Middle-East Journal of Scientific Research 13 (Research in Contemporary Islamic Finance and Wealth Management): 50-55, 2013; ISSN 1990-9233

DOI: 10.5829/idosi.mejsr.2013.13.1881

Information Content of Post-Crisis Sukuk Announcement in Malaysia

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Abstract: The aim of this study is to investigate post-crisis stock market reactions to the issuance of selected *sukuk* in Malaysia for the period 2009 to 2010. A total of 29 companies are selected and data are sourced from the Securities Commission Malaysia and Bloomberg. The study employs event study methodology using cumulative average abnormal return (CAAR) on [0, 0] 1-day, [-1, +1] 3-day and [-2, +2] 5-day events based on the reaction of FTSE Bursa Malaysia Kuala Lumpur Composite Index (FTSEKLCI) to the announcement of *sukuk* issue. The results show positive but insignificant market reactions to *sukuk* issues indicating that post-crisis *sukuk* announcement carries no surprise to the market. This implies that, *sukuk*, being neither debt nor equity, reflects the economic strength of the company and the real economic activities. Hence, policymakers and practitioners may react accordingly to this finding. Future research should investigate whether stock market reacts asymmetrically to different types of *sukuk* issuance.

Key words: *Sukuk* · Event-study · Wealth effect · Islamic capital market

INTRODUCTION

Factors that affect shareholders' wealth is one of the central issues in finance. Financing decisions, which are to determine how much and what type of debt and equity should be issued to raise capital are among the factors affecting shareholders wealth. The empirical evidence on conventional bond indicates that pure equity offers have a relatively large negative effect, while issues of straight debt have a small non-negative wealth effect. On the other hand, convertible securities, having both debt and equity features, have negative wealth effects that lie in between those observed for equity and straight debt [1]. Stock market adjustments are considered as a leading indicator that can be used to forecast future changes in income. Higher stock prices forecast higher expected future income and raise permanent income. Changes in wealth affect consumption. Higher wealth lowers saving and therefore raises consumption which is referred to as wealth effect.

The recent 2008 global financial crisis increased the need for risk diversification within the financial system. *Sukuk*, or Islamic bond, is an alternative for risk diversification and is the most active Islamic debt market financial instrument to date. They are investment certificates with both bond and stock-like features issued to finance trade or the production of tangible assets. Due to rapid expansion of Islamic financial instruments, the *sukuk* market has become an important avenue for fund raising and investment activities. The global outstanding volume of *sukuk* exceeded USD90 billion in 2007 and was expected to reach USD200 billion by 2010. Issuance quadrupled from USD7.2 billion in 2004 to nearly USD39 billion by the end of 2007 and was up from USD336 million in 2000 [2]. More than 50% of the USD26.1 billion of *sukuk* issued in 2009 originated in Malaysia [3].

The paper is motivated by three key factors affecting *sukuk* market. First, the regained market confidence after the restructuring of the high profile *sukuk* in Dubai after the 2008 crisis. Second, investors are avoiding the riskier

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markets of United States and Europe. Third, positive economic growth and favourable debt dynamics in the two most important *sukuk* issuing regions of the Gulf and Malaysia have attracted investors to the Islamic capital market. This paper adds to the literature since empirical works on the information content of *sukuk* issues is relatively few. The objective of the paper is to examine the recent post-crisis wealth effect of *sukuk* by examining the information content of *sukuk* issuance in Malaysia.

MATERIALS AND METHODS

Definition of *Sukuk*: *Sukuk* is an Arabic name for financial certificates, which in economic terms are akin to conventional bonds. Unlike conventional bonds, *sukuk* needs to have an underlying tangible asset transaction either in ownership or in a master lease agreement. It represents ownership of underlying assets, usufructs (benefits), services, or investment. The Securities Commission Malaysia (SC) [4] defines *sukuk* as 'certificates of equal value which evidence undivided ownership or investment in the assets using Shariah principles and concepts approved by the Shariah Advisory Board (SAC)'. The Accounting and Auditing of Islamic Financial Institutions (AAOIFI) [5] listed 14 different types of *sukuk*. However, the most common principles used in *sukuk* structuring to date are *ijarah, mudharabah, musharakah, murabahah, salam* and *istisna* [6].

