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TESTING THE LEGITIMACY INDEX IN LIGHT OF SHARIAH RISKS FOR SUKUK MARKETS

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Abstract

The purpose of current study is to be participated in such trends throughout testing the Index of legitimacy in the presence of shariah risks in Shariah reports. Furthermore, it aims to investigate and detect the influence of Shariah risks on legitimacy of Sukuk . Theoretical model is developed by the present study and analyzed data of 82 Sukuk's in Malaysian' Bursa. The data collected from the reports of Shariah in the period years between 2005 to 2015. The current study is a quantitative used Partial Least Squares (PLS). The study revealed that there is evidence show a negative impact of shariah risks on index legitimacy in the reports of shariah. The unique contribution of the present study that might strongly added to the literature regarding the impact of legitimacy index and risks of shariah from the shariah reports for Sukuk Markets. In addition, this study contributes by adding some implication to be added to policy whereby the policy is made management of Islamic financial institutions (IFIs) and shariah advisory council.

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Keywords: Legitimacy, Shariah risks, Sukuk markets.

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1. Introduction

It has been excepted an increasing in the populations for Muslim, as mentioned by Lipka and Hackett (2015), to be from 1.6 billion to 2.8 for the year from 2010 to 2050. This increasing as demonstrated by Mitchell et al. (2014) is considered as an essential motivation for industries' Islamic finance that has faced also notable extension in emerging markets. The majority's the previous studies such as Ahmed et al. (2014a), Ahmed et al. (2019c), Ahmed et al. (2018a), Naser et al. (1999), Alnasser and Muhammed (2012) admit that the key elements to get the global satisfaction of Islamic finance lie in compliance of Islamic banking represented by its services with the orientation of religious by their clients followed by the construction issued by Islamic low. Ahmed et al. (2014b) and Tahmoures (2013) show that one of the innovations of Islamic are Sukuk that is considered as a financial tool of Shariah complaint. If one compare Sukuk and bond as a concept, the first one is asserts based securities whereas the second concept is debt based securities (Ahmed et al., 2019b; Ahmed et al., 2015). Different from traditional bonds, the owners of the Sukuk are considered the real owners of the implicit asset and thus, this might participate in the real success of the project. Ahmed et al. (2019b) and Lahsasna et al. (2014), and also Grassa (2016) mentioned that Sukuk are characterize by legal features that make the investors and financial institutions to be interested due to such features, such as rating, shariah risk, pricing and Auditing of Shariah. For all that, as shown by Ahmed et al. (2015), other elements might be have impact on Sukuk legitimacy, such features are generally nature and also Sukuk demonstrates the available of review by regulators, investors, and IFI's. Yet, in 2007, presented of AAOIF, Usmani (2007) upbraid that production of Sukuk in general in the financial market were mostly not followed with Shariah and this create an urgently need a review. As a reaction of this matter, both Islamic financial Council and Muslim Council of Britain, Transparency Standard of Islamic Finance, a triple-purpose advisory document in improving the understanding of consumer in Islamic retail products, to limit consumer doubts about non-compliance regarding the Shariah products and also to improve consumer protection as mentioned by Ginena (2014).

Previous studies such as Ahmed et al. (2019a), Ahmed et al. (2015), Ginena (2014), and Ahmed et al. (2018b) admitted that one of the matters that might have an impact on shariah compliance in Sukuk markets is the Shariah risk which is unique risk from operational perspective. IDB & IFSB (2007) show that Shariah risk should be managed probably to enhance the confidence of several parties such as; depositors, employees, and customers and other stakeholders who understand the all institutions are not abide to live for-good in its commitments. Traditional Bonds face credit risk and also for the Sukuk are faced the same (Ahmed et al., 2013). Cried risk as mentioned by Khan and Ahmed (2001) reflects what extent it may occur because of the disability By the partners of corporations to in time fulfil all obligation according to the agreed. It also indicates that probably the asset and also the loan may become non-refundable due to the delay or sometimes the default in settlement as demonstrates by Tariq and Dar (2007). Investors should be aware of the kinds of sukuk and their categories to help the investors in making decisions. Prior studies such as; Casper (2012), Shafii et al. (2010), Nanaeva (2010), Abdullah et al. (2014), Lahsasna (2014), Ginena (2014) confirmed that limit the risk of noncompliance of Sukuk Shariah is an essential factor that might enhance the legitimacy of Sukuk and also increase its compliance with the building-blocks of Shariah. Nonetheless, as expecting probable risk related to the investments,

