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## **Sukuk Characteristics and Financial Performance Among Top 100 Listed Companies in Malaysia**

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### **Abstrak**

This study examines the relationship between sukuk characteristics and financial performance by top 100 Malaysian public listed companies. The study uses 100 firm-year observations drawn from the population of non-financial companies in 2021. To achieve the objectives of this study, quantitative method of analysis is employed. Agency theory supports the application of several governance strategies to control "agents" behaviour in organizations. Thus, new financial instrument called sukuk has given rise to several concerns. Using multiple regression analysis, the results reveal that sukuk issuance and sukuk ratings have a positive significant impact on financial performance. The findings imply that the fact that the incentives for sukuk rely on the project's income or profit is another significant way they vary from traditional bonds. Additionally, the higher rated sukuk or known as investment grade sukuk, the safer and stable investment by the sukuk holders which may enhance financial performance. The present study is unique as it helps the researcher and others to explore the practice and prospect of sukuk market in Malaysia. Exploring new practice of sukuk in Malaysia will help to understand the importance of invest in sukuk as it can lower the risk of the company's portfolio.

**Keywords:** Financial Performance, Sukuk Issuance, Sukuk ratings

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## INTRODUCTION

Islamic finance is based on Shari'ah principles, which reflect a specific purpose to satisfy participants' financial requirements with integrity and in a way that is just, fair, trustworthy, and honest, while also promoting a more equal wealth distribution (MIFC, 2007). This, on the other hand, implies that Islamic financial markets and institutions are concerned with resource allocation, management, acquisition, and investment. It unavoidably touches on the most important subject in finance: risk transformation and management. As a result, Islamic finance is intended to work similarly to conventional finance, or at the very least create the same economic effect. Islamic financial transactions must fulfil the Shari'ah's standards for equality and justice, refrain from unjust enrichment, be based on the genuine consent of all parties, and be a crucial element of legal business or economic activity such a sale, leasing, manufacture, or partnership (Zamir Iqbal, 2013).

The study's problem is to identify what is the true definition of sukuk and what are the main characteristic of sukuk. Nowadays, sukuk has become one of the most popular in Islamic financial. The financial infrastructure of countries all around the world is unbalanced. However, the infrastructure of most emerging economies is poor. Furthermore, Shari'ah-compliant design is required for Sukuk. As a result, there is an institutional rigidity that is difficult to change in the near term, boosting the risks of Sukuk. By decreasing institutional rigidity and establishing standard accounting, auditing, and income and loss recognition methodologies (AAOFI, 2002).

A new financial instrument called sukuk has given rise to several concerns. Given that the Sukuk have only recently arrived, this is a logical assumption. On the other hand, it is critical that these problems are studied and researched more thoroughly. Wilson (2008) contends that Sukuk returns are set up to resemble the characteristics of conventional bonds, but Cakir and Raei (2007) disagree, citing empirical evidence that shows Sukuk are different from bonds because they provide diversification advantages in terms of risk reduction when included in a portfolio of fixed income securities. Wilson makes the case that Sukuk returns are set up to mimic the features of conventional bonds (Alswaidan, 2017).

Although conceptually simple, some financial institutions combine elements of two or more distinct types of tools to develop hybrid securities, making the primary Sukuk structure types more difficult than traditional bonds. In order to improve the appeal of Sukuk in both the conventional and Islamic financial markets, issuers regularly highlight Sukuk with traits like those of conventional bonds. The fact that the incentives for sukuk rely on the project's income or profit is another significant way they vary from traditional bonds. Conventional bonds, on the other hand, are just debt obligations. A Sukuk's price is determined by the market value of the underlying asset, whereas the price of a typical bond is solely dependent on the issuer's creditworthiness. The sale of a Sukuk is basically the sale of a share of an asset, as opposed to the sale of a bond, which is effectively the selling of debt. However, there are other traits that sukuk and conventional bonds have in common, including rate ability, credit enhancement, and flexibility (Alsaeed, 2012).

## LITERATURE REVIEW

Financial performance is a purely arbitrary indicator of a company's capacity to make money from its core activity. The phrase is frequently used as a general indicator of an organization's long-term financial health. Financial performance is a crucial part of managing financial risk and refers to the extent to which financial objectives are being met or have been achieved. It is a technique for figuring out how much money a company's

operations and policies are worth. It is used to compare companies in the same industry, assess a company's overall financial health over time, and assess an industry or sector.