Theoretical Framework: Capital structure irrelevant theory was first introduced by Modigliani and Miller in 1958 [7]. They assumed that under perfect market condition, the capital structure of the firm is irrelevant. However, later they proposed that with corporate taxes, shareholders' wealth would increase with the increase in debt usage due to the interest tax shield benefit of debt [8]. On the other hand, under imperfect market, models based on the idea of an optimal structure emphasise trade-offs between debt and equity; the corporate tax advantage of debt versus the costs of financial distress. Alternatively, asymmetric information and cash flow effects model assumed that managers have better information than outsiders about the firm's value. Myers and Majluf [9] developed a model in which external financing has a negative effect on common stock prices. When raising external funds, managers tend to issue securities in ascending order of risk (or in a 'pecking order') in order to preserve the wealth of shareholders. Therefore, the effect of new financing may be positive, neutral or negative, depending on how the implied changes in cash flow interact with the changes in leverage implied by the type of security issued [10].

There are limited studies that examined the wealth effects of *sukuk*. Cakir and Raei [11] examined the risk-reduction advantages of issuing sovereign *sukuk*. Using a sample of sovereign *sukuk* and Eurobonds from the same issuer, the authors estimated and compared value-at-risk (VaR) for a portfolio that included both instruments to a pure Eurobond portfolio. They found that the VaR is reduced when *sukuk* are added to the portfolio of fixed-income securities; demonstrating that these investment certificates created diversification benefits for investors. However, Godlewski *et al*. [12] found that there was no significant market reaction to conventional bond issues, but a significant negative stock market reaction to *sukuk* issues. The different stock markets reactions were due to two factors. First, investors expected that an adverse selection mechanism encouraged less-healthy companies to prefer *sukuk* over conventional bond financing. Second, investors may take the view that even if companies issuing *sukuk* may have been shut out of the conventional bond market, they could still take advantage of excess demand for *sukuk* from Islamic banks.

Other recent studies included Ibrahim and Minai [8] who found that market reaction is significantly positive during event windows [-3, 0] and [-3, 3] during the announcements of Islamic debt issuance for the period 2000-2006 in Malaysia. The finding implied that the positive reaction was not due to investors' preference for Islamic compliant activities, but it was due to similar factors found in studies on conventional bonds. Ameer and Othman [13] found significant negative abnormal returns near the announcement days and the responses were asymmetrical to different types of bonds issuance announcements in Malaysia over the period 2001-2007. Modirzadehbami and Mansourfar [14] reported a significant negative abnormal return occurred one day before announcement date in a sample of 45 listed companies on Bursa Malaysia involved in issuing of Islamic debts during 2005-2008. Mohd Ashhari *et al*. [15] indicated that there was a wealth effect on the announcement of Islamic bond issues for the period 2001-2006 in Malaysia.

For the purpose of the study, market is hypothesized to react positively to the announcement of *sukuk* issues. This is due to several factors. First, cheaper financing

costs since *sukuk* has higher liquidity due to wider investor base encompassing of both Muslims and conventional investors. Second, there is higher demand for Shariah compliant stocks since 85% of total securities listed in Bursa Malaysia are Shariah compliant. Third, funds raised from the Islamic debt instruments are used to finance new activities [8]. In short, empirical evidences show that stock market reactions to *sukuk* issuance are mixed and inconclusive.

Growth and Development of *Sukuk* Market in Malaysia: In Malaysia, as on December 2009, 57% of outstanding corporate bonds in the bond market are Shariah-compliant [4]. The overall share of *sukuk* to GDP was increasing each year since 2000 until 2009. In 2009, the percentage share of domestic *sukuk* to share to GDP was 6.2%, corporate *sukuk* represented 0.73% of GDP and sovereign *sukuk* represented 5.47% share to GDP in 2009 [16] BNM). Malaysia dominates the *sukuk* market in terms of both number and volume, with trade totaling approximately USD25 billion [17].

Table 1 shows the turnover ratio for the period 2008 to 2010 in Malaysia. Both *sukuk* and bond markets show declining trend, due to market still recovering from the impact of 2008 financial crisis. *Sukuk*, under the category of 'others,' outperformed the conventional market for the period under review.

