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A DELVE INTO PERFORMANCE OF SUKUK (ISLAMIC BONDS) AND CONVENTIONAL BONDS ISSUED BY PLCS IN MALAYSIA

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ABSTRACT: *The purpose of this study is threefold; (i) to analyze the performance of the public listed companies (PLCs) that issues sukuk (also known as Islamic bonds) as compared to conventional bonds. (ii) to validate the relationship between bond facets and firms' performance and (iii) to evaluate the effects of independent variables in terms of size of issuance, bond's rating, coupon rate, types of instruments and tenor of each issuance towards firm's performance. The results revealed by multivariate regression and independent T test were shown there is a statistically significant relationship between bond facets with firm's performance. Most of the public listed issuer was issued sukuk as compared to conventional bonds during study periods.*

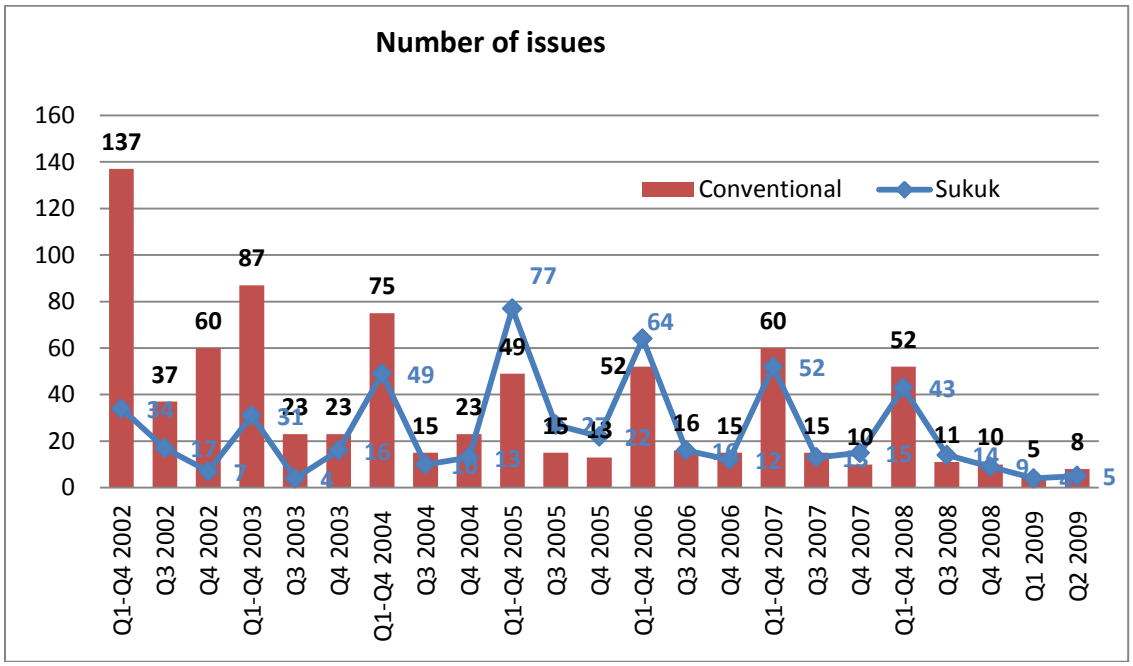
KEYWORDS: Sukuk, Conventional Bonds, Bond facets, Public Listed Companies,Performance

