

SHARIA IPO MARKET. EVIDENCE FROM MALAYSIA

Sofya Glavina¹

¹ ORCID orcid.org/0000-0002-5174-8962

RUDN University

Digital Economy, Economics Faculty

Miklyho-Maklaya st. 6, 117198 Moscow, Russia

E-mail: glavina_sg@rudn.university

Abstract: *For the future development, company needs capital, and sometimes IPO is the only way to get it. Initial public offering or stock market launch is a type of public offering in which shares of a company are sold to investors.*

At the same time, religion always influences the circulation of money around the world. In particular, the article deals with Islam and Sharia law. Despite the fact that the Quran does not have direct information and references to shares, as well as a ban on their use, nevertheless, in Muslim countries, Sharia law regulates financial relations between people.

Malaysian Stock Exchange (Bursa Malaysia) is the leading stock exchange in the region and one of the largest in the Islamic world. The exchange is a member of the Federation of Stock Exchanges of Asia and Oceania. This article will study the role of the Malaysian Exchange in the development of the Islamic IPO, as well as the phenomenon of Islamic finance in general. The main factors and differences in approaches to attracting investments in the sub-European and Islamic worlds will be considered.

Key words: *Initial public offering, sharia law, Islamic finance, Bursa Malaysia*

JEL codes: *G24, F31, N25, N95, N20*

1. Introduction

The Initial Public Offerings (IPOs) market is a part of the securities market where issuers raise capital. Investors, who purchase shares, form market demand: issuers and shareholders, who need funds, form market supply. On the other hand, a large number of small national stock exchanges struggle their way to serve regional businesses and local investors. Globalization strongly affects this seemingly stable system increasing a number of international investors and listings of foreign companies on national stock exchanges throughout the world. Because of

globalization, national factors and diversity of local economies tend to have less influence on local securities market than global factors. Most studies (Loughran et al., 1994; Reilly & Hatfield, 1969; McDonald & Fisher, 1972; Ibbotson & Jaffe, 1975; Chowdhry & Sherman, 1996) cover the conventional IPO market development. Very little studies evaluate the effect of Shariah-compliance IPOs on the IPO market development (Yaakub & Sherif, 2019; Abdul-Rahim & Che-Embi, 2013; Tajuddin & Abdulahh, 2018; Ammer & Ahmad-Zaluki, 2017; Badru & Ahmad-Zaluki, 2018; Mayes & Alqahtani, 2015).

2. Methodology and Data

The article provides quantitative analysis of Malaysian stock exchanges official reports and analytical papers of key audit and consulting experts. Data consists of 637 firms listed on Bursa Malaysia during the period of 1999 to 2019. It is particularly focused on a number of IPO's, volume of raised capital by year. The sample in this study includes Shariah complied and Non-Shariah IPO's. The main source of data is prospectus that was downloaded from Bursa Malaysia website. The aim of the study is to figure out the Islamic impact on the one of the conventional instruments for the capital rise.

3. Results and Discussion

There is a legal postulate from fakih, which states: "Matters that are prohibited may be allowed to continue, provided that they were done before the fact. However, the same rule is not allowed for its initiation."

This postulate had a significant impact on the development of Islamic finance.

The issuance and even purchase of shares in companies engaged in unacceptable activities, no matter how insignificant, in accordance with the standard No. 21 of the Organization for the Accounting and Auditing of Islamic Financial Institutions (AAOIFI) are unacceptable according to Shariah law. The company business must be legal. All companies are divided into several groups by type of business:

- 1) Sharia-authorized business. The activities of these companies cannot be based on fraud, lies and lending. The company cannot use interest and futures transactions as a tool for earning income. *Riba* literally means excess and increase. Technically, *riba* is defines as an increase in any exchange or sale of product or by virtue of loan without providing equivalent value to another party (Khan, 2013). Islamic transaction rules (known as *fiqh al-Muamalat*) were created to prevent use of interest. However, it is worth noting that, according to the

agreement of marabakh (murâbahah), late payments are forbidden, and this type of income is possible only if it is used for charitable purposes (Elgar, 2009).