Malaysia has the comparative advantage to become a global *sukuk* hub in the future. With the launching of the Malaysian International Islamic Financial Centre (MIFC) initiative in 2006, Malaysia offers the facilities for the origination, distribution and trading of *sukuk*. The large volume of corporate issuance indicates the convenience of obtaining funds and the accessibility for private sector in the *sukuk* market. Malaysia also requires the recognition of credit rating agencies for rating *sukuk*.

Methodology

Data: Following the literature, the study employed a standard event study methodology to estimate abnormal returns around the event date for the selected *sukuk* issues. The sample period (2009-2010) contained 29 events for *sukuk,* where 15 companies were selected in 2010 and 14 companies were selected in 2009 (lists of companies are available upon requests). The following data were collected from each company: date of issuance, issuers, instruments, issue size in million, tenure in years and the advisers. Historical daily data of FTSEKLCI closing prices were collected for the purpose of the study.

The 15 *sukuk* issued in 2010 totaled RM36,139 million (USD1=RM3.20). Danga Capital Berhad issued the highest amount worth RM 10,000 million on August 11, 2010, 25 tenure years with two advisors, AmInvestment Bank Berhad and CIMB Investment Bank Berhad. AmBank (M) Berhad was the second highest company who issued RM7,000 million *sukuk* on March 25, 2010, 30 tenure years with one adviser, AmInvestment Bank Berhad.

The total value of *sukuk* issuance from the 14 selected companies in 2009 were RM43,374 million. Pengurusan Air SPV Berhad issued the highest amount in *sukuk* RM20,000 million on 5th November 2009, 30 tenure years with one adviser-CIMB Investment Bank Berhad. Danga Capital Berhad was the second biggest issuer company with RM10,000 million on 24th April 2009 with 25 tenor years of issuance. The average tenure and standard deviation for the whole sample is 14.69 years and 8.76, respectively. For the issue size, the average is RM2,690.10 and the standard deviation is 4,359.97. The performance of stock prices of firms on certain days is measured using equation (1) below:

$$Ar_{it} = R_{it} - (\alpha_{it} + \beta_i R_{mt}) \quad (1)$$

where:

Ar_{it} = *Abnormal returns for firm i at time period t*
R_{it} = *Actual returns for firm i at time period t*
R_{mt} = *Returns on market portfolio in period t*
α_i = *The constant average return of stock i*
β_I = *Beta estimate of stock*

Table 1: Turnover Ratio for Sukuk and Bond Market in Malaysia, 2008-2010

	2008		2009		2010	
Category	Bond (%)	Sukuk (%)	Bond (%)	Sukuk (%)	Bond (%)	Sukuk (%)
BNM	1077	665	1307	336	1007	-
Government	141	98	126	109	140	150
Others	24	30	19	44	24	78
Total	209	88	176	71	194	93

Source: Bond Info Hub (2010).

α and β are estimated using market model which relates the given *sukuk* to the return of market portfolio. The return on the FTSE Bursa Malaysia Kuala Lumpur Composite Index (FTSEKLCI) is used as a proxy of market returns. They are calculated by running regression of sukuk returns against the market returns. After estimating the abnormal returns for each firm, the abnormal return for all of the firms on each day of the event window are then aggregated and averaged as equation (2); where *N* is equal to the number of firms in the sample:

$$AAR_t = \frac{1}{N}\sum_{t=1}^{N} AR_{it} \quad (2)$$

The t-test for AAR_t is estimated as equation (3):

$$t - statistics = AAR_t / \delta(AAR) \quad (3)$$

where

AAR_t = *abnormal return of period t*
δ = *standard deviation of average abnormal return over the estimation window*