INTRODUCTION

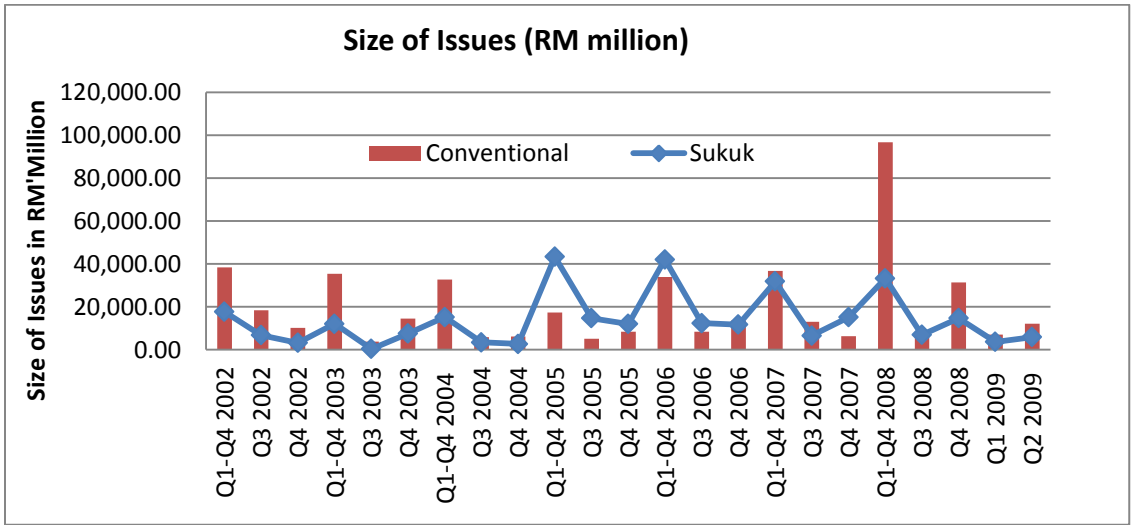
Sukuk are identical to conventional bonds in Malaysia. It always has time to maturity, a coupon rate, and trades on the normal yield price relationships. For conventional investors, the structuring of the bonds by the issuer is irrelevant. The difference lies only in the way the issuer structure the bonds. Sukuk is structured such that the issuance is not an exchange of paper for money consideration with the imposition of an interest as per conventional. It is based on an exchange of approved asset for some financial consideration that allows the investors to earn profits from the transactions. Approval of the assets and the contract of exchange would be based on Shariah (Islamic law) principles, which is necessary to meet the Islamic requirement. On the other hand, conventional bonds are standard bonds bearing a coupon, paying interest twice a year and have a maturity date at which they will redeem their bonds at face value or par value. The price of conventional bonds will change primarily with the change in interest rate, which could include trading activities that are deemed prohibited and are not regarded as suitable for Muslim investors.

The Islamic Banking Act of 1983 was based on an acknowledgement of the aspirations of Muslims to have *riba*-free banking and investment services as well as the government's goal of establishing a modern financial system in every aspect to Malaysia's socio-economic goals for

the 21st century economy. On a continuous basis, the Malaysian government has been revising and adapting its Interest Free Banking Scheme and securities programs to meet market and economic changes. Sukuk was regulated under the powers of the Securities Commission (SC) in Malaysia which nowadays demanding by issuer. This is statistically shown in graph below;



Graph 1: Number of Issuances



Graph 2: Size of Issues

Graph 1 and 2 shows a tabulation of number of issues and size of issues in quarterly and yearly basis from the study period. Graph shows that the sukuk increasing in number and size of issues in Malaysian capital market in 2005 and 2006 as compared to conventional bonds. However, a drop in the number of sukuk issued in Southeast Asia mainly result of a fall in Malaysian corporate medium-sized issuance. Despite this, Malaysia remains the world's leader in sukuk issuance by both number and value. However, the level of bond show decreasing in bond market for either Islamic or conventional starting from quarter 3, 2008 until latest empirical data to quarter 2, 2009. Probably due to economic recession in 2008 and Malaysia take a proactive action to avoid huge debt and mitigate risk through monitoring firm's leverage level.

The remainder of the paper is structured as follows. In section 2, the study discusses the development of hypotheses through reviewing previous articles. In section 3, it was introduce the operational definition used, present the proposed methodology and describe the data for the study. The methodology is applied in section 4. Then, section 5 highlight the contribution and significant of study and last section 6 was concludes the paper.

