets papers. In many cases, the attorney and the founder are the same. Securities issuer also acts both as a publisher and a trustee since both issues the bonds and holds the basic assets as trustee on behalf of the holders of the securities. When the bonds mature, the founder buys the assets of the bonds issuer. Thus, the holders of securities can regain their original investment. Investment projects and constructed assets as bonds assets on behalf of holders of the securities, become issuer

CONCLUSION

Financing and the use of appropriate tools to provide the liquidity requirements of enterprises as one of the most important production entities, plays a fundamental role in the success of any business and economic activity. With respect to the lack of diversity in financing tools in our country, designing various financial tools and providing the financing possibility through them is one of the basic needs of enterprises in the oil, gas and petrochemical industries. Introduction and spread of a variety of Islamic securities (advocacy Sukuk) can be measured as effective innovations of the recent decade in the field of Islamic monetary and financial issues, he said. These securities now being mainly issued to finance the government, government-affiliated organizations and enterprises are designed on the basis of Islamic obsessive and are appropriate alternative to usury securities particularly the loan securities.

1- One of the various types of Islamic securities, are the advocacy securities. These papers can be along with other types of Islamic securities such as rental, Murabaha and Astsna securities, etc .

2- Provide a variety of Islamic finance tools in the Islamic capital market for investors and also the issuers of securities.

3- Advocacy bonds because of being released based on contract have high flexibility and the founder (companies of the oil, gas and petrochemical industries) can be as investors attorney and use its result resources in various sectors of his or her business such as financing the plans, purchasing the durable and consumable assets, providing liquidity and working capital. The advantage of this method compared to issuing other bonds is that the founder can meet all the various needs, and is not like the other papers to have specific functions, such as Murabaha bonds useful for financing the consumable items.

properties and in accordance with the memorandum of investments are managed by investment manager and the investment manager should perform the following activities:

- 1- Completion and development of investment projects;
- 2- Sales of investment projects to a third party;
- 3- Invest the remaining funds at disposal of the founder and the legal assets.

4. These securities can reduce the costs of publishing different papers and the founder can meet the needs by issuing one type of securities, although this high flexibility leads to representation risk for the founder.

Offers

With regard to the above and to develop, diversify and use the Islamic finance instruments, the following suggestions are offered:

- ❖ Due to the risk increase, operating costs in the oil and gas sectors, providing the necessary space to accelerate the release of various sukuks can lead to direct the society liquidity to the productive economic activities.
- ❖ Revision of the lucre-free banking operations law, the country monetary law and also the regulations and executive instructions related to financing system in order to provide the necessary conditions to accelerate the development and adoption of Islamic financial instruments;
- ❖ Proper use of the opportunities created by the implementation of Article 44 policies of the Constitution for investment and financing the projects through the new instruments;
- ❖ Paving the way for more prominent presence of finance and develop companies and deepening of the distribution of various types of Islamic securities in the energy sector;
- ❖ Essential planning to train and introduce the new Islamic financial instruments to the managers and financial analysts of oil, gas and petrochemical industries to enhance their knowledge on issues of Islamic banking and economy;
- ❖ Advertising and introducing the types of Islamic contracts to investors in order to attract them;

- ❖ Project-based sukuk issuances based on future earnings such as issuance of Astsna securities (construction order) and participation in foreign exchange and Rial profit and loss in different types by considering the features such as being legal and legitimate, effective (with a rate that is reasonable and proportionate to the market conditions and real needs of investors and other parallel markets) and being accepted (with a good efficiency and high liquidity);
- ❖ Necessary measures to publish chain Sukuk to provide the ability to convert the issued Sukuk to its other types and available financing tools;
- ❖ With respect to fail the desired estimate of the sales volume of partnership bonds for reasons such as inflation rate, effectiveness rate of other financial markets (housing, gold, foreign exchange, etc.), caught liquidity in the community, the costs of financing the Infrastructural projects, etc. In order to maintain the motivation of securities purchasers and financing of country infrastructural projects and with respect to the inflation rate and considering the mentioned cases, it is necessary to modify the partnership bonds interest rate and organize the other parallel markets.
- ❖ Adopt necessary laws and regulations and provide preparations of Islamic financial instruments design by relevant institutions such as government, parliament, the Stock Exchange Organization and the Central Bank;
- ❖ Establish a working group composed of Tehran Stock Exchange Organization experts and other money market, capital and insurance experts and the representatives of different economic sectors especially industries by the Ministry of Economy and Finance Affairs to review the current protocols of issuing the bonds, along with special studies on various types of bonds and the experience of other countries.

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