

THE EFFECT OF SHARI'AH COMPLIANCE ANNOUNCEMENTS ON STOCK RETURNS IN MALAYSIA

Nor Suhaira Jamil
Politeknik Sultan Idris Shah

Hamizah Hassan
Universiti Teknologi MARA, Kedah Branch

Imbarine Bujang*
Universiti Teknologi MARA, Sabah Branch

ABSTRACT

There are increasing demands and interests in Shari'ah compliant stocks in Malaysia. The identification of Shari'ah compliant stocks is known as Shari'ah screening, which is announced to the public twice a year. Hence, the objective of this study is to investigate whether the announcements provide valuable information and the impact of such announcements on stock returns. This study applies market model to estimate the stock returns. Alternative hypotheses that are being tested are the inclusion (removal) of stocks in (from) the Shari'ah Compliant List give a significant effect on the stock Cumulative Average Abnormal Return (CAAR). Employing the event study methodology in years 2007 – 2015, this study provides unambiguous evidence that the inclusion of a stock in the Shari'ah Compliant List has increased the price that lead positive stocks returns 1 day within the announcement date. Meanwhile, the removal from the list results a negative stock returns due to the declined of the stock price. As such, the announcements of Shari'ah Compliant List do carry informational value and have significant effect on the stock returns in Malaysian capital market. Shari'ah compliance announcement is significant especially to the Muslim investors to assist them avoiding prohibited investment activities. The present study has significantly contributed to the Malaysian Efficient Market Hypothesis as well as to the practical implication for the companies in avoiding with haram activities.

Keywords: Shari'ah compliance; Shari'ah screening methodology; Inclusion and removal.

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1. INTRODUCTION

Islamic capital market (ICM) is a part of the main capital market in Malaysia. Activities and transactions in the ICM are based on Islamic laws and principles. Consequently, the establishment of a Shari'ah index plays an important role to enhance Muslim investors' confidence and assist Muslims to identify Shari'ah compliant investment. The history of Shari'ah index in Malaysia began when Kuala Lumpur Stock Exchange Shari'ah Index (KLSI) was launched in April 1999 in response to the increasing demands and interests in Shari'ah compliant investments (Mcgowan &

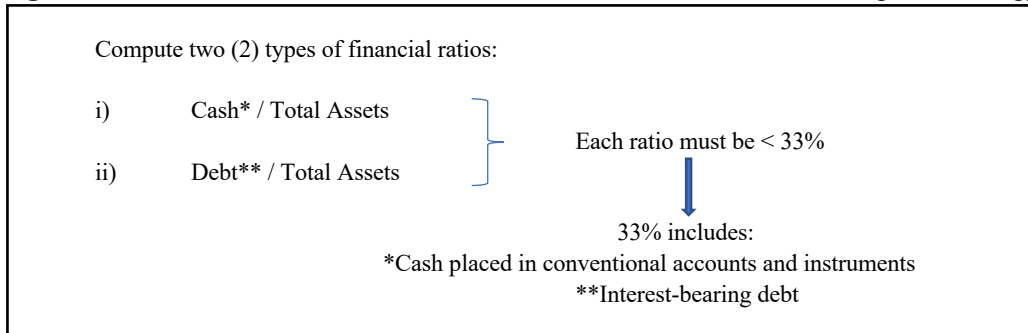
*Corresponding author: Imbarine Bujang, Faculty of Business and Management, Universiti Teknologi MARA, Sabah Branch, 88997 Kota Kinabalu, Sabah, Malaysia. Email: imbar074@warga.uitm.edu.my

Muhammad, 2010). Previously, all securities were traded in Kuala Lumpur Composite Index (KLCI), until 2006, when Bursa Malaysia partnered with FTSE to provide a suite of indices for the Malaysian market. As a result, Bursa Malaysia launched FTSE Bursa Malaysia Hijrah Shari'ah Index and FTSE Bursa Malaysia EMAS Shari'ah Index on 22nd January 2007 and 21st May 2007, respectively (Bursa Malaysia, 2016).

In Malaysia, the process of identification of Shari'ah compliant stocks is known as Shari'ah screening. It is conducted twice annually by Shari'ah Advisory Council (SAC) of Securities Commissions (SC). This Shari'ah screening process is grounded on the inputs and support received from the SC (Azmi, Non, & Ab Aziz, 2017). To classify security as either Shari'ah compliant or not, SAC will analyse the data gathered by SC from various sources, including companies' annual reports and enquiries made to the companies. SAC continuously reviews the Shari'ah status of these listed companies based on their latest annual audited financial statements. In this light, the SAC had established this Shari'ah screening methodology in 1995 and it has been used until May 2013. Meanwhile, a revised screening method was adopted for the first time to compile Shari'ah Compliant List announced in November 2013 (Securities Commission, 2016).

The previous screening methodologies applied comprise of two forms of assessments: quantitative assessment and qualitative assessment. For the quantitative assessment, the SAC measures the level of mixed contributions from both permissible and non-permissible activities to a company's turnover and before tax profits. In this regard, the calculated contributions from non-permissible activities should not exceed four benchmarks: 5%, 10%, 20% and 25%. Meanwhile, for qualitative assessment, the SAC considers two additional criteria for companies with mixed activities, which are the companies' image and the *maslahah* (Wee, 2012).