REVIEW OF LITERATURE AND HYPOTHESIS DEVELOPMENT

In this study, the hypothesis are developed based on previous literature and report done by many authors, for instance Shahrim (2006) and Al-Amine (2001) were focused on leverage and risk when issuing bonds. They mentioned that bonds issued by high leverage companies are considered risky for Muslims, as they might contain elements of gharar and may lead to maysir. In conventional bonds there is exploitation of interest rate movement, and the bond risk is assessed not by the bondholder, but by a third party rating agency. Therefore, it can be said that the bondholder's only concern is the return, without any consideration of the use of the proceeds. Besides the return, size of sukuk issuance need to be considered when making a decision in creating structure of capital by firms. Usually, the money raised from the sukuk issuance is used to invest in the underlying asset (Clifford, 2008; Manaf, 2007; Shahrim, 2006). In addition, the issuance of Sukuk has undergone rapid increase; for example, London based financial institutions had arranged more than a dozen Sukuk issuances on behalf of Middle Eastern clients in 2006, while in 2008 Indonesia will increase the sale of both conventional and Islamic bonds in order to generate a domestic source of finance to solve its financial deficit (Emergingmarketsmonitors.com, 2007; Alvi (2006; 2007).

Aziz (2007) a governor of Bank Negara Malaysia said that the growing role of Islamic finance in mobilising and channeling funds to productive investment activities across borders contributes to more efficient allocation of funds across borders and facilitates international trade and investment. The more recent developments in Islamic finance are the rowing significance of the sukuk market to become an increasingly important component of the development of the global sukuk market. Similar with Thomas (2007) also stress on the important of the sukuk market by argued the application of forward lease is an innovation developed. Alshowaikh (2008) also mentioned that Malaysia has been developing a more extensive capital market after the Asian financial crisis to ensure a more resilient financial system. Here with, this study was developing the first and second hypotheses to outfit for the pooling regression model as below:

H1: There is a significance relationship between size of issuances and firm's performance.
H2: There is a significance relationship between coupon rates and firm's performance.

Tariq (2004) mentioned the success and popularity of the Sukuk framework as an alternative asset management platform will invariably require inbuilt mechanisms which can be instrumental in mitigating risks that exist in the structures due to the benchmarking of Sukuk with market references such as London Inter-bank Offer Rate (LIBOR). Then, Rodney (2008) provides an analysis of different sukuk structures from a financial perspective includes murabahah and ijara-based sukuk, the former offering a fixed return, and the latter, the most popular form of sukuk, a variable return. However, Rosly and Sanusi, (2008) argue that financial contracts involving use of bay' al-inah and bay' al-dayn have been extensively used in design of Malaysian Islamic bonds. These mechanisms for both have been found unacceptable by the majority of Islamic scholars and propose the use of financing based on murabahah and musharakah principles as genuine alternatives to Interest-bearing financial instruments. Thus, this study was comes out with third hypothesis as below:

H3: There is a significance relationship between types of instruments and the firm's performance.

From view of conventional bonds, Modigliani and Miller (1958) argue that the presence of perfect capital markets, all financial decisions including debt maturity do not matter. Stiglitz (1974) has formalized and extended Modigliani and Miller's propositions to demonstrate that the debt maturity structure is irrelevant for firm value under perfect market assumptions. However, market imperfections, which are later introduced primarily based on the role of agency cost, signaling and asymmetric information, liquidation risk or taxes, have led to theories supporting the choice of debt maturity mix either short or long term debt. Enclosed, the study was concluding the fourth hypotheses as below:

H4: There is significance relationship between maturity periods of bond or tenure and firm's performance

Jobst et. al (2008) said that the recent years have witnessed a surge in the issuance of Islamic capital market securities *(sukuk)* by corporates and public sector entities amid growing demand for alternative investments. As the *sukuk* market continues to develop, new challenges and opportunities for sovereign debt managers and capital market development arise. Moreover, Ismail (2002) mentioned the growth of Islamic Private Debt Securities ("IPDS") in Malaysia has been very encouraging since the first issue in 1990. In 2001, the issuance of IPDS constituted 43% of total PDS issued compared to 34% in 2000. With that, the last hypothesis was set up as below:

H5: There is significant means different between Islamic bonds and conventional bonds among public listed issuer in Malaysia.