The number of Islamic financial institutions has increased to over 300, with operations in over 75 countries and assets exceeding \$400 billion since the establishment of the Dubai Islamic Bank in 1975 (with operations in the United Arab Emirates, Egypt, the Cayman Islands, Sudan, Lebanon, the Bahamas, Bosnia and Herzegovina, Bahrain, and Pakistan) (Qorchi, 2005). Islamic finance is governed by Sharia, Islam's legal system and Quranic interpretation, as well as Sunna's teachings. People can use this framework to make judgments in all aspects of their lives based on the principles of the Holy Quran and the Sunna. One of the most important components of Sharia law is financial transactions, which are expected to generate a more equitable distribution of income and wealth among Muslims in Islamic economies. (Pratami, A., & Pratama, I. 2018).

Sukuk are investment certificates that may be issued by businesses or governments, and they have certain similarities and distinctions with bonds. Sukuk, like bonds, have a maturity date and provide income streams throughout the security's life cycle, as well as a dividend to the security's holders at maturity (Abdo, 2014). Because sukuk shares represent ownership in actual assets, usufruct, or services offered by revenue-generating issuers, the value of sukuk is not determined by the issuer's creditworthiness, unlike bonds. As a result, the price of a sukuk may fluctuate based on the creditworthiness of the issuer as well as the market value of the underlying asset. (Pratama, I. 2022).

### 2.1 Sukuk Issuance and Financial Performance

The agency model is one of the first concepts in management and economics literature. The separation of owners and managers in firms causes issues, which agency theory examines and attempts to solve. This theory supports the application of several governance strategies to control "agents'" behavior in organizations. Agency theory investigates the problems and potential solutions associated with the delegation of responsibilities to agents by principals in the context of conflicting interests between the parties (Stefan Linder, 2015).

When there is a conflict of interest, particularly between the company's management and shareholders, the agency theory is one of the theories that is widely employed in the accounting industry to address issues and problems. The notion is especially significant in situations involving two parties, with one acting as the principle and the other as the agent, where the principal refers to the owners of the corporation or business (Brahmadev Panda, 2017).

Previous research concentrated on the challenges on developing sukuk's market. According to (Zulkhibri, 2017), Sukuk is becoming into a global asset class that fosters growth by luring a diverse group of issuers and investors, regardless of their connection with a particular religion. To fully exploit the sukuk market's potential as a source of development finance, international development agencies and multilateral organizations, such as the World Bank and the Asian Development Bank, should examine a range of possibilities for structuring and issuing more inventive sukuk. (Atrizka, D., & Pratama, I. 2022).

The previous research also mentioning about the sukuk default. New research on sukuk is more focused on the consequences and hazards of sukuk since the propensity of sukuk default may be detected growing from time to time. The developer of Dubai World, Nakheel, was the first sukuk to collapse, startling the financial world. Nakheel was well known for the construction of the Dubai Palm Islands in 2009. According to Zhamal (2010), because syariah forbids debt trading, any debt rescheduling for a greater markup is also illegal under sukuk, he argued in his essay that the chance of default for sukuk is higher than for conventional bonds. Thus, it is hypothesised that:

H1: There is a positive relationship between Sukuk Issuance and Financial Performance.

## 2.1 Sukuk Ratings and Financial Performance

Agency theory supports the application of several governance strategies to control "agents" behaviour in organizations (Stefan Linder, 2015). Thus, new financial instrument called sukuk has given rise to several concerns. Additionally, Larmount (2004), Alchian and Demsetz (1972) and Jensen and Meckling (1973) suggested that entities with a single product and a single goal of maximizing profit, corporations can be seen as a center for a collection of contractual relationships between people. According to Larmount (2004), businesses may be seen of as contracts that are regularly negotiated by a variety of parties, all of whom want to maximize their own profits. The agency theory heavily relies on agreements between different stakeholders to describe how a firm function. Instead of the business owners, those who invest money in the operations of the firm are perceived as taking risks. Investors that have faith in a manager's ability to use funds wisely and successfully for the firm will give them money. The contracts that the managers sign specify the obligations they must uphold as well as the format for profit sharing. The contracts that managers sign is difficult to put into practice since it is difficult to specify and foresee forthcoming issues (Andrei Shleifer, 1997).