Thus, financial sector's main prohibitions can be divided into the following groups:

- a) prohibition of general loan interest;
 - b) prohibition on speculation (gharar). However, the “western” financial instruments in amended form are used by two exchanges in accordance with Sharia law: NASDAQ Dubai and the Dubai financial market - owner of the Arab holding company Borse Dubai. *Gharar* literally implies risk, uncertainty and hazard. Technically, gharar determines relations where the vendor is not in position to hand over the subject matter to the buyer, whether the subject matter is in existence or not.;
 - c) prohibition on gambling (maisir). This group includes companies engaged in transport activities, logistics companies, production of goods (if they do not belong to the prohibited categories). Purchase and sale of shares of similar companies and firms are permitted. *Maisir* is defined as any activity, which involves betting. It means games of pure chance where any party might gain at the expense of the loss of the other party.
- 2) Sharia-prohibited activities. It is forbidden to invest in companies that engage in prohibited activities (haraam) (www1; I-Hawary et al., 2004):
- a) production and consumption of alcohol and tobacco products (including tobacco for hookah);
 - b) activities related to prostitution;
 - c) the porn industry (including publishing houses, and distribution companies);
 - d) gambling (including slot machines);
 - e) witchcraft;
 - f) interest operations;
 - g) processing of animal meat that died their own death, pork, meat of forbidden animals;
 - h) blood processing.
- 3) Shariah permitted business with partly prohibited activities. For example, a transportation company that has bank deposit income, it also applies to banks providing loans in purpose to finance its projects. At the moment, there is no unequivocal opinion on the legality of investing in securities of these companies. (www2; www3)

On the other hand, Islamic finance has its own instruments for capital rise. Sukuk is an Islamic financial certificate that complies with Sharia law. A sukuk is similar to a bond in Western finance, that complies Shariah. Since the traditional Western interest-paying bond

structure is not permissible, the issuer of a sukuk sells a certificate to investor, and then uses the proceeds to purchase an asset, of which the investor has partial ownership. The issuer must also make a contractual promise to buy back the bond at a future date at par value.

Sukuk are divided into two different types:

- Asset-based - sukuk holders have beneficial ownership of the asset and have rights to appeal to the originator in the case of lack of payment.
- Secured by assets – sukuk holders have the legal ownership of the asset and, as a result, do not have the right to appeal to the originator in case of lack of payment.

Tab. 1 IPO and Sukuk comparison

Factor	sukuk issue	Security issue
The economic and law nature	Sukuk - a financial instrument that provides the holder with a certain share of ownership in a tangible asset or in an investment project	Security - a document certifying compliance with the established form and mandatory details of property rights
Financing principle	Sukuk issue under a lease, leasing, partnership, sale	Issue of securities
Investment object	The assets that underlie sukuk must not be in conflict with Sharia.	The ability to finance any assets, projects, enterprises that comply with the laws of this country
Sources of income	Income from leasing and rental payments. Profit income of the investment project. Margin under the contract of sale.	Dividends on shares. Coupon yield on bonds
Investor, creditor	Special legal entity.	Shareholders Bond holders
Providing real assets	Required	Not required
Price	The nominal value of sukuk is determined by the market price of the underlying asset	Depends on the solvency and credit rating of the issuer
Risk type	Mostly sovereign, quasi-sovereign	corporate
Profit	Not guaranteed, but can be determined by a fixed percentage and a floating determinant	Not guaranteed for stocks. The bonds record coupon income.

Source: compiled by the author

Republic of Sudan is the first Muslim country to host an Islamic stock exchange where shariah companies only are traded. Khartoum Stock Exchange (Khartoum Stock Exchange, KSE). According to the requirements of the exchange:

- all participants in the exchange are required to follow Sharia law; it is allowed to make profit only from transactions that are permitted by Sharia;
- trading on the stock exchange with securities is allowed only on the spot method basis (the parties must make immediate calculations, payment value of given security should be made immediately in full, and not in installments or tranches);

- in order to avoid various kinds of speculative consequences, transactions on this exchange should not be referred to the future.

