ORIGINAL RESEARCH PAPER | Social Science | Volume - 7 | Issue - 4 | April-2017 | ISSN - 2249-555X | IF : 4.894 | IC Value : 79.96

A Comparative Performance Analysis between Shariah Investment and Non-Shariah Investment: Empirical Evidence from Prior Literature

KEYWORDS: Shariah Investment, risk and return, Shariah, Non-Shariah investment.

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ABSTRACT

Objective – Islamic finance is distinguished from its conventional counterparts in the context of prohibiting interest because the former abide by Shariah principles which need the companies or financial institutions to forbid interest however, latter operate on interest based transactions. Therefore, there is needed the financial institutions to fulfil the minimum guidelines provided by Shariah advisors but by following these standards is there any significant difference bring in to the performance of Shariah investment in comparison to its counterparts. The primary objective of this paper is to study the performance by examining the risk and return of Shariah investment as compared to established one.

Methodology – The study conducted systematic review using secondary sources of information.

Findings – The study found mixed results or even showed no significant differences in the returns.

Limitations - The selection bias for the literature were there and study majorly be contingent upon journals and ignored other sources.

Introduction

The concept of Shariah-compliant investment has its root since long time ago but the sector has acquired widespread attention in the last few years. After 1990, the various reforms has been taken place in the financial system which mushroomed Shariah investment all over the world and provides new avenue and alternative to the Muslim investors so that they could invest their savings in Shariah manner i.e. complies with their religious faith in the stock market. It showcased remarkable resilience during the period of global financial crisis and now the continuing negative prospects for the Eurozone and mixed macroeconomic indicators for emerging market has also fuelled the demand for Shariah compliant products around the world. Investors are also become aware of corporate governance issues of social responsibility and ethical practices prompted them to make Shariah compliant investment. With the growing demand and awareness for investing as per Shariah principles all over the world, it has become important to examine their performance. Performance evaluation plays a significant role in making a rational decision for investment. Given that, literatures pertaining to the risk-return analysis have been reviewed in order to evaluate the performance of Shariah as compared to non-Shariah investment. Since, risk-return analysis is an integral part to the process of investing and finance. So it is necessary to understand the relationship between risks and return analysis because all the financial decisions involve some risk. Every investor wants to make more money or highest possible return for the level of risk one is willing to take. The main motive behind risk-return analysis is to maximize the return by creating a balance of risk.

Review of Literature

In this section, past studies regarding the performance of Shariah investment as compared to non-Shariah investment undertaken by the various researchers have been studied.

Hassan et al. (2011) found no difference found out in the performance of Islamic and non-Islamic indexes and similar reward to risk and diversification exist between them. **Sadeghi (2008)** found out that Shariah index had a positive impact on the financial performance of shares. **Bauer et al. (2007)** belied the claim made by previous researches that ethical investment style resultant weaker performance and reported same return performance as delivered by conventional funds. **Kreander et al. (2005)** found no statistical difference between the ethical funds and the market benchmark as well as between ethical and their matched group of non-ethical funds. The ethical fund evident to be less risky.

In summary, prior work done by different authors discussed above examining the performance of Shariah versus non-Shariah investment has remained indeterminate, with findings suggested desegregated result. Therefore, this area necessitate further inquiry.

Research Design

Objective

The main objective of this study is to evaluate the performance by examining risk and return of Shariah investment in comparison to non-Shariah investment.

Sources and Methodology

The present study included various empirical literatures pertaining to the risk and return of the Islamic verses non-Islamic investment that have been published between the years 1995 until 2015. A broad key word search was carried on to find relevant papers from the various databases which left with 34 papers. The papers were scanned subsequently for their suitability with the particular subject of the literature review and excluded 27 papers from the advance analysis. In the end, 7 papers were utilised to perform the systematic review of literature proposed by Tranfield et al. (2003) and make the foundation for the results.

Empirical evidence from Literature

Shariah investment can be viewed as another alternative for making investment while meeting spiritual goals and do have significance in the current financial market. Therefore, ascertaining the performance of Shariah investment is much of concern in the present time. A large body of literatures are in existence which showcased mixed results regarding the risk return performance of Shariah versus non-Shariah investment. The first strand of literature witnessed no significant difference in the performance of Shariah and non-Shariah investment. **Hussein (2004)** showed that the application of ethical screening had no adverse effect on the FTSE Global Index performance. **Elf *et al.* (2012)** suggested no significant difference found in the risk-adjusted return of Islamic Index as compared to its counterparts. **Bauer et al. (2005)** found no significant differences in the return of ethical and conventional funds by taking into account various factors. The ethical mutual fund demonstrates distinct investment style and found to be less exposed to market return variability than its counterpart. However, performance estimates calculated are failed to explain the variation in mutual fund return. However, second strand of literature evident that Islamic funds outdid its conventional counterparts. The results of the study undertook by **Izquierdo & Saez (2008)** demonstrated superior or similar financial performance achieved by the ethical

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fund as its conventional counterparts on the basis of first analysis whereas second analysis found no significant differences between them. Therefore, it has been concluded that financial performance of ethical mutual fund leads to no sacrifice in Spain implies that ethical investment serves investors better than conventional funds. **Kok et al. (2009)** established significant improvement found in the performance of the Islamic mutual funds and indicated the possibility of diversification opportunities for non-Muslim investors. However, the remaining threads of literature suggested manifold findings while studying the performance of Islamic funds, **Mallin et al. (1995)** reported that initially ethical trust found to be underperformed than non-ethical trust and market as per mean return. However, both the ethical and non-ethical trust tends to underperform than market according to risk-adjusted measure whilst Jensen measure indicated outperformance of ethical trust than non-ethical. **Najeeb et al. (2015)** reported effective portfolio diversification opportunities in the short period whereas minimal diversification gains shown where stockholdings exceed one year.