Besides, Musharakah Theory explains the Arabic term "sharikah" or "shirkah," which signifies the mixing of assets, a partnership, or sharing, is basically translated as "musharakah." It also has the meaning of "ikhtilat," which is the mixing of two things to the point that it is impossible to tell them apart. Musharakah finance, which comprises the musharakah of depositors, banks, and investors in project funding and participation in the risks and benefits, is the most significant means to influence economic activity in the Islamic economy. As a result, it affects savings, investment, and the deficit of domestic resources. When compared to interest rates, the implementation of musharakah finance is considered as more flexible. The Musharakah of depositors, the Musharakah of banks, and the Musharakah of investors are the three rates of return that are included.

Other research looking into other sukuk pricing benchmarks are gaining steam as the market continues to ignore the argument that sukuk pricing is linked to LIBOR (R, 2008). LIBOR alternatives include structured sukuk securities with unique structures based on musharakah or a mix of numerous sukuk structures. According to some study, alternative standards to LIBOR might be adopted and linked to macroeconomic indexes of real activity for sovereign sukuk and business success for corporate sukuk.

The previous research also mentioning about the sukuk default. New research on sukuk is more focused on the consequences and hazards of sukuk since the propensity of sukuk default may be detected growing from time to time. The developer of Dubai World, Nakheel, was the first sukuk to collapse, startling the financial world. Nakheel was well known for the construction of the Dubai Palm Islands in 2009. According to Zhamal (2010), because syariah forbids debt trading, any debt rescheduling for a greater markup is also illegal under sukuk, he argued in his essay that the chance of default for sukuk is higher than for conventional bonds.

Despite the Sukuk capital market's rapid expansion, Islamic finance research is still in its infancy. In reality, the majority of study on sukuk has focused on their structures and processes in connection to conventional responsibilities. Indeed, by analyzing sukuk structures and comparing them to traditional bonds, Vishwanath & Sabahuddin (2009) support the notion that sukuk is an effective vehicle for mobilizing money and managing liquidity, and that its asset backing makes sukuk investment more secure. Thus, it is hypothesised that:

H2: There is a positive relationship between Sukuk Ratings and Financial Performance.

## **METHODOLOGY**

The population covers top 100 listed companies in Bursa Malaysia in year 2021. Data are gathered from annual report as and Thompson Reuters DataStream, Bloomberg DataStream. Consistent to previous studies, this study also excludes the information from financial and banking institutions. This is mainly because the terms of ownership and the fiscal policies are more closely monitored and partially due to the various accounting methodologies used in the financial statement.

The research is carried out for the cause of empirical analysis and classified according to the purpose (Robson, 2002). This study uses descriptive tests to clarify the connections between variables and to explore them. In an explanatory analysis specific data is clarified and considered (Gray, 2009). Thus, the measurement of variables for this study can be divided into three part such as dependent, independent and control variables which are similar variables used in prior studies. In previous studies, these variables were tested and assumed to be consistent when performing the test because they can influence ROA. The measurement on each variable used is as follows:

Acronyms	Variable Name	Measurement
ROA	Return on Assets (Performance) (DV)	Net Income / Total Asset
SKI	Sukuk Issuance (IV)	Sukuk is a dummy variable that equals "1" if firm issued Sukuk or disclose related information and "0" with no issuance.
SKR	Sukuk Ratings (IV)	Dummy variable that equals "0" with no ratings or no issuance sukuk, "1" is for AAA rating sukuk, "2" is for AA rating sukuk, "3" is for A rating sukuk, "4" is for BBB rating sukuk, "5" is for BB rating sukuk, "6" is for the B rating sukuk and "7" otherwise.
AQ	Audit Quality (CV)	Equals "1" if firm is audited by a Big 4 firm and "0" otherwise.

*Regression model:*

$$ROA = \alpha_{it} + \beta_1 SKI_{it} + \beta_2 SKR_{it} + \beta_3 RC_{it} + \beta_4 AQ_{it} + \mu_i$$

## **4.0 Findings and Analysis**

This section presents the results of the empirical tests based on the research process outlined in section 2 and section 3. Basically, this chapter presents and discusses the result of the model that estimates the sukuk characteristics and financial performance among top 100 listed companies in Malaysia.