RESEARCH METHODOLOGY

3.1 Operational Definition of sukuk versus conventional bonds and its facets.

Sukuk or Sikak come from Arabic word means Islamic bond or Islamic Investment Notes. Abadi (2007) was defined the words sukuk in his Al Muhit qamus, p.960 as "to strike or to hit, the connotation is allied to strike one's seal on a document. Sukuk also refers to Islamic securities that comply with syariah principles and rules which prohibit the issues of gambling and riba (excessive interest rate charging). As compared to conventional bonds definition, as a debt security issued by a corporation and sold to investors. In Malaysian capital market, word sukuk has been used interchangeably with the syariah securities as poles apart from the conventional bonds. Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) released an exposure draft of its Shari'ah standards concerning Sukuk in November 2002. The exposure draft of AAOIFI Shari'ah Standard No. 18, p.4 stated that *"Investment Sukuk are certificates of equal value representing, after closing subscription, receipt of the value of the certificates and putting it to use as planned, common title to shares and rights in tangible assets, usufructs, and services, or equity of a given project or equity of a special investment activity."* According to Manaf (2007), sukuk is an investment certificate which allows investors to claim ownership of underlying assets. Many types of sukuk issues in Malaysia capital market i.e. sukuk Murabahah and sukuk Bai Bithamin Al-Ajil (BBA) which rated the most popular Islamic private debt securities issued (Saad et. al, 2009) and these are also proved by Rating Agency Malaysia (RAM), besides sukuk Musyarakah, sukuk Ijarah, sukuk Istisna and etceteras.

In this study, the types of bond instrument were indicated 1 for the sukuk and 2 for the conventional bonds. Data on coupon rate was collected based on the ranking; 1 if the bond issuance is zero coupon bond or 0 percent interest, 2 for less than 3 percent, 3 for 3 to 5 percent, 4 for more than 5 percent and 5 for floating rate of interest. Similar ranking was developed to represent data on bond rating where 1 for AAA (high class bond); 2 for AA; 3 for A; 4 for BBB and 5 for others (C and below which is classify as a speculative bond or junk bond).

3.2 Sampling and Data Collection

The sample of mixed 970 issuance Islamic and conventional bond had been randomly selected from the BNM bond info's website in Malaysia for eight conservative year's period from 2002 to 2009. For the purpose of collecting information on the bond facets, this study obtained data from the RAM where there are sufficient for gathering such data considering Islamic and conventional perspectives. Thompson's DataStream and Bloomberg were used to employ the data on firm's performance (N=966). The determination of the dependent variables mostly depends on these recent surges of studies done by Cantor and Packer (1995) on rated or non-rated securities affect default risk; Kaminsky and Schmukler (2002) on types of rating affect other asset and Gande and Parsley (2003) also on rating or bond grade effects yield or returns; Karmilla et. al. (2009) on various types of returns links to sukuk pricing and in details was mentioned sukuk issuer may devise sukuk pricing in setting returns to the holders in many ways. For example, sukuk issuer may introduce a variable returns to the holders of the certificates. A contrast to return factor which is focus on risk done by Khan and Ahmad (2001) identify various unique credit risks that are particular to Islamic finance. Sukuk issuances maneuver for the large fraction in emerging

bond markets where posses less sophisticated risk management mechanisms counterparty. The rescheduling and rearrangement of bond issuances at higher markup rate is not permissible due to the prohibition of excessive interest rate charging or riba. Thus, counterparties would be more inclined to default on their commitments to other parties. In fact, agency costs are higher with regard to equity arrangements.

Next, the relationship between the bond facets and firms' performance will be estimated using the following regression equations:

$$ROA_i = \alpha + \beta_1(RATING_1) + \beta_2(ISSUE_2) + \beta_3(INST_3) + \beta_4(TENOR_4) + \beta_5(COUPON_5) + \varepsilon_i$$
$$ROE_i = \alpha + \beta_1(RATING_1) + \beta_2(ISSUE_2) + \beta_3(INST_3) + \beta_4(TENOR_4) + \beta_5(COUPON_5) + \varepsilon_i$$
$$OPM_i = \alpha + \beta_1(RATING_1) + \beta_2(ISSUE_2) + \beta_3(INST_3) + \beta_4(TENOR_4) + \beta_5(COUPON_5) + \varepsilon_i$$
$$AT_i = \alpha + \beta_1(RATING_1) + \beta_2(ISSUE_2) + \beta_3(INST_3) + \beta_4(TENOR_4) + \beta_5(COUPON_5) + \varepsilon_i$$
$$BV_i = \alpha + \beta_1(RATING_1) + \beta_2(ISSUE_2) + \beta_3(INST_3) + \beta_4(TENOR_4) + \beta_5(COUPON_5) + \varepsilon_i$$
$$NPM_i = \alpha + \beta_1(RATING_1) + \beta_2(ISSUE_2) + \beta_3(INST_3) + \beta_4(TENOR_4) + \beta_5(COUPON_5) + \varepsilon_i$$
$$FAT_i = \alpha + \beta_1(RATING_1) + \beta_2(ISSUE_2) + \beta_3(INST_3) + \beta_4(TENOR_4) + \beta_5(COUPON_5) + \varepsilon_i$$
$$LnSALES_i = \alpha + \beta_1(RATING_1) + \beta_2(ISSUE_2) + \beta_3(INST_3) + \beta_4(TENOR_4) + \beta_5(COUPON_5) + \varepsilon_i$$
$$LnDTE_i = \alpha + \beta_1(RATING_1) + \beta_2(ISSUE_2) + \beta_3(INST_3) + \beta_4(TENOR_4) + \beta_5(COUPON_5) + \varepsilon_i$$
$$LnDTA_i = \alpha + \beta_1(RATING_1) + \beta_2(ISSUE_2) + \beta_3(INST_3) + \beta_4(TENOR_4) + \beta_5(COUPON_5) + \varepsilon_i$$

RESULTS AND DISCUSSION

Table 1 revealed the minimum, maximum, mean and standard deviation of bond facets and firm's performance indicators. Amidst the period of studied (2002-2009), the minimum value of firm's performance is shown bad sign representing statistically negative value to all variables for instance ROA (-13.486), ROE (-134.283), OPM (-62.172), NPM (-106.753), LnDTE (-0.797) and LnDTA (-1.061). Otherwise, the maximum value indicates positive value to all. Nonetheless, the means value didn't show encouraging figure since ROE indicate negative and other ratios indicate low. Most of the bond issuance is sukuk or Islamic bond and represent high grade bond with the mean 2.315 means the bond rating is between AA to A. The size of issuance value bond have been log due to thousand million figure issues by certain companies for examples Projek Lebuhraya Utara-Selatan Berhad (PLUS Bhd) on 27-Dec-2007 for RM3,550 million and Public Bank Berhad on 5-Jun-2009 for RM5,000 million. Statistics shown the maturity period of the bond or tenure indicate 100 years is the longest and less than a year for the short term bond with the mean of 7.105 years maturity period. Bond coupon shows that majority of the issuance is zero coupon. It should be noted that government is a major player in Malaysian capital market which offered low rate to zero resulted to low standard deviation at 1.109 meaning bearing a low risk.

Table 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Dev.
ROA	966	-13.486	44.909	2.011	7.415
ROE	966	-134.283	129.642	-8.703	52.619
OPM	966	-62.172	79.510	43.952	28.416
AT	966	.000	2.130	.307	.348
BV	966	.000	6.000	2.174	1.761
NPM	966	-106.753	59.688	3.595	46.879
FAT	966	.000	57.906	1.572	3.417
LnSALES	962	1.034	4.492	2.859	.608
LnDTE	947	-.797	2.524	1.940	.428
LnDTA	948	-1.061	5.253	1.665	.594
RATING	970	1.000	5.000	2.315	1.087
LnISSUANCE	970	3.602	9.892	6.828	1.105
INSTRUMENT	970	1.000	2.000	1.224	.417
TENURE	970	.000	100.000	7.105	5.589
COUPON	970	.000	6.000	1.408	1.109