Since November 2013, SC has practiced a two-tier quantitative approach to identify Shari'ah compliance stocks. The first tier measures the contribution of non-Shari'ah permissible activities to the companies' the turnover and profit before tax. The 5% benchmark is used for activities clearly prohibited by Shari'ah such as gambling, *riba* based activities and business dealing with liquor and pork. Meanwhile, the 20% contribution condition is adopted for mixed activities that are generally permissible but there are evident of vague elements, such as hotels and resorts operations and stock trading. The second-tier measures two financial ratios, cash over total assets and debt over total assets, where the company's *riba* and *riba* based element in both ratios, should be less than 33%. In addition to the above two-tier quantitative criteria, the SAC also considers qualitative aspects, which involves public perception or image of the company's activities from the perspective of Shari'ah. Consequently, since the first Shari'ah compliant list was introduced in 1997, the number of Shari'ah compliant stocks traded on Bursa Malaysia has risen from 52 percent in 1997 to 90 percent in May 2011, which is highest recorded number. Moreover, since 2003, the number of Shari'ah compliant stocks has always remained between 80 to 90 percent of the total stocks traded in Bursa Malaysia (Yazi, Morni, & Saw, 2015).

Figure 1: New Quantitative Assessment Introduced in Revised Shari'ah Screening Methodology

The revised Shari'ah screening methodology has been introduced in 2013 as an SC's effort to harmonise the standards to global expectation and hence experience a surge in capital inflows. The inclusion of financial ratio benchmarks as new added assessment has been a practice of global Shari'ah index providers such as by Dow Jones, MSCI, and FTSE. It is expected that this will bolster the competitiveness of the Malaysian Islamic equity market and Islamic fund management industry and expand its international reach, especially from Middle East investors. This is aligned with SC's initiatives to expand the Islamic capital market's international reach, as outlined in the Capital Market Masterplan 2 (Malaysian International Islamic Financial Centre, 2013).

In the context of the Malaysian capital market, the Shari'ah Compliant List is a very important document for the reference of investors and fund managers to manage their investments. Investors and fund managers are seeking to invest in Shari'ah compliant investments would have to make changes in their investment portfolio should the stocks that they are investing are declared as non-Shariah compliant. In this regard, McGowan & Muhammad (2010), divided investors into two groups; first, Muslim investors who seek Shari'ah approved investment to avoid prohibition in Islam, including riba, uncertainties and gambling activities, next, Muslim or non-Muslim investors who opt for Shari'ah compliant stocks not just because of religious scruples, but to get better return on investments. This study will focus on the second group of investors, and whether the inclusion and removal of stocks from the Shari'ah Compliant List has significant impacts to the changes of price of the stocks.

When stock is removed from the Shari'ah Compliant List, it is expected that investors or fund managers who are concerned with Shari'ah compliant wealth, investments and profits will sell off these stocks and replace them with Shari'ah compliant stocks. This will adversely affect the price of the stocks. Similarly, previously non-Shari'ah compliant stocks which are now included in the Shari'ah Compliant List are expected to increase in value. However, conventional finance theories, based on the Efficient Market Hypothesis, suggest that securities are perfect substitutes for each other (Sadeghi, 2008). Therefore, the inclusion or removal of stocks from the Shari'ah Compliant List is generally assumed to be information free events that should not influence stock prices in an efficient market.

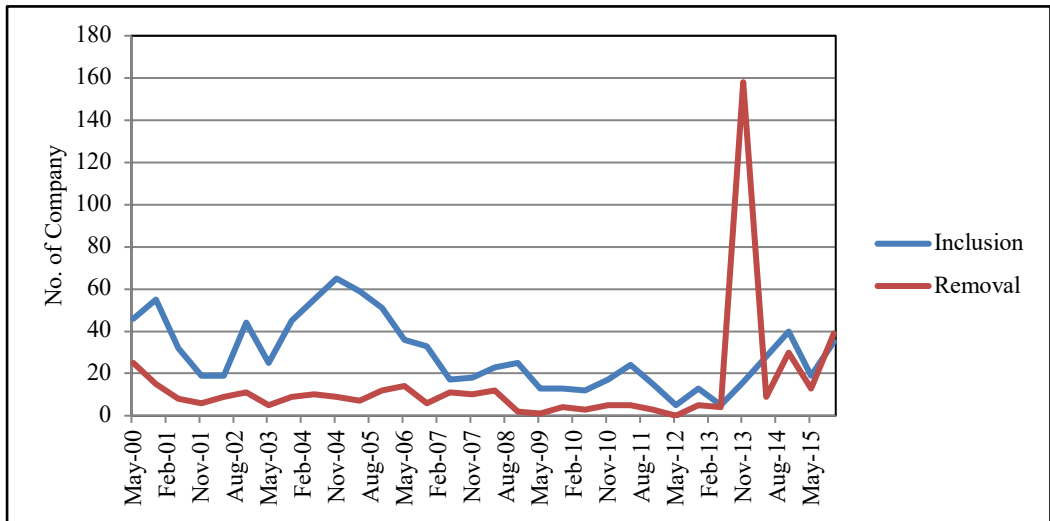
A company's stock price is the clearest measure of market expectations about its performance. The price of a company's stocks is often used as an indication of the overall strength and health of a company. In this light, scholars have attributed several internal and external factors as factors

which affect the changes in stock price that consequently give impact to the stock returns. These include company specific or internal factors like company performance, a change in the board structure, asset position, dividends and earnings, and external factors include such as governmental regulations, business cycle, investor's attitude, market conditions, as well as natural calamities and contingencies like strikes, lock outs etc. (Sharif, Purohit, & Pillai, 2015). In conventional financial theory, investors are assumed to be rational wealth maximisers who, follow basic financial rules and basing their investment strategies purely on risk-return consideration (Jagongo & Mutswenje, 2014).