Table 1: Empirical Evidence Analysing the Performance of Shariah Investment against Non-Shariah Investment

Author	Article type	Data Collection	Sample Size	Country of research
Mallin et al. (1995)	Empirical quantitative	Database	29 Ethical Investment Funds, 29 Non-Ethical Investment Funds and three-month Treasury bill for the risk-free interest rate proxy	UK
Hussein (2004)	Empirical quantitative	Database	Companies under FTSE-GII, FTSE All-World and FTSE4Good Global index	England
Bauer et al. (2005)	Empirical quantitative	Database	103 Ethical and 4384 Conventional mutual funds	UK, U.S and Germany
Izquierdo & Saez (2008)	Empirical quantitative	Database	2064 Ethical funds	Spain
Kok et al. (2009)	Empirical quantitative	Database	2 Islamic index, viz. FTSE Global Islamic Index (FTSEIS) and Dow Jones Islamic Index (DJIMI), 2 non-Islamic index, viz. FTSE 100 (FTSE) and Dow Jones Industrial (DJ) and 2 sustainability index, viz. FTSE 4 Good Sustainability Index (FTSE4G) and Dow Jones Sustainability Index (DJSI).	London and New York
Elf et al. (2012)	Empirical quantitative	Database	Dow Jones Islamic World Market Index (DJIM), NASDAQ Composite, benchmark proxy (Standard and Poor 100) and 90 days Treasury bill for the risk free rate proxy.	U.S
Najeeb et al. (2015)	Empirical quantitative	Database	9 Islamic Indices	Malaysia

Source: Adapted from empirical studies.

Critical analysis and Findings

Table 1 provides bibliographic information pertaining to 7 studies included in this study. The period of prior studies included in this paper range from the year 1995 till 2015. These 7 literatures have been published in different journals. Table 1 also presents that in all the studies data were gathered from different databases and classified as quantitative empirical. It can be seen that performance of screened and non-screened investment is evaluated in both developing and developed countries like USA, UK etc. With respect to techniques, the previous studies employed several statistical and econometric models such as Capital asset pricing model CAPM model, Fama-French model 3 and 4 factor model, GARCH family models. Four studies (Elf et al., 2012; Kok et al., 2009; Mallin et al., 1995) applied Capital asset pricing model (CAPM). However, Capital asset pricing model (CAPM) along with multifactor model, Carhart model, Bootstrap model, Fama-French 3 factor model and Fama-French 4 factor model were used in the two studies (Izquierdo & Saez, 2008; Bauer et al., 2005). Najeeb et al. (2015) used econometric model comprised of all GARCH family model were employed over traditional time invariant methods. The findings of the three papers (Elf et al., 2012; Bauer et al., 2005; Hussein, 2004) exhibited no significant difference found between the performance of Shariah and non-Shariah investment. On the other hand, two papers (Kok et al., 2009; Izquierdo & Saez, 2008) showed that Shariah investment outperformed non-Shariah investment and further indicated that non-Muslim investors could be benefitted from diversifying for Islamic funds and Muslim investors should not worry about opportunity cost of investing in Shariah funds only because that could be reduced by swapping their portfolios. Followed by Najeeb et al., (2015) reported effective portfolio diversification opportunities in the short period whereas minimal diversification gains shown where stockholdings exceed one year. Consequently, Mallin et al. (1995) reported that initially ethical trust found to be underperformed than non-ethical trust and market as per mean return. However, both the ethical and non-ethical trust tends to underperform than market according to risk-adjusted measure whilst Jensen measure indicated outperformance of ethical trust than non-ethical.

Concluding remarks

This study endeavoured to present a systematic review of the prior literature on evaluating the performance of Shariah investment as compared to non-Shariah investment. The review of the previous studies suggested mixed results or even showed no significant differences in their returns. For instance, several studies (Kok et al., 2009; Izquierdo & Saez, 2008) showed that Shariah investment outperformed non-Shariah investment. Furthermore, some studies (Elf et al., 2012; Bauer et al., 2005; Hussein, 2004) demonstrated no significant difference in the performance of Shariah investment and non-Shariah investment. The debate has not been resolved so far concerning to the performance of Islamic investment in comparison to the conventional investment because previous studies around the world reported desegregated results hence, an attempt should be made for future research in this area with the objective of having deeper insight of this rising subject. By adding more literatures on this emerging issues, a further research could be conducted. Also, further research avenue could evaluate the relationship between returns of the firm and different factors. As far as limitations is concerned then this review paper has limitations which are to be addressed. This study subjected to selectivity bias of the papers and using different keyword search for the prior literature might have led to the broader perspective on this subject. The selected studies were majorly from journals and ignored book chapters, books and so on.

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