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SHARIAH-COMPLIANT SECURITIES

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Introduction

The history of Shariah index in Malaysia began when Kuala Lumpur Stock Exchange Shariah Index (KLSI) is launched in April 1999 in response to the increasing demands and interests in Shariah-compliant investments (Mcgowan & Muhammad, 2010). Previously, all securities are traded in Kuala Lumpur Composite Index (KLCI), until 2006, when Bursa Malaysia partnered with Financial Times Stock Exchange (FTSE) to provide a suite of indices for the Malaysian market. As a result, on 22 January 2007 and 21 May 2007 Bursa Malaysia has launched FTSE Bursa Malaysia Hijrah Shariah Index and FTSE Bursa Malaysia EMAS Shariah Index respectively ("FTSE Bursa Malaysia Indices", 2016). In Malaysia, the process of identification of Shariah-compliant securities is known as Shariah screening. It is conducted in May and November every year by the Shariah Advisory Council (SAC) of the Securities Commissions (SC). Since the first list of Shariah-compliant securities is introduced in 1997, the number of Shariah-compliant securities traded on Bursa Malaysia has risen from 52% in 1997 to 90% in May 2011, which is the highest recorded number. Furthermore, since 2003, the number of Shariah-compliant securities has always remained between 80% and 90% of the total securities traded on Bursa Malaysia (Yazi, Morni, & Saw, 2015). The latest list of Shariah-compliant securities is published by the SAC on 29 November 2019 and exhibits 77% of the securities listed on Bursa Malaysia are Shariah-compliant, which consist of 696 securities ("List of Shariah-compliant Securities by the SAC of the SC", 2019).

The Shariah screening process is grounded on the inputs and support received from the SC. To classify security as either Shariah-compliant or not, SAC will analyze the data gathered by SC from various sources, including companies' annual reports and enquiries made to the companies. SAC continuously reviews the Shariah status of these listed companies based on their latest annual audited financial statements. In this light, the SAC has introduced the Shariah screening methodology in 1995 and it has been exercised until May 2013. Later, a revised screening methodology is adopted for the first time in November 2013. Based on the screening process, there are securities that have been classified as Shariah-compliant securities and Shariah non-compliant securities. As such, they will be included (removed) in (from) the list of

Shariah-compliant securities. By employing descriptive analysis, this paper examines the trend of these inclusion and removal of the securities, as well as examines the time taken by the securities that have been removed from the list of Shariah-compliant securities to be included back as Shariah-compliant securities, starting from May 2007 until November 2015, as the FTSE Bursa Malaysia Emas Shariah Index is introduced in 2007.

Descriptive Analysis

In years 2007-2015, there are a total of 652 securities listed as the Shariah-compliant securities. Three hundred and thirty-eight securities are classified as Shariah-compliant, while 314 are removed from the list. From the analysis, it is found that the exact number of securities involved in the Shariah-compliant listing is only 444 as a result of the existence of the securities that have been included or removed from the list for more than once. Two hundred and ninety-seven have experienced one time inclusion (removal) in (from) the list, 107 experienced two times inclusion (removal) in (from) the list, 29 experienced three times inclusion (removal) in (from) the list, while the remaining 9 and 2 securities experienced four and five times inclusion (removal) in (from) the list respectively. The summary of the findings is illustrated in Figure 1.1. below.

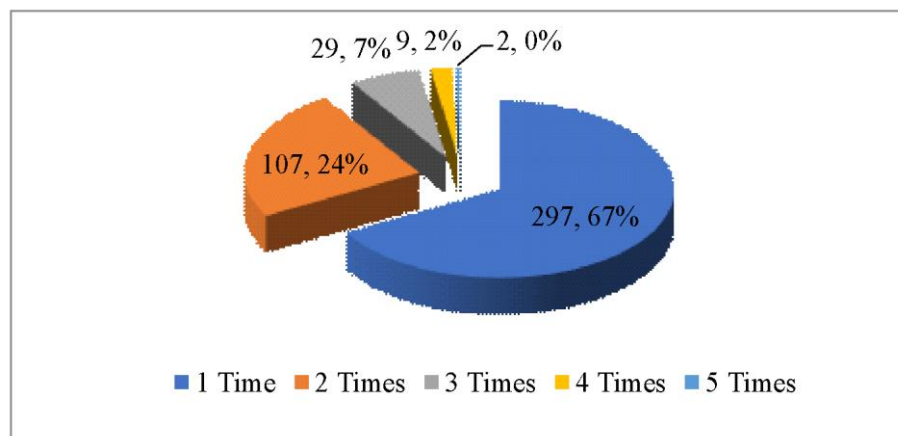


Figure 1.1. The frequency of inclusion (removal) of the securities in (from) the list of Shariah-compliant securities

For the analysis on the time taken by the securities that have been removed from the list of Shariah-compliant securities to be included back as Shariah-compliant securities, the study excludes securities that have experienced either inclusion (removal) in (from) the list for more than twice. In all, 97 securities are selected for further analysis. It was found that 19 securities took a half year to be relisted on the Shariah-compliant list, 21 securities took one year, and 23 securities took more than one year. The remaining of the 34 securities is found to be not relisted as Shariah-compliant securities. The summary of the findings is shown in Figure 1.2.