Shari'ah compliant announcement contain information on whether a share is being categorized as Shari'ah compliant or non-Shari'ah compliant for the Muslim investors to know whether it is halal or haram for them to trade the shares. In Islam, Muslims are called to find halal and avoid haram to get the blessing from Allah. Muslim investors are expected to buy Shari'ah compliant shares and sold shares declared as non-compliant. Subsequently, the impact of this action towards company stock returns is questionable, hence it is hard to determine whether the stock price will appreciate or depreciate once the announcement is made. Therefore, this research is conducted in order to identify whether there is any abnormal return lead by the Shari'ah compliant announcement made by SAC.

There are numerous researches done to compare the performance between conventional and Shari'ah compliant stock. However, there are few researches conducted to study the effects of classifying stocks as Shari'ah compliant or conventional. For instance, Habib and Islam conducted a study to compare the return performance of Shari'ah compliant and conventional stocks in India and Malaysia. They found that Shari'ah compliant returns are not significantly different with the return of conventional stocks (Habib & Islam, 2014). In addition, Reddy & Fu conducted a research comparing risks and returns of Shari'ah compliant and conventional stocks on Australian Stock Exchange. It was found that Shari'ah compliant stocks are riskier but gives better return than conventional (Kr & Fu, 2014). Therefore, instead of comparing Shari'ah compliant stocks and conventional stocks, this research will study the stock return itself by analyzing whether the announcement influence changes in the stock price; for stocks included in the Shari'ah Compliant List and those removed from the list. On top of that, Yazi et al., (2015) has conducted a research to test the effect of inclusion and removal of stocks from the Shari'ah Compliant List once SAC applied revised screening methodology in November 2013.

The number of Shari'ah compliant stocks traded in Bursa Malaysia is illustrated in Figure 2 below. It shows that the Shari'ah Compliant List has been announced for approximately 37 times beginning it first announcement on 1997. Therefore, this research aims to identify the trend of companies which has been removed from the Shari'ah Compliant List to be reclassified back as Shari'ah compliant. In addition, this study is crucial to ensure whether the information obtained from the Shari'ah compliant announcement gives significant impact to the stock returns which can influence investors' investment decision. Indirectly, this study shows the level of importance of Shari'ah compliant announcements towards companies and investors. This study applies descriptive analysis to investigate the trend of the stocks removed from the list to be relisted as Shari'ah compliant and the event study methodology is used to calculate the abnormal return as indicated by the changes of stock price before and after the announcements.

Figure 2: Number of Shari'ah Compliant Stocks Traded in Bursa Malaysia

2. LITERATURE REVIEW

2.1. *Efficient Market Hypothesis (EMH)*

The efficient markets hypothesis or popularly known as the Random Walk Theory, is the proposition where the current stock prices fully reflects the available information about the value of the firm, and there is no way to earn excess profits, by using this information (Muhammad & Rahman, 2010). Hence, a market that is efficient prevents investors with no special information from making abnormal profit. Consequently, new information that becomes available is quickly reflected in a stock price. It is an idea where all subsequent price changes represent random departures from previous prices. The logic of this hypothesis is that if the flow of information is unimpeded and information is immediately reflected in stock prices, then, tomorrow's price change will reflect only tomorrow's news and will be independent of the price changes today (Malkiel, 2003). Therefore, stocks will always be traded at their fair value on stock exchanges, making it impossible for investors to purchase undervalued stocks or sell stocks for inflated prices, and it should be impossible to outperform the overall market through expert stock selection or market timing, and the only way an investor can possibly obtain higher returns is by purchasing riskier investments.

There are three forms of market efficiency; weak, semi-strong and strong (Fama, 1970). The weak form of market efficiency comprises historical prices and volumes information. The semi-strong form widens the scope to include all publicly available information, which, in the modern world of technological sophistication can reach really deep into the companies. The stretch of semi-strong form of information has really thinned out the scope of strong form of information, which specifically caters for only private and inside information (Soon & Abdul Rahim, 2016).

In the meantime, EMH validity comes with several assumptions. First, markets are made up of large, competent and fully informed investors that are always aiming for profit maximization and risk averse in their decision-making. Second, all agents have homogeneous expectations. Third, current information about the economy and individual firm fundamental are freely available and always instantaneously and correctly fully reflect available information. Fourth, no taxes, no transaction costs and no danger of bankruptcy, and fifth, the competitive pressure among economic agents will keep securities fairly priced as any opportunity to realise the excess profit is exploited without delay and then disappears (Tuyon & Ahmad, 2016).

On top of that, event studies are grounded on several assumptions, which follow market efficiency hypothesis that stock prices adjust rapidly to the information (Sennanye, 2015). Therefore, it was generally believed that securities markets were extremely efficient in reflecting the information about individual stocks and the stock market, as a whole. The accepted view is that when information arises, the news spreads very quickly and is incorporated into the prices of stocks without delay. Thus, neither technical analysis, which is the study of past stock prices in an attempt to predict future prices, nor fundamental analysis, the analysis of financial information, such as company earnings, asset values, or in this case, the announcement Shari'ah Compliance List, will enable an investor to achieve returns greater than those that could be obtained by holding a randomly selected portfolio of individual stocks with comparable risk.