*Table 4.1: Descriptive statistics of dependent variable and independent variables*

Variable	Mean	Median	Std. Dev.	Min	Max
ROA	1.82	1.23	1.74	0.42	4.28
SKI	0.67	1	0.47	0	1
SKR	1.22	0	0.95	0	3
AQ	0.56	1	0.50	0	1

Note: n=100. ROA is return on assets; SKI is sukuk issuance; SKR is sukuk ratings; AQ is audit quality.

Table 4.1 shows the descriptive statistics of the independent variables of SKI, SKR, AQ and ROA as the dependent variable. The mean for ROA is 1.82. It explains that return on assets reported RM1.82 million on the average. As for the SKI, the mean is 0.67. It shows that among top 100 companies, 0.67 or approximately 70 companies issue sukuk on the average. The mean for SKR is 1.22 which explains the most ratings for top 100 companies is AAA which is the highly rated sukuk. AQ as the control variable outlines the average of 0.56 or approximately 60 companies on the average are being audited by big 4 audit companies in Malaysia. Besides, the minimum value for ROA is RM0.42 million and the highest value is RM4.28 million. As for the SKI and AQ, the minimum level is 0 and the maximum level is 1 respectively. This shows that, there are companies with sukuk issuance and audited by big 4 companies and otherwise. SKR illustrates the minimum value is 0 and the highest value is 3 which means that there companies with AAA, AA and A rated sukuk and non rated sukuk due to non issuance sukuk companies.

*Table 4.2: Pearson Correlation Matrix of the Research Variables*

	ROA	SKI	SKR	AQ
ROA	1.00			
SKI	0.58***	1.00		
SKR	0.56***	0.59**	1.00	
AQ	0.40***	0.24	0.21	1.00

Note: n=100. ROA is return on assets; SKI is sukuk issuance; SKR is sukuk ratings; AQ is audit quality.

Table 4.2 presents the Pearson correlation matrix for the research variables included in the financial performance (ROA) model. Based on the Pearson correlation matrix, ROA correlates with SKI, SKR and AQ according to the estimate statistical significance levels of 1% respectively. ROA is positively correlated with the SKI, SKR and AQ ( $r = 0.58, 0.56$  and  $0.40$  respectively at  $p < 0.01$ ) at 1% significance level. SKI is correlated to SKR at ( $r = 0.59$  at  $p < 0.05$ ). Overall, based on the Pearson correlation matrix, the indicated significantly correlation values are considered small when all  $r$  values are lower than the range of  $\pm 0.30$  to  $\pm 0.7$ . Hence, there is no evidence of multicollinearity problem among variables in the model as suggested by Pallant (2007).

**Table 4.3: Regression Analysis of Sukuk Characteristics and Financial Performance.**

ROA	Expected Sign	Coefficient	Std. Error	P-value
SKI	+	1.61	0.48	0.001***
SKR	+	0.41	0.24	0.087*
AQ	+	0.60	0.28	0.032**
Adj. R <sup>2</sup>	38.51			

Note: n=100. ROA is return on assets; SKI is sukuk issuance; SKR is sukuk ratings; AQ is audit quality. \* p<0.10; \*\* p<0.05; \*\*\* p<0.01

It can be seen in Table 4.3, the adjusted R<sup>2</sup> value shows that the regression model which consists of SKI, SKR and AQ could explain 38.51 percent variations in ROA. With regards to significant p-value, all variables presented are significant on ROA at their own p-value. SKI is reported to be significantly associated with PERF at 1% (p < 0.01), SKR is significant at 10% (p < 0.1) and AQ is significant at 5% (p < 0.05).

Apart from p-value, the (+/-) sign shows the direction of the relationship between the independent variables and dependent variable. All variables are found to meet the expected sign or can be best described to support the constructed hypotheses in section 2: literature review. SKI, SKR and AQ have positive relationship with ROA. It means that, Sukuk Issuance, Sukuk Ratings and Audit Quality play important roles in enhancing the Return on Assets among top 100 companies in Malaysia.