To observe the cumulative effects, the cumulative abnormal returns ($CAAR_{t,+t2}$) are computed as (4) below:

$$CAAR_{(-t1,+t2)} = \sum_{=t1}^{=t2} AAR \quad (4)$$

$CAAR_t$ is a more precise representative of the longer term effect on share prices from bond offering announcements. The t-value for the $CAAR_t$ is given as (5):

$$t = CAAR / \delta(CAAR)_t \quad (5)$$

The standard deviation of *CAAR* is defined as (6); where *N* is the number of days in the *CAAR* statistics calculated as follows:

$$\delta(CAAR) = \delta(AAR)\sqrt{N} \quad (6)$$

RESULTS AND DISCUSSION

Measuring Return on Bursa Malaysia Kuala Lumpur Composite Index (FTSEKLCI): The study defined returns as follow: Return = [P(t)-P(t-1)] / P(t-1)], where P is the stock market daily price at closing of FTSEKLCI. We examine 1-day [0, 0], 3-day [-1, +1] and 5-day [-2, +2] event windows and calculate average abnormal daily returns. The cumulative average abnormal returns (CAARs) are calculated by summing daily excess returns over the respective event windows. The announcement date is the issue date of *sukuk*. We perform *t*-test and *z*-test to investigate the statistical significant of $CAAR_t$.

Table 2 below shows the total return on events of [0, 0] 1-day, [-1, +1] 3-day and [-2, +2] 5-day in 2010. The findings indicated that there were positive returns on the FTSEKLCI for the 15 selected companies in 2010. The largest average abnormal return of 0.104 was recorded during 5-day event.

Table 2: Total Returns on 1-Day, 3-Day and 5-Day Events, 2010

Year: 2010			Return		
No.	Issuer (Companies)	Issue Date	[0,0]	[-1,+1]	[-2,+2]
1	TTM Sukuk Berhad	15/11/2010	0.0011668	0.002487	-0.01126
2	Konsortium Lebuhraya Utara-Timur (KL) Sdn Bhd	28/10/2010	0.0002201	0.004369	0.008497
3	AmIslamic Bank Berhad	20/9/2010	0.0018542	0.006149	0.001222
4	Padiberas Nasional Berhad	7/9/2010	-0.000286	-0.00038	0.00147
5	Celcom Transmission (M) Sdn Bhd	1/9/2010	0.0066573	0.013062	0.017448
6	Malaysia Airports Capital Berhad	30/8/2010	0.0081074	0.014819	0.023487
7	Cagamas Berhad	19/8/2010	0.0050884	0.006864	0.017904
8	Danga Capital Berhad	11/8/2010	-0.005001	-0.00763	-0.00037
9	LBS Bina Group Berhad	23/7/2010	0.0072078	0.011803	0.008359
10	CJ Capital Sdn Bhd	15/7/2010	-0.00522	-0.0033	0.00036
11	Maju Expressway Sdn Bhd	18/6/2010	0.0101344	0.023626	0.019309
12	Muhibbah Engineering (M) Bhd	27/4/2010	-0.000261	-0.00515	-0.00069
13	Haluan Gigih Sdn Bhd	30/3/2010	0.0001061	0.001031	0.011178
14	AmBank (M) Berhad	25/3/2010	0.0023139	0.004345	0.011005
15	Naim Cendera Holdings Berhad	18/3/2010	-7.68E-06	-0.00411	-0.00401
	Total		0.0320812	0.067983	0.103901

Table 3: Total Returns on 1-Day, 3-Day and 5-Day Events, 2009

Year: 2009			Return		
No.	Issuer (Companies)	Issue Date	[0,0]	[-1,+1]	[-2,+2]
1	Sime Darby Berhad	16/11/2009	0.005783	0.007073	0.002634
2	Pengurusan Air SPV Berhad	5/11/2009	9.571E-05	0.005519	0.02047
3	CIMB Islamic Bank Berhad	25/9/2009	-0.00055	-0.00994	-0.00891
4	UMW Holdings Berhad	15/9/2009	0.0034154	0.007994	0.008707
5	UMW Holdings Berhad	15/9/2009	0.0034154	0.007994	0.008707
6	Makro Utama Sdn Bhd	20/8/2009	0.0068367	0.007148	0.008657
7	Petronas Global Sukuk Ltd	12/8/2009	-0.004839	-7.6E-05	0.00048
8	Talam Corporation Berhad	29/6/2009	6.507E-05	-0.00049	0.004925
9	Seafield Capital Berhad	27/5/2009	-0.003756	-0.00988	-0.00857
10	Dawama Sdn Bhd	27/4/2009	-0.012653	-0.02718	-0.01142
11	Danga Capital Berhad	24/4/2009	0.0143464	0.001512	-0.00297
12	Putrajaya Holdings Sdn Bhd	22/4/2009	0.0020484	0.012456	0.025104
13	Pinnacle Tower Sdn Bhd	6/3/2009	-0.012678	-0.01609	-0.0191
14	Offshoreworks Capital Sdn Bhd	20/2/2009	-0.010983	-0.01307	-0.0013
15	TSH Sukuk Ijarah Sdn Bhd	12/2/2009	-0.009771	-0.01651	0.000164
	Total		-0.019223	-0.04355	0.027569