According to Tuyon & Ahmad (2016), Malaysia shows the trends of an adaptive pattern of weak market efficiency across various economic phases and market states. The result is similar with a study conducted by Chin (2008), who discovered that almost all sectorial markets in Malaysia have weak form of market efficiencies, except the property index. The weak form efficient market hypothesis stated that the current asset price is determined only by the historical prices (information set) of that particular asset. This is however, in contrast with research done by Yazi et al., (2015) and Sadeghi (2008) which show that each year, once the Shari'ah Compliance List was released, the stock price would be affected as the information released reflected the changes of stock price in Malaysia market.

2.2. Stock Returns

The main difference between conventional and Shari'ah compliant company is the existence moral and ethics elements in their business operations. Islam prohibits business activities that are against the Shari'ah, such riba, gambling and alcohol as they have adverse impact to not only the society, but also the economy. Habib & Islam (2014) has conducted a study to compare the performance of Shari'ah compliant index with conventional index in India and Malaysia and revealed that conventional index perform better than Shari'ah compliant index in India. The finding shows opposite result in the case of Malaysia, where Shari'ah compliant index shows a better return. However, after the mean abnormal returns to t test was conducted it shows that the Shari'ah compliant index is not significantly different with the conventional index. In addition, Albaity & Ahmad (2008), compared the Kuala Lumpur Shari'ah Index (KLSI) and Kuala Lumpur Composite Index (KLCI) from Bursa Malaysia and found that KLSI is inferior than KLCI, and as the research objective was to both examine short term and long term relationship, it was concluded that there are no significant differences between KLCI and KLSI, in term of performance.

Similarly, Kr & Fu (2014) conducted a comparative research on the Australian Stock Exchange and found that Shari'ah compliant stocks are riskier than conventional stocks. Their study also found that Shari'ah compliant stocks give better return compared to conventional stocks. Moreover, Norman, Almsafir, & Smadi, (2013) compared conventional and Shari'ah based unit trust performance of Public Mutual Berhad. The study measured the performance by classifying three periods, namely non-financial crisis period, financial crisis period, and post-financial crisis period. The study shows that Shari'ah compliant funds performed better during a financial crisis period compared to conventional funds. However, conventional funds performed better in non-financial crisis and post-financial crisis period. Bashir, Rasyidah, & Nawang (2011) in their study found that conventional funds perform better in terms of returns compared to Islamic fund. However, Shari'ah compliant stocks cannot be generalised as bringing lower expected return.

Shari'ah indices were firstly introduced in Malaysia in 1999. The Bursa Malaysia Shari'ah index is a weighted-average index and its component was initially made up of 276 Main Board companies which have been designated as Shari'ah approved securities. At the first place, a study conducted by Sadeghi (2008) examined the performance and liquidity of included stocks. An event study methodology was used to estimate the mean cumulative abnormal returns in the days surrounding the event. The result shows that there are significant negative abnormal returns from 15 days prior to the event to 15 days after the event and there is a significant percentage decrease in the bid-ask spread over the same time interval. However, over longer periods, the cumulative average abnormal returns (CAAR) become positive and increase over time. Moreover, the change in the bid-ask spread also becomes positive and increases over longer periods. It is concluded that the market reaction to the introduction of Shari'ah indices has been generally positive due to the increases in the bid-ask spread in the longer period after the event.

A study conducted by Yazid et al., (2015) investigated the effects of the changes imposed by the SAC of Securities Commission Malaysia, to its Shari'ah screening method. The research shows that the CAAR had increased after the inclusion of stocks in the Shari'ah Compliant List while elimination of a stock from had decreased its value. The study revealed that being listed as a Shari'ah compliant stock influences the value of a stock. This indirectly shows that investors in Malaysia are very concerned with the halal and haram status of the business activities. This is consistent with observation done by McGowan & Muhammad (2010,) that a few counters have tried to be listed as Shari'ah compliant after being removed from the list. They assumed that being included or removed from the Shari'ah Compliant List will impact a company's image. Moreover, it is concluded that stock returns reaction is simply the effect of people's behavior or perception and belief in their daily business trading and this is not related to the obedience to the teaching of Islam. It is also supported by a recent study, (Tajuddin, Abdullah, & Taufil Mohd, 2018) who found a positive significant relationship between Shari'ah compliant status and initial public offerings (IPOs) oversubscription in Malaysia that leads to a suggestion that Shari'ah status company does play a vital role in investment decision making.

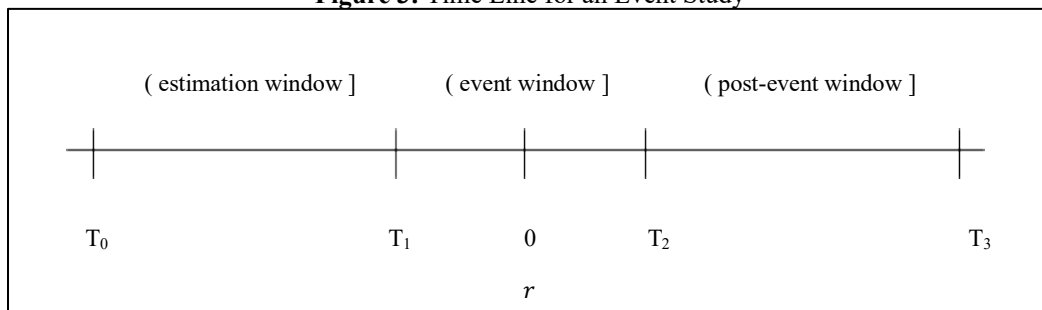
3. METHODOLOGY

Event date is identified as the day when Shari'ah Advisory Council (SAC) released the Shari'ah Compliant List. Table 1 below lists the date of announcement made by SAC.