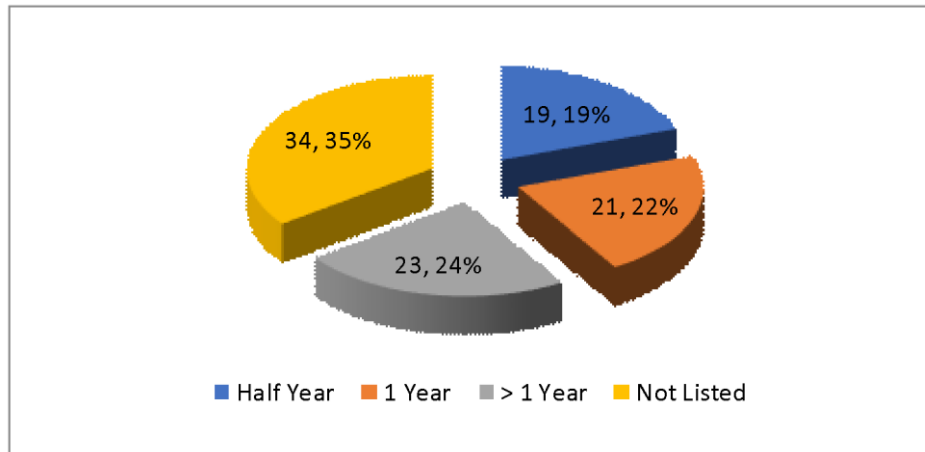


Figure 1.2. Time taken by the securities to be included back as Shariah-compliant securities

Furthermore, the study classifies the securities according to the screening methodology exercised on these securities; for securities that are removed from the list before November 2013, the previous screening methodology is exercised, while securities which are removed from the list starting from November 2013 onwards are screened utilizing the revised screening methodology. Thus, the previous screening methodology involved 21 securities and the revised screening methodology involved 76 securities. The findings exhibit that by utilizing the previous screening methodology, 9.52% securities took a half year to be relisted as Shariah-compliant, as compared to 22.37% securities by utilizing the revised screening methodology. Next, 33.33% of the securities took 1 year and more than 1 year utilizing the previous screening methodology, while 18.42% and 21.05% respectively for the revised screening methodology. In addition, 23.81% and 38.16% of the securities are still not relisted based on the previous screening methodology and the revised screening methodology respectively. The summary of the findings is shown in Table 1.1.

Table 1.1

Time taken by the removed securities to be included back as Shariah-compliant securities based on the screening methodology

Period	Previous Shariah Screening Methodology		Revised Shariah Screening Methodology	
	Number of Securities	Percentage	Number of Securities	Percentage
A Half Year	2	9.52%	17	22.37%
1 Year	7	33.33%	14	18.42%
> 1 Year	7	33.33%	16	21.05%
Not Relisted	5	23.81%	29	38.16%
Total	21	100.00%	76	100.00%

The findings show that the revised screening methodology has resulted in more securities to be removed from the Shariah-compliant list as compared to the previous screening methodology. This is aligned with the critique on the previous screening methodology by Zandi,

Razak and Hussin (2014) who claimed that the benchmarks developed by the SC seems to be purposely to increase the number of Shariah-compliant securities in Malaysian market. Moreover, it is known that the revised screening methodology adopts two tier quantitative approaches which added financial ratio benchmarks as the quantitative assessment and abolished the 10% and 25% benchmarks used in the previous screening methodology. Therefore, it directly affects companies with high level of conventional debt since there is no screening based on a company's total conventional debt previously. This shows that Islamic Capital Market in Malaysia has considered the critique that previous screening methodology is too liberal (Wee, 2012). In addition, the previous screening methodology has been adopted in 1997 and it has been utilized for almost 16 years before it is replaced with the revised screening methodology.

Conclusion

There are increasing demands and interests in Shariah-compliant investments in Malaysia. Investment in Shariah-compliant securities is part of it. The identification of Shariah-compliant securities is known as Shariah screening, which is announced to the public twice a year. The findings of the descriptive analysis show that majority of the securities are only been included or removed once in or from the list of Shariah-compliant securities. As for the findings on the time taken for the reinstatement of securities which have been removed from the Shariah-compliant list, it shows that 19% of the securities took a half year, 22% took one year, 24% took more than one year, while the remaining 35% are still not been relisted. In addition, the revised screening methodology has resulted in more securities to be removed from the Shariah-compliant list as compared to the previous screening methodology. Also, more securities are not relisted on the Shariah-compliant list utilizing the revised screening methodology as compared to the previous screening methodology. However, it can be concluded that most of the companies are interested in their securities to be included back as Shariah-compliant as majority of them are classified back as Shariah-compliant securities after the removal.

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