To follow these requirements the law was issued - all limited liability companies, banks, insurance companies must become members of this stock exchange. (Ahmad, 1997) As of 2019, there are 67 companies on this exchange.

Despite the fact, the key Islamic capital markets are located in Southeast Asia, Malaysia and Indonesia. The Malaysian Stock Exchange (MSE) was incorporated on 14 December 1976. It has two types of markets that are the main market and the ACE market. The main market was established for companies with a profitable track record for three to five full financial years. ACE was established for high growth and technology companies. The MSE was provided with two types of boards known as the shariah-compliant board and the non shariah-compliant board.

However, to control and regulate issues related to the implementation of Shariah law, in 1997 the Central Bank of Malaysia created the agency Shariah Advisory Council (SAC) - introduces new Islamic products to the market based on research and analysis of the basic principles of Shariah; assesses traditional (non-Islamic) instruments, and estimates their applicability within the framework of Sharia law.

Another function is to consult with future issuers, investors, industry and government agencies, as well as to provide relevant instructions, and publish market analytics. The SAC publishes a list of listed companies that operate according to Shariah law twice a year - which is one of the main sources of information for investors acting in accordance with the principles of Islamic finance.

Tab. 2 Distribution of IPOs population and sample by the year of listing, 1999 to 2019

Listing Year	'99	'00	'01	'02	'03	'04	'05	'06	'07	'08	'09
IPO population	19	38	20	51	58	72	79	40	26	23	14
Sariah IPOs	14	32	15	41	50	66	63	31	20	15	13
Non-Sariah IPOs	5	1	1	4	5	9	3	2	4	3	1

Listing Year	'09	'10	'11	'12	'13	'14	'15	'16	'17	'18	'19
IPO population	14	29	28	17	17	15	13	12	14	22	30
Sariah IPOs	13	23	23	11	12	14	12	11	7	16	22
Non-Sariah IPOs	1	6	5	6	5	1	1	1	7	6	8

Source: compiled by the author: (www4)

The Securities Commission (SC) of Malaysia was established on March 1, 1993. The SC is a self-funding statutory body with focus on capital market regulation in Malaysia. The roles

of the SC are to regulate, supervise and systematically develop Malaysia's capital market. In January 1996, the SC liberalized a new method of IPO shares issue on the Malaysian market that is based on a market-based pricing mechanism. The Malaysian IPO market has a unique way of defining an IPO issue. IPOs in Malaysia may refer to public offers by private sector companies or can be privatization initial public offers (PIPOs) issued by state-owned companies.

Table 2 shows the shariah-compliant companies and non shariah-compliant companies listed on the MSE. 511 IPO shares are from shariah-compliant companies while 84 are from non shariah-compliant companies. It differentiates shariah-compliant companies from non shariah-compliant companies because of their different regulatory guidelines. This also helps Muslim investors to differentiate shariah-compliant companies from non shariah-compliant companies.

The highest number of IPO share issues occurred in 2005 (79 IPOs) and the lowest number of IPO shares issues occurred in 2016 (12 IPOs). A possible explanation of the low number of IPO issues in 2016 is the sub-prime crisis that happened from 2014 to 2017. This crisis had a negative impact on the issuance of IPO shares in the MSE.

Despite the size Malaysia IPO market is still developing open and liquid capital markets. Foreign firms looking to list in the region are likely to pick Singapore and Hong Kong over Kuala Lumpur. That fact makes Malaysia regional IPO market focused on shariah compliant IPOs.

