

Measurement of Shariah Compliant Companies Performance using Risk-Adjusted Methods: Evidence from Health Care Sector

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Introduction

In recent years, the Islamic finance industry growing exponentially due to the demands from Muslim investors that required halal products and investments that are in line with the Shariah principle (Ahmad & Ibrahim, 2020; Ahmed & Siddiqui, 2019). An investment that is made based on Shariah-compliant principles is an example of an ethical investment. The demand increases because Islam is the second-largest religion in the world with forty-six countries having a Muslim population (Abdullah & Ahmad, 2010). Specifically, Muslims need to follow the Islamic law that has been set by the *Quran* and *Sunnah*.

The Health Care sector was established in the Kuala Lumpur Shariah Index in 2018. The companies in the Health Care sector play a vital role in providing health care equipment and services such as producing gloves, sterilization and medication for medical purposes. Currently, this sector is one of the fastest-growing sectors since the entire world experiencing the outbreak of Covid-19 disease including Malaysia. All types of investments, including Shariah-compliant stocks involve risk. Rule of thumb stated that high risk-high returns, which means the greater risk is borne, the greater the generated returns (Suryani & Herianti, 2015). This sector will benefit Muslim investors as the return of each company is higher due to the demand of the current condition. By considering the situation, it has motivated this study to examine the overall performance of local Shariah-compliant companies, especially in the Health Care sector.

Methodology

The main aim of this study is to examine 12 selected Shariah-compliant companies' performance in Malaysia's Health Care sector. Therefore, this study employed three standard risk-adjusted methods such as Sharpe, Treynor and Sortino to compare the performance of the companies towards FTSE Bursa Malaysia EMAS Shariah Index. The analysis used historical data consisting of monthly closing prices from 2015 until 2020 and 3-months Malaysian Islamic Treasury Bills as a risk-free rate.

Results and Discussion

The performance of companies in the Health Care sector has been calculated by using the methods of risk-adjusted states. Based on these three methods, the higher the value of the ratio, the better the performance of stock in the Health Care sector. Table 1 below shows the ranking of the 12 selected companies in the Health Care sector.

Table 1: Ranking of Stocks in Health Care Sector

Companies	Methods and Rank					
	Sharpe Ratio	Rank	Treynor Ratio	Rank	Sortino Ratio	Rank
Company 1	-0.0357	5	-0.0022	5	-0.0878	5
Company 2	-0.1796	9	-0.0119	8	-0.2787	8
Company 3	-0.0574	6	-0.0045	6	-0.1062	6
Company 4	0.0108	3	0.0008	3	0.0205	3
Company 5	-0.7803	11	-0.0737	11	-1.1804	11
Company 6	-0.0202	4	-0.0015	4	-0.0431	4
Company 7	-0.1671	8	-0.0179	9	-0.3366	9
Company 8	-0.8910	12	-8.9542	12	-1.3191	12
Company 9	-0.1401	7	-0.0082	7	-0.2769	7
Company 10	0.1039	2	0.0065	2	0.2987	1
Company 11	0.1050	1	0.0102	1	0.2068	2
Company 12	-0.2279	10	-0.0247	10	-0.3672	10
FTSE EMAS	-0.9171		-0.0315		-1.3628	
Shariah Index						



The empirical result shows that the majority of the Shariah-compliant Health Care companies outperformed their market benchmark. This indicates that it produces a higher return than FTSE EMAS Shariah index or the overall stock market. In addition, the result shows that all companies in Health Care sector outperformed the benchmark using Sharpe and Sortino ratios. Sortino ratio shows the same capability as Sharpe ratio. This result thus consistent with Kupčák & Gottwald (2016). Observed that the differences in the rankings were influenced by the type of risk estimated in each of the ratios. Sharpe ratio emphasis on total risk (standard deviation), Treynor ratio emphasis on systematic risk as measured by beta and Sortino ratio (a variation of the Sharpe ratio) only emphasis on the downside risk or negative volatility. Thus, this study used Spearman's Rank Correlation Coefficient test. The validation result proved that there is a very strong correlation between Sharpe, Treynor and Sortino ratios with 0.9930, 0.9860 and 0.9861 respectively. Finally, the findings highlight the importance of embedding risk into performance analysis and provide valuable insight to investors who are considering Shariah-compliant stocks as a potential income source.

Conclusion

The rapid growth of Islamic finance in the past decades has motivated many investors to focus on stocks that are in line with Shariah Principles rather than conventional stocks. Our study provided some insights on performance of Shariah compliant companies in the Health Care sector in order to assist investors in making logical investment decisions and allocating their resources in the correct company. The performance of a company is important to every company because it can help the company to improve their financial management and their management strategy. In addition, companies that perform well will give a good demand on stock. Finally, it can be concluded that all the objectives were successfully accomplished by using Sharpe, Treynor and Sortino ratios.

References

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