Table 4: Total daily return, total market model expected return and total abnormal return, 2009-2010

	Total Daily Return of Stock			Total Market Model Expected Stock Return			Total Abnormal Return (AR_t)		
	$R_{it} = \ln (P_{it} / P_i(t-1))$			$E(R_{it}) = \alpha_i + \beta_i(R_{mt})$			$AR_t = R_{it} + E(R_{it})$		
Year	[0,0]	[-1,+1]	[-2,+2]	[0,0]	[-1,+1]	[-2,+2]	[0,0]	[-1,+1]	[-2,+2]
2010	0.03191	0.06732	0.10287	0.03208	0.20395	0.51951	0.06399	0.27128	0.62237
2009	-0.01967	-0.04459	0.02659	-0.01922	-0.13065	0.13784	-0.03889	-0.17523	0.16443

Table 5: Abnormal returns of *sukuk* on announcement dates

	Cumulative Average Abnormal Return ($CAAR_t$)		
Event Window	$CAAR_t = (1/N) \Sigma CAR_t$	*t*-test	*z*-test
[0,0] 1-day	0.00297	0.1280	0.0552
[-1,+1] 3-day	0.01224	0.5278	0.2276
[-2,+2] 5-day	0.01224	2.0250	0.8730

Meanwhile, Table 3 shows the total return on events of [0, 0] 1-day, [-1, +1] 3-day and [-2, +2] 5-day for sukuk issues in 2009. The results showed that there was a negative return on FTSEKLCI for the [0, 0] and [-1, +1] events. The total returns on the [-2, +2] 5-day event was positive. The smallest return was registered during 3-day event.

Table 4 depicts the total daily return of stock, total market model expected return and total abnormal return on events of [0,0] one day, [-1,+1] three days and [-2,+2] five days for the period 2009 - 2010. By referring to Table 4, the patterns are quite similar for the results of total daily return, total market model expected return and total abnormal return for the [0,0], [-1,+1] and [-2,+2] event windows. In 2010, *sukuk* issues generated positive responses for all calculations for all event windows. On the other hand, in 2009, the shorter horizons recorded negative returns and positive reactions were recorded only during the 5-day event.

Table 5 shows that cumulative average abnormal returns ($CAAR_t$) were positive during 1-day, 3-day and 5-day event windows. However, none of these results was significant at 5% level. Therefore, the announcement of sukuk after the 2008 financial crisis carried no surprise to the market. Thus, the results rejected the hypothesis of positive market reactions on *sukuk* announcement. These could be attributed to two reasons. First, there was leakage of information to the market before the Islamic debts announcements. Second, there was increased awareness among investors regarding *sukuk* having common features with equity instead of conventional bond.

In short, financial markets in emerging economies are not expected to be as efficient as those in more advanced economies, so there could be a leakage of information when new *sukuk* are issued. As such, it is possible that abnormal returns are realized prior to the announcement date. In addition, small sample size and short duration of estimation windows might also contribute to the insignificant findings of the study. However, the increasing trend of $CAAR_t$ is a good early indication that the recent *sukuk* announcement is perceived to be non-negative by investors after the 2008 financial crisis.

CONCLUSION

The paper concludes that there is positive but insignificant market reactions towards *sukuk* announcement. However, the positive market reactions can be interpreted in two ways. First, market can readily distinguish the news. Second, there are confidence effects that shareholders wealth will increase through the issuance of *sukuk*. This might imply that, *sukuk*, being neither debt nor equity, are true to the calling of Islamic economics whereby the issue reflects the economic strength of the company and the real economic activities. Future research should distinguish the instruments according to different types of *sukuk* issuance and tests for asymmetric responses. In addition, investigating macroeconomic influences affecting *sukuk* are also important to understand *sukuk* market behavior.

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