Table 1: Shari'ah Compliance List Released Date

Shari'ah Compliance Announcement		Event Date	Shari'ah Compliance Announcement		Event Date
Year	Period		Year	Period	
2007	1 st	25-05-2007	2012	1 st	25-05-2012
	2 nd	30-11-2007		2 nd	30-11-2012
2008	1 st	30-05-2008	2013	1 st	31-05-2013
	2 nd	28-11-2008		2 nd	11-29-2013
2009	1 st	29-05-2009	2014	1 st	30-05-2014
	2 nd	30-11-2009		2 nd	28-11-2014
2010	1 st	31-05-2010	2015	1 st	29-05-2015
	2 nd	26-11-2010		2 nd	27-11-2015
2011	1 st	27-05-2011			
	2 nd	25-11-2011			

According to MacKinley (1997), the timing sequence of this event study analysis follow the timeline illustrated in Figure 2. The estimation window for this study was around 100 days, which spanned from 120 days to 21 days before the Shari'ah Compliant List was released to the public. Meanwhile, the event period ranges from 20 days before to 20 days (41 days in total) after the announcement.

Figure 3: Time Line for an Event Study

This research used quantitative research approach by collecting and analysing secondary data to meet the research objectives. The data are obtained online from three main sources which are:

- 1) The daily stock price index and company's financial reports using DataStream International.
- 2) The reports of Shari'ah screening from Securities Commission website, which were accessed through <http://www.sc.com.my>
- 3) Previous announcements and relevant data by Bursa Malaysia, which were accessed through <http://www.bursamalaysia.com>

The population for this study comprises of companies with stocks that are traded in Bursa Malaysia from 1997 up to 2015. The total population comprised of companies listed on all boards as long as the stocks have the opportunity to be listed as Shari'ah compliant. In Malaysia, the Shari'ah

compliance list was introduced in 1997 and has been imposed until now. Therefore, the population for this study comprise of all companies which has been included into and removed from the Shari'ah Compliant List, from 1997 until 2015.

The Kuala Lumpur Stock Exchange Shari'ah Index (KLSI) was launched in April 1999, and previously, all securities were traded in Kuala Lumpur Composite Index (KLCI). In 2007, Bursa Malaysia has launched FTSE Bursa Malaysia EMAS Shari'ah Index, where the FTSE EMAS Shari'ah Index was selected to be used to calculate the market return for each sample.

The Shari'ah Compliance List is announced twice in a year. Therefore, the selected sample should comprise of the company affected by the announcement. As the FTSE Bursa Malaysia EMAS Shari'ah Index was only introduced in 2007, the sample frame for this study comprised of the company which has been included and removed in/from the Shari'ah Compliant List starting year 2007 until 2015. The details of the sample frame in this study are illustrated in Table 2.

Table 2: Numbers of Company Affected by Shari'ah Compliance Announcement

Date		Previous Shari'ah Screening Methodology				Revised Shari'ah Screening Methodology			
Year	Period	No. of Included Stocks	Percentage (%)	No. of Removed Stocks	Percentage (%)	No. of Included Stocks	Percentage (%)	No. of Removed Stocks	Percentage (%)
2007	1 st	17	8.50	11	16.92	-	0.00	-	0.00
	2 nd	18	9.00	10	15.38	-	0.00	-	0.00
2008	1 st	23	11.50	12	18.46	-	0.00	-	0.00
	2 nd	25	12.50	2	3.08	-	0.00	-	0.00
2009	1 st	13	6.50	1	1.54	-	0.00	-	0.00
	2 nd	13	6.50	4	6.15	-	0.00	-	0.00
2010	1 st	12	6.00	3	4.62	-	0.00	-	0.00
	2 nd	17	8.50	5	7.69	-	0.00	-	0.00
2011	1 st	24	12.00	5	7.69	-	0.00	-	0.00
	2 nd	15	7.50	3	4.62	-	0.00	-	0.00
2012	1 st	5	2.50	0	0.00	-	0.00	-	0.00
	2 nd	13	6.50	5	7.69	-	0.00	-	0.00
2013	1 st	5	2.50	4	6.15	-	0.00	-	0.00
	2 nd	-	0.00	-	0.00	16	12.50	158	61.00
2014	1 st	-	0.00	-	0.00	28	21.88	9	3.47
	2 nd	-	0.00	-	0.00	30	23.44	40	15.44
2015	1 st	-	0.00	-	0.00	19	14.84	13	5.02
	2 nd	-	0.00	-	0.00	35	27.34	39	15.06
Total Stock		200	100.00	65	100.00	128	100.00	259	100.00

This study is conducted using the same sample frame. However, for descriptive analysis, the sample selected is all 107 companies which experienced one times inclusion and removal in/from the Shari'ah Compliant List within the period of 2007 until 2015.