4. Conclusions

The article shows changes in the Malaysia IPO dynamics and change of roles of the conventional and Islamic stock exchanges. Modern religious differences leave their mark on the development of the financial market. Neither in the Quran, nor in the Sunnah there is no direct information or mention of shares, as well as prohibition on their use. This is largely due to the lack of such financial instruments during the transfer of the Quran to the Prophet Muhammad (610-632). Nevertheless, the recent emergence of Islamic finance within the predominantly conventional finance system operating on interest implies that interest may affect Islamic finance even if indirectly. The same affect we see in the global IPO market development.

Similar to other share markers worldwide, the Malaysian stock market was not left behind in the IPO trend. Shariah-compliant companies have become important participant in the global

capital market. This phenomenon was due to the awareness and demand from Muslim people in Malaysia and around the world to participate in the capital market. Shariah-compliant companies' IPOs have also gathered significant attention in attracting non-Muslim companies and investors. Shariah-compliant companies are different from non shariah-compliant companies. The main features of shariah-compliant companies are that their activities are guided by shariah injunctions. Shariah-compliant companies' IPOs must represent an assertion of religious law where the market should be protected from such elements as riba, gharar and maisir.

References

- Abdul-Rahim, R. and Che-Embi, N.A. (2013) "Initial returns of Shariah versus Non-Shariah IPOs: are there any differences?" *Jurnal Pengurusan*, Vol. 39, 37-50.
- Abu Bakar, N.B. and Uzaki, K. (2013). "An empirical study of initial public offerings underpricing for Shariah-compliant companies: the case of Malaysian market". *International Journal of Economics, Business and Finance*, Vol. 1 No. 9, 262-274.
- Ammer, Ma. And Ahmad-Zaluki, NA. (2017), "The role of the gender diversity of audit committees in modelling the quality of management earnings forecasts of initial public offers in Malaysia", *Gender in Management*, Vol 32, No 6, 420-440.
- Ausaf Ahmad. Towards an Islamic Financial Market: A Study of Islamic Banking and Finance in Malaysia. Jeddah: Islamic Research and Training Institute, 1997.
- Badru, Bo. And Ahmad-Zaluki, NA (2018). "Explaining IPO initial returns in Malaysia: ex ante uncertainty vs signaling". *Asian Review of Accounting*, Vol 26, No 1, pp. 84-106.
- Chowdhry, B. & Sherman, A. (1996). The winner's curse and international methods of allocating initial public offerings. *Pacific Basin Finance Journal*, 4,15-30.
- Ibbotson, R. & Jaffe, J. (1975). Hot issue markets. *Journal of Finance*, 30, 1027-1042.
- Khan M. A., (2013) What is wrong with Islamic Economics? Analyzing the present state and Future Agenda, Edward Elgar, UK, 2013, pp. 503.
- Loughran, T., Ritter, J. & Rydqvist, K. (1994). Initial public offerings: international insights. *Pacific Basin Finance Journal*, 2: 165-199.
- Mayes, D. and Alqahtani, F. (2015). "Underpricing of IPOs in Saudi Arabia and Sharia compliance". *Journal of Islamic Accounting and Business Research*, Vol 6, No 2, 189-207.
- McDonald, J.G. & Fisher, A.K. (1972). New issue stock price behaviour. *Journal of Finance*, 27, 97-102.
- Reilly, F.K. & Hatfield, K. (1969). Investor experience with new stock issues. *Financial Analyst Journal*, 25, 73-80.
- Tajuddin, A., Abdullah, N. and Taufil Mohd, K. (2018). "Shariah-compliant status and IPO oversubscriptions", *Journal of Islamic Accounting and Business Research*, Vol. 9 No. 4, pp. 531-548.
- Yaakub N., and Sherif M. (2019). "Performance of initial public offerings (IPOs): the case of Shariah-compliant companies". *Emerald Insight*, 65-76.

Online sources

(www1) <http://www.wdibf.com>

(www2) <https://www.islamweb.net/ar/fatwa/33029/>

(www3) <https://umma.ru/rynok-aktsij-v-islame/>

(www4) https://www.bursamalaysia.com/listing/listing_resources/ipo/ipo_summary