Table 2 shows the result for the multiple regressions for all variables involved in the study. From the result we can see that bond rating and coupon have a statistically significant positive relationship with the ROA at 1 percent and 10 percent confidence level with P value of 9.047 and 2.505 respectively. Other bond facets such as issuance, instrument and tenure do not have significant value. Meaning that, H1 and H3 were rejected at this level. Similar evidence applied to ROE where only rating (P=13.047) and coupon (P=3.394) was shown significant positive relationship at 1 percent confidence level and the other explanatory variables are not. OPM shown significantly negative relationships with rating, instrument and coupon but tenure indicate positive and result was shown not significant with size of issuance. Surprisingly that AT and FAT were shown a significant result to all bond facets. This is, however, only 2 bond facets (rating and tenure) shown a significant positive result to NPM and the improvement of significant result for log Sales and log DTA with 4 and log DTE with 3 bond facets have a relationships. Thus, H2 and H4 were accepted. R-squared and adjusted R-squared for all firm's performance proxies indicate results between 0.083 to 0.398 and 0.079 to 0.395 respectively and therefore explaining a somewhat not strong relationship because only 8.3 to 39.8 percent of the variation in firm's performance proxies is explained by the variation in the bond facets. F-statistics had shown significant value for all variables at 1 percent confident level.

Table 2: Regression Results

Dependent	Constant	Rating	Issuance	Inst	Tenure	Coupon	R Square	Adj. R	F-value
ROA	-2.020	9.047	-.087	.029	-.285	2.505	0.109	0.104	23.452
	.044	.000***	.931	.977	.776	0.012*			.000***
ROE	-5.440	13.047	-.595	1.021	.322	3.394			52.353
	.000	.000***	.552	.308	.747	0.001***	0.214	0.210	.000***
OPM	16.399	-6.399	-.567	-9.336	8.409	-9.593			127.094
	.000	.000***	.571	.000***	.000***	.000***	0.398	0.395	.000***
AT	3.067	2.850	-4.321	9.409	-5.137	2.663			57.924
	.002	0.004**	.000***	.000***	.000***	0.008**	0.232	0.228	.000***
BV	-1.759	2.444	8.615	-7.264	-.898	3.460			17.469
	.079	0.015*	.000***	.000***	.369	0.001***	0.083	0.079	.000***
NPM	-2.173	12.993	-1.515	-.768	2.663	.868			43.518
	.030	.000***	.130	.443	0.008**	.385	0.185	0.181	.000***
FAT	-6.137	4.129	3.740	2.066	1.822	5.172			27.553
	.000	.000***	.000***	0.039**	0.069*	.000***	0.125	0.121	.000***
LnSALES	9.977	-7.954	13.859	-.990	-2.803	1.865			88.759
	.000	.000***	.000***	.322	0.005**	0.062*	0.317	0.313	.000***
LnDTA	25.309	-5.610	-.735	-2.393	2.215	-9.156			46.703
	.000	.000***	.462	0.017**	0.027**	.000***	0.199	0.195	.000***
LnDTE	13.192	-.158	3.003	-6.974	-3.002	-1.407			22.387
	.000	.874	0.003***	.000***	0.003***	.160	0.106	0.101	.000***

The results in the table 3 reported out of 966 issuance, a total of 753 issuance is sukuk and 213 issuance is conventional to represent data on firm's performance and 753 out of 970 is sukuk and remaining balance of 217 is conventional bonds representing bond facets. Results of conventional bonds (ROA=3.790) and (ROE=11.298) indicate higher mean as compared to sukuk (ROA=1.508) and (ROE=11.298). However, inverse result shown to OPM where Islamic bonds (51.798) is higher mean than conventional (16.216). In terms of other proxies of firm's performance shown that conventional bonds indicate higher means except for OPM as mentioned. BV is important for the firms as a default risk benchmark (Hakim and Shimko 1995). In general, default is caused by the firm's inability to meet its obligations in a required timely given. It can be highlighted here; the firm's with issuance of Islamic bonds have many default risk cases as compared to conventional bonds issuances. As regards on leverage performance, the lowest is better for the firm means that they bear a low risk in their financing. Result shows that conventional bonds have a lower means compared to Islamic bonds for both log DTA and log DTE. Sukuk indicate good rating offers to public listed issuer as compared to conventional bonds based on mean results of 2.131(high grade of bonds with majority of AA class) instead of 2.954 (quite low grade, BBB class).