However, for event study analysis, the sample selected is based on the availability of data in DataStream International, as the daily stock price is needed in conducting this study. Therefore, new stocks traded as Initial Public Offering was excluded from the sample due to unavailability of stock price for 120 days (estimation window) before the announcement date. For the inclusion of stock in the Shari'ah Compliant List, 79 companies out of the 200 (39.5%) sample frame were selected using the previous Shari'ah screening methodology, while 98 companies out of the 128 (76.6%) sample frame was selected using revised Shari'ah screening methodology. For the elimination of stocks from the Shari'ah Compliant List, 55 companies out of 65 (84.6%) sample frame were selected using the previous Shari'ah screening methodology while 130 companies out of 259 (50.2%) sample frame were chosen using the revised Shari'ah screening methodology. Consequently, the total sample used for this study is 362. The summary of sample size is illustrated in Table 3.

Table 3: Sample Size

Shari'ah Screening Methodology	Inclusion	Removal	Total Sample
Previous Methodology	79	55	134
Revised Methodology	98	130	228
Total	177	185	362

This research aims to investigate the impacts of Shari'ah compliance announcement towards stock price performance. The objectives are achieved using two different analysis; descriptive analysis and event study analysis. No hypothesis available for descriptive analysis; and for event study analysis, there are three hypotheses as follows:

- 1) Null (H1₀): Inclusion or removal of stocks in/from the Shari'ah Compliant List gives no impact on the Cumulative Average Abnormal Return (CAAR) within the event window.

$$H1_0: CAAR = 0$$

Alternative (H1_a): Inclusion or removal of stocks in/from the Shari'ah Compliant List gives significant impact on the Cumulative Average Abnormal Return (CAAR) within the event window.

$$H1_a: CAAR \neq 0$$

- 2) Null (H2₀): Inclusion of stocks in the Shari'ah Compliant List using previous and revised Shari'ah screening methodologies gives no impact on the Cumulative Average Abnormal Return (CAAR) within the event window.

$$H2_0: CAAR = 0$$

Alternative (H2_a): Inclusion of stocks in the Shari'ah Compliant List using previous and revised Shari'ah screening methodologies gives significant impact on the Cumulative Average Abnormal Return (CAAR) within the event window.

$$H2_a: CAAR \neq 0$$

- 3) Null (H3₀): Removal of stocks in the Shari'ah Compliant List using previous and revised Shari'ah screening methodologies gives no impact on the Cumulative Average Abnormal Return (CAAR) within the event window.

$$H3_0: CAAR = 0$$

Alternative (H3_a): Removal of stocks in the Shari'ah Compliant List using previous and revised Shari'ah screening methodologies gives significant impact on the Cumulative Average Abnormal Return (CAAR) within the event window.

$$H3_a: CAAR \neq 0$$

The analysis of this study aims to examine the impact of Shari'ah compliance announcements on stock price performance. Therefore, the most suitable method in measuring the impact of releasing new news and information towards stock prices performance is the event study methodology (Binder, 1998). Event study was used to measure the magnitude of the abnormal stock price performance at the time an event is announced, i.e. the disclosure of the Shari'ah Compliant List to the public. This provides a measure of the unanticipated impact of this event on the stock prices (Yazi et al., 2015).

Subsequently, the analysis undertaken in this study involved the estimation of the expected returns model to calculate abnormal returns in the analysis period. This study applied market model to estimate the expected return. The market model was selected as it assumes that there is a stable linear relationship between stock returns and the market return (MacKinley, 1997). For this study, the event study analysis was done using a special software called 'Event Study Metric' version 1.06. The details calculation for this analysis is shown through the following steps:

The calculation of the stock return is as follows:

$$r_{i,\tau} = \ln(P_{i,\tau}) - \ln(P_{i,\tau-1}) \quad (3.1)$$

Where $r_{i,\tau}$ is the natural logarithm of the daily price or a continuously compounded rate of return and P is the closing stock prices for the company i at day τ . This study imposed a short-term event study. Therefore, calculation of stock return using continuously compounded returns (log returns) is recommended (Pagan, 1996).

The calculation of market return is as the follows:

$$R_{i,\tau} = \alpha_i + \beta_i R_{M,\tau} + \varepsilon_{i,\tau} \quad (3.2)$$

Where $R_{i,\tau}$ is the expected return of the company i stock price on event day τ , α_i is the intercept term for stock i , β_i is the slope term for stock i and $R_{M,\tau}$ is the return on the benchmark FTSE Bursa Malaysia EMAS Shari'ah Index for each day in the event window. The variables α and β are estimated using the historical stock returns and market returns over a 120 day estimation period ending 21 days prior to the announcement date.

The calculation of abnormal return is as the follows:

$$AR_{i,\tau} = R_{i,\tau} - E[R_{i,\tau}|\Omega_{i,\tau}] \quad (3.3)$$

Where $AR_{i,\tau}$ is the daily abnormal returns of stock i of company for event day τ , $R_{i,\tau}$ is the actual return of the company stock i on event day τ and $E[R_{i,\tau}|\Omega_{i,\tau}]$ is the expected return of the company stock i for event day τ .