Table 4.3 illustrates that SKI or sukuk issuance is positively associated to ROA. Consistent with the hypothesis of this study, the p-value is 0.001 and the sign is positive. Therefore, it means that the sukuk issuance can be the benchmark for the profitability measured by return on assets. Agency theory supports the application of several governance strategies to control "agents" behaviour in organizations (Stefan Linder, 2015). Thus, new financial instrument called sukuk has given rise to several concerns. Given that the Sukuk have only recently arrived, this is a logical assumption. On the other hand, it is critical that these problems are studied and researched more thoroughly. Wilson (2008) contends that Sukuk returns are set up to resemble the characteristics of conventional bonds, but Cakir and Raei (2007) disagree, citing empirical evidence that shows Sukuk are different from bonds because they provide diversification advantages in terms of risk reduction when included in a portfolio of fixed income securities. Wilson makes the case that Sukuk returns are set up to mimic the features of conventional bonds (Alswaidan, 2017).

Although conceptually simple, some financial institutions combine elements of two or more distinct types of tools to develop hybrid securities, making the primary Sukuk structure types more difficult than traditional bonds. In order to improve the appeal of Sukuk in both the conventional and Islamic financial markets, issuers regularly highlight Sukuk with traits like those of conventional bonds. The fact that the incentives for sukuk rely on the project's income or profit is another significant way they vary from traditional bonds. Conventional bonds, on the other hand, are just debt obligations. A Sukuk's price is determined by the market value of the underlying asset, whereas the price of a typical bond is solely dependent on the issuer's creditworthiness. The sale of a Sukuk is basically the sale of a share of an asset, as opposed to the sale of a bond, which is effectively the selling of debt. However, there are other traits that sukuk and conventional bonds have in common, including rate ability, credit enhancement, and flexibility (Alsaeed, 2012).

Next, SKR or sukuk ratings is positively associated to ROA. Consistent with the hypothesis of this study, the p-value is 0.087 and the sign is positive. Thus, sukuk ratings

portrays better firm performance by explaining that Islamic financial instrument can raise money in accordance with Sharia, or Islamic law. It also refers to the types of investments that are allowed under this guideline. Islamic finance may be thought of as a unique form of socially responsible investing. Specifically, the higher rated sukuk or known as investment grade sukuk, the safer and stable investment by the sukuk holders.

As a result, the highly rated instruments are compliant with Islamic financial standards, which limit interest payments (Abdo, 2014). The essence of sukuk in today's world is the concept of asset monetization, also known as securitization, which is achieved through the issuance of sukuk. It has a lot of promise when it comes to turning future cash flow from an asset to present cash flow. Furthermore, the financial performance is a purely arbitrary indicator of a company's capacity to make money from its core activity. The phrase is frequently used as a general indicator of an organization's long-term financial health. Financial performance is a crucial part of managing financial risk and refers to the extent to which financial objectives are being met or have been achieved. It is a technique for figuring out how much money a company's operations and policies are worth. It is used to compare companies in the same industry, assess a company's overall financial health over time, and assess an industry or sector.

## CONCLUSION

This study is unique as it considers sukuk characteristic and financial performance among top 100 listed companies in Malaysia. It can help us to understand the existence issue and ratings of sukuk in Malaysian companies taking into consideration the return on assets as the benchmarks for companies' performance. Besides, this research will also help the researcher and others to explore the practice and prospect of sukuk market in Malaysia. Exploring new practice of sukuk in Malaysia will help to understand the importance of invest in sukuk as it can lower the risk of the company's portfolio. The findings of this research were analyze using data gathering. The data collected by the researcher by looking at the annual reports of the companies in Bursa Malaysia. According to the result, sukuk issuance and sukuk ratings enhance companies' performance in Malaysia.

Agency theory supports the application of several governance strategies to control "agents" behavior in organizations (Stefan Linder, 2015). With regards to the agency theory, it heavily relies on agreements between different stakeholders to describe how a firm function. Instead of the business owners, those who invest money in the operations of the firm are perceived as taking risks. Investors that have faith in a manager's ability to use funds wisely and successfully for the firm will give them money (Andrei Shleifer, 1997). In order to improve the appeal of Sukuk in both the conventional and Islamic financial markets, issuers regularly highlight Sukuk with traits like those of conventional bonds. The fact that the incentives for sukuk rely on the project's income or profit is another significant way they vary from traditional bonds (Alsaeed, 2012).

Nevertheless, several constraints are encountered by the researcher during this research. One of the study's key weaknesses is this study focuses on financial year 2021 only among only top 100 companies in Malaysia. Limited observations are available in one year. Next, there is very limited study pertaining to sukuk characteristics. Therefore, it is suggested that further studies need to be done in order to fully understand the role of these Islamic values to business practices and to contribute more knowledge to this area.

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