Size of issuance shown that conventional bond is higher means than Islamic bonds with value of 7.877 and 6.525 respectively. Albeit, the numbers of sukuk is higher than conventional bonds but the total value in ringgit Malaysia shows that conventional bond issuance is higher. Therefore, a rise in the firm's debt may be interpreted as the beginning of more risky investment to follow and consequently, a large amount of bond issues a higher a risk bear in long term investment. This an empirical study only employ eight years period study is not

enough to prove the long term investment managed by firms. Result of coupon rate postulate that sukuk issuance have better (lower mean = 1.231) than conventional bonds (higher mean = 2.018) where low coupon rate will be increase the price of the bond by theoretically and versed versa. It can be concluded that, H5 was accepted since sukuk indicate higher means than conventional bonds among public issuer in Malaysia.

Table 3: Group Statistics

INSTRUMENT		N	Mean	Std. Dev.	Std. Error Mean
ROA	Sukuk	753	1.508	7.518	.274
	Conventional Bonds	213	3.790	6.760	.463
ROE	Sukuk	753	-14.361	57.532	2.097
	Conventional Bonds	213	11.298	18.617	1.276
OPM	Sukuk	753	51.798	24.565	.895
	Conventional Bonds	213	16.216	23.311	1.597
AT	Sukuk	753	.237	.231	.008
	Conventional Bonds	213	.555	.531	.036
BV	Sukuk	753	2.249	1.835	.067
	Conventional Bonds	213	1.906	1.445	.099
NPM	Sukuk	753	1.669	52.412	1.910
	Conventional Bonds	213	10.405	14.126	.968
FAT	Sukuk	753	1.073	2.260	.082
	Conventional Bonds	213	3.334	5.570	.382
LnSALES	Sukuk	749	2.802	.577	.021
	Conventional Bonds	213	3.058	.669	.046
LnDTE	Sukuk	747	2.005	.303	.011
	Conventional Bonds	200	1.700	.673	.048
LnDTA	Sukuk	748	1.751	.582	.021
	Conventional Bonds	200	1.345	.523	.037
RATING	Sukuk	753	2.131	.878	.032
	Conventional Bonds	217	2.954	1.446	.098
LnISSUANCE	Sukuk	753	6.525	.920	.034
	Conventional Bonds	217	7.877	1.052	.071
TENURE	Sukuk	753	7.230	3.201	.117
	Conventional Bonds	217	6.673	10.209	.693
COUPON	Sukuk	753	1.231	.862	.031
	Conventional Bonds	217	2.018	1.566	.106

CONTRIBUTION AND SIGNIFICANT OF THE STUDY

The originality of this study is by providing an evidence regards to the effects of sukuk and conventional bonds characteristics towards issuers' performance which can serve as signal to them to make a right decision on capital investment by properly analyzing their high-low rating, big-small size of issuance and long-medium-short term period to alleviate a certain default risk. Besides the issuer or company benefits, Malaysian regulatory bodies like Securities Commission, RAM Rating Services, Bank Negara Malaysia and other financial institutions that are acted as

banker and trustee for sukuk and conventional bonds trading can closely monitor the length, amount of issues and grade of rating of trading for approval and recommendations to issuers and sukukholders or bondholders.

CONCLUSION AND RECOMMENDATIONS

Majority of the issuances is sukuk. This finding was proven by Muhammad and Adrian from Bank Negara Malaysia in their paper on corporate bond market in Malaysia (BIS papers No.26) p.126, Islamic capital market products have garnered universal acceptance as viable alternatives to conventional products where 49.4 percent of funds raised in the private debt securities (PDS) market in 2004 were through Islamic products. It also found evidence indicating that there is a relationship between bond facets with the AT and FAT. Almost all firms' performance proxies have shown a significant value with rating except for DTE imply that issuer should deeply considered bond rating in their future issuances to tap the bond market at competitive rates. In Malaysia capital market, prior to July 2000 all corporate bond issues were subject to a mandatory minimum rating requirement of BBB or above, however this compliance rule was subsequently lifted. Overall multivariate regression shown that bond facets; size of issuance, instrument, tenure and coupon rate also significantly influenced the at least 5, 6, 7 and 8 out of 10 proxies of performance respectively. It was also found that there is a relationship between the variables despite the fact that the relationship was not a strong relationship as the value of R square is below 60%, consistent with suggestion made by Gompers et al. (2003). Again, this an empirical study only employ eight years period study is not enough to prove either Islamic or conventional bonds do performed better in the long term investment managed by firms. The study also believe that for future research, more sample period should be used.

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