The calculation of average abnormal return is as the follows:

$$AAR(\tau_1, \tau_2) = \frac{1}{N} \sum_{i=1}^N AR_i(\tau_1, \tau_2) \quad (3.4)$$

Where $AAR(\tau_1, \tau_2)$ is the average abnormal return for a specific day τ , N is the number of firms with abnormal returns on day τ . The AR is averaged across firms to minimize the other event effects, thus providing a better measure of the effect of the announcement event (Yazi et al., 2015).

The calculation of cumulative abnormal return is as the follows:

$$CAAR_{\tau} = \sum_{i=-20}^N AAR_i \quad (3.5)$$

Where $CAAR_{\tau}$ represents the average total effect of the event across all firms. Both AAR and $CAAR$ are calculated over an event window of $i = -20$ days to $+20$ days.

There are several event studies used in empirical finance that they can be grouped into parametric and nonparametric tests. Parametric tests include Standardised Residual Test by Patell (1976) and Standardised Cross-Sectional Test by Boehmer, Musumeci and Poulson (1991) while non-parametric tests include Rank Test by Corrado (1985) and Generalized Sign Test by Cowan (1992) (Serra, 2002). The testing procedure used in this study is discussed below.

In this study, the test statistic for the abnormal return was based on the standardized cross-sectional t-test as proposed by (Boehmer, Masumeci, & Poulson, 1991). The same method was also used by Sadeghi (2008), who studied performance of Shari'ah compliant investment in Malaysia market. The standardized cross-sectional standard deviation can be written as:

$$S(\overline{CSAR}) = \frac{1}{N(N-1)} \sum_{i=1}^N [CSAR_i(\tau_1, \tau_2) - \overline{CSAR}(\tau_1, \tau_2)]^2 \quad (3.6)$$

4. RESULTS AND DISCUSSION

This study determines event date as the date the Shari'ah Compliant List was released to the public, with the estimation window is around 100 days, beginning 120 days through to 21 days before the announcement and the event period ranges from 20 days before to 20 days after the announcement. In addition, this study applies market model and used daily stock price to calculate abnormal return. FTSE Bursa Malaysia EMAS Shari'ah Index was used as the benchmarks in calculating market return. As such, the findings are classified into eight sub periods covering three phase of announcement:

- i) Pre-announcement period.
(-10 day to 0 day) and (-20 day to 0 day).
- ii) During the event announcement.
(-1 day to +1 day), (-3 day to +3 day), (-10 day to +10 day) and (-20 day to +20 day).
- iii) Post-announcement period.
(0 day to 10) and (0 day to 20 day).

Table 4: Impact on Stock Price Performance to the Announcement of Shari'ah Compliant List

Subperiod	Non Shari'ah Compliant Stocks to Shari'ah Compliant Stocks (Inclusion)		Shari'ah Compliant Stocks to Non Shari'ah Compliant Stocks (Removal)	
	CAAR	t-statistic	CAAR	t-statistic
i) Pre announcement				
(-10...0)	-0.019	-1.522	-0.025	-2.709**
(-20...0)	-0.003	-0.073	-0.023	-1.475
ii) During announcement				
(-1...1)	0.006	1.801*	-0.013	-3.158***
(-3...3)	-0.012	-1.501	-0.022	-4.495***
(-10...10)	-0.014	-1.059	-0.038	-3.638***
(-20...20)	-0.005	-0.812	-0.057	-3.776***
iii) Post announcement				
(0...10)	0.006	0.802	-0.019	-3.398***
(0...20)	-0.002	-0.417	-0.041	-5.042***

Notes: ***p< 0.01, **p< 0.05, *p< 0.10

The objective is to examine the impact of stock returns to the Shari'ah Compliance Announcement without segregated the sample based on their screening methodology. Therefore, a total of 117 inclusion samples in the Shari'ah Compliant List and 185 removal samples from the Shari'ah Compliant List were used to represent the total population. The summary of the findings is shown in Table 4.

The findings for hypothesis 1 are mixed. For the inclusion of stocks in the Shari'ah Compliant List, this study fails to reject H10 except for the event announcement in -1 day to +1 day sub periods. Therefore, the inclusion of stocks in the Shari'ah Compliant List gives no significant impact on the companies CAAR except one day before and after the announcements. For the removal of stocks from the Shari'ah Compliant List, this study has to reject H10 except for the event announcement in -20 day to 0 day sub periods. This shows that the removal of stocks gives negative significant impact on companies' CAAR.

Stocks that are included in the Shari'ah Compliant List showed insignificant impact, except for -1 day to 1 day period that denotes a significant level of confidence at 10%. It shows that the stock returns was positive within one day before and after the announcement was made. There was not enough evidence to conclude that the inclusion of stocks in the Shari'ah Compliant List has positive

impact to its returns. However, the stocks removed from the Shari'ah Compliant List show a significant negative impact to its return, except for pre-announcement period within -20 day to 0 day. The negative price performance is significant at 5% level of confidence for day -10 day to 0 day while for all sub periods, during and post announcement are significant at 1% confidence level. Therefore, it can be concluded that the removal of stocks from the Shari'ah Compliant List has negative impact on the stock return after the announcement was made by the SAC, as Shari'ah compliant investors choose to sell their stocks which lead to the decline of stock prices.

Figure 4: Comparison of CAAR between inclusion (removal) of stocks in (from) the Shari'ah Compliant List

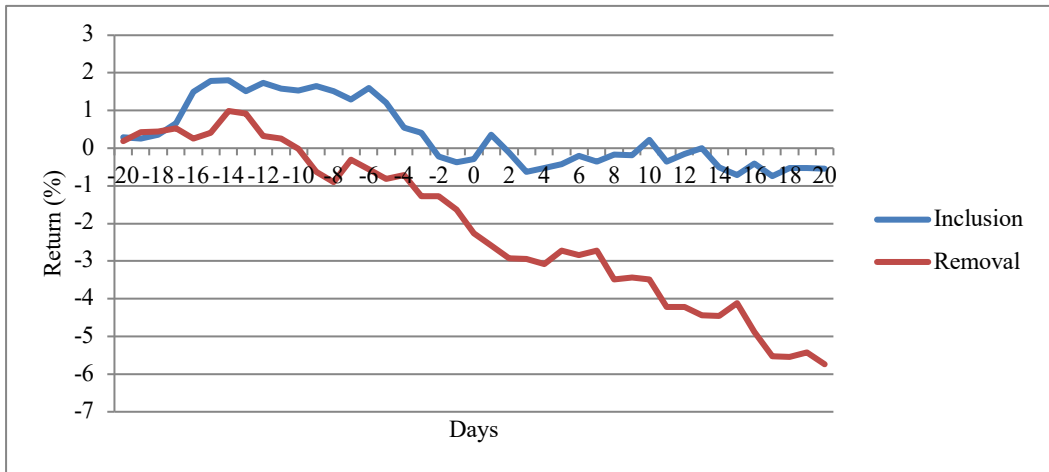


Figure 4 shows the comparison of the CAAR between the inclusion and removal of stocks in/from the Shari'ah Compliant List. It shows that the CAAR for removal stocks had obtained negative returns started from -10 day (-0.02%). The return continued to decrease until the highest negative return in 20 days (-5.74%). Yazı et al. (2015) assumed that there are information leakages that cause the investors to sell their stocks earlier before the announcement was even made. For the inclusion of stocks into the Shari'ah Compliant List, the CAAR shows positive return only on 1 day (0.36%, 10 day (0.23%) and 13 day (0.01%). This result contrasts with Yazı et al., (2015) which found that CAAR for the inclusion stocks was 10.67% at day 9 prior the announcement and the stocks remained to give positive returns until day 60.

The results show that Shari'ah compliance announcement has a valuable information content which influence investors action, which appears to be contradict with the theory that Malaysian equity market is a weak efficient market. As such, the present study has significantly contribute to the body of knowledge in Malaysian Efficient Market Hypothesis. It is highlighted that Shari'ah compliance announcements are made for Muslim in order to assist them avoiding haram investment activities, resulting Muslim investors reacted to the announcements being made. Therefore, the present study has significantly contribute to the practical implication for companies' management teams by measuring the significant of listing in the Shari'ah Compliant List, where,

listing in the Shari'ah Compliant List is not just to follow religious rules, but also provide positive impacts on company performance.

5. CONCLUSION

Event study is employed to test whether Shari'ah compliant announcement have any informational value to market participants. The inclusion of stocks in the Shari'ah Compliant List has positive impact towards stock price performance during the event announcement in -1 day to +1 day sub period only. Meanwhile, for the removal of stocks, there is sufficient evidence to support that the Shari'ah compliance announcement has negative impact on stock price which lead to the decrease of stock returns, starting from the -10 day before announcement and the prices have continuously dropped until the -20 day. However, the announcements have the most impact when the stocks were removed from the Shari'ah Compliant List. The inclusion of stocks in the Shari'ah Compliant List only has positive impact during -1 day to +1 day.

As a conclusion, the announcements of Shari'ah Compliant List carry informational value and have significant impact to the stock returns in Malaysia Capital Market. In other words, the investors give reaction to the announcements that lead to the changes of CAAR. Even though Malaysian market has been classified as weak efficient market which stated that the stock price is determined only by the historical prices, it is not witnessed when it relates to the Shari'ah compliance announcements as suggested by a decline of stock returns when the stock is removed from the list and increased of stock returns on the day new stocks has been classified as Shari'ah compliant. This suggests that the Shari'ah Compliant List, which has been announced for twenty years, influence investors' decision that lead to the increased or decreased of stock returns. Therefore, Shari'ah compliance announcements are important to the Malaysian market players as it gives significant abnormal return to the stock price. In addition, this study found a consistent result with the theory of efficient market; which any information arises or news spreads very quickly and is incorporated into the prices of securities without delay. Thus, neither technical analysis, which is the study of past stock prices in an attempt to predict future prices, nor even fundamental analysis, which is the analysis of financial information would enable an investor to achieve greater returns.

The study makes the following recommendations for future research:

- 1) The period of the study used in this study was 9 years from May 2007 to November 2015 and was grouped into two types, May 2007 until May 2013 – Samples using previous Shari'ah screening methodology, and November 2014 until November 2015 – Samples using revised Shari'ah screening methodology. The previous screenings cover almost seven years while the revised methodology represents samples from only three years. A longer study period to represent the revised screening methodology is recommended for future research.
- 2) A quantitative approach using primary data should be conducted to explore the perceptions of investors with regard to the Shari'ah compliance announcements. Even though the announcement has an impact to the stock price performance, but it is hard to decipher the identity investors who react to the announcement, particularly whether they are Muslims or not.

- 3) This study can be replicated in for other Islamic indices to examine the informational value of Shari'ah compliant announcements to respective market participants. This will provide a comparison with the current findings.

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