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investors are perhaps. Nonetheless, as explained by Haneef (2009); given the anticipated potential risk related to investments, investors may be a type of semi-equity risk, which is not favorable to investment, and also the documents of sukuk are completely silent when information is disclosing. The concepts of Shariah and its principles utilized in issues regarding Sukuk most be in line with Shariah advisory recommendations (BNM, 2007). All activities of Sukuk are compatible with compliant with two parties; Sukuk and issues which are fragmented with the principles are taking in the account by the SAC (ISRA, 2013). Therefore, the aim of the current study is to explain and describe the importance of the risks of Shariah and Index of the legitimacy for Sukuk Markets.

2. Problem Statement

Several studies in the literature have been notified. For example, Tariq and Dar (2007) investigate Sukuk risk to be as financial instrument. They mentioned about notable role of Sukuk in developing resources mobilization and debt market in developing countries. They found the structure refinement for Sukuk is is absent and further a poor risk management mechanisms. Shafii et al. (2010) tested auditing of Shariah role auditing in IFIs in limiting the risk compliance of Shariah. They show that IFIs' risk can be limited audit of a Shariah compliance. The committee of Shariah is responsible to say their viewpoint about for example the IFIs operation whether is compatible with shariah principles and also to support decisions making. An audit provided information on the different perspectives of operation of the IFI's that might help making decisions that document and support the idea of separation and control. Nanaeva (2010), in his empirical study, he investigates the competitiveness level of IFIs. Regarding Sukuk risk and also for the traditional bonds to reflect a clear picture for the Sukuk's potential investors. He found that majority investors of Sukuk keep on their own securities till the time of maturity. Zakaria et al. (2012) tested the Sukuks' concept and implications regather the risk. The data collection of thieve study represented by text and observation, and documentation. They found that a continuous of growth using countries as a cross study. Nonetheless, issuance of Sukuk might enhance the default risk. Although sukuk issuance is tied to asset security, any unfavorable passage of rating assessment would refer to the default risk. Casper (2012) investigates role of SSBs, compliance of Shariah and corporate governance (CG) in Europe corporations. He demonstrated that the uniformity is not there to explain Shariah principles. This, there will be a risk of Shariah conformity product. This will lead to the risk for no compliance for Shariah. El Shazly and Tripathy (2013) study the tools' risk of Islamic financial elements in a forms and then test a model with the consideration of Ijara Sukuk. All the finding were under transparency regarding the information that most be given different companies in various levels. They mentioned about the dire need for testing the tools of risks. Ahmed et al. (2014a) investigate risks facing tools for the international financial institutions. The study has done by defining the mechanisms and its application of these tools in relation to The finance and Islamic investment. Recently, a study done between Agency Malaysia and Sukuk issuance revealed that BBA practice for Sukuk is not existence. Previous studies such as Ahmed et al. (2015) examine link between compliance of Shariah risk in Malaysia and legitimacy of Sukuk IFI. The in addition test elements have effect on legitimacy Sukuk. The found there is a negative relation between them.

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3. Research Questions

The aim of the present study lies in the question: do risks of Shariah and index important for the Sukuk market legitimacy?

4. Purpose of the Study

The aim of the current study is to explain and describe the importance of the risks of Shariah and Index of the legitimacy for Sukuk Markets.

5. Research Methods

The basic designing of the current study represented by using a quantitative method. The sample of the study population is 82 Sukuk with SC improvement and listed in Malaysian's Bursa. The data collection was from the reports of Shariah of Sukuk identifying. This study is a secondary data study for the period tear from 2005 to the year of 2015 with utilizing of PLS.

5.1. Measurements of the study

Legitimacy Index: previous literature, in testing disclosure of Shariah, have adopted content analysis. By using this way, there will be examining the quantity of the disclosure of Shariah as mentioned by Gray et al. (1995), Rahman et al. (2010), and Maali et al. (2006). The measurement is represented by index as a way to analyzing disclosure level to provide expected information that in line with pronouncements of Shariah. To reach the purposes of the present study,

Risks of Shariah: To assess and measure risks of Shariah, the current study used method of grid for analyzing Sukuk reports risks.

6. Findings

As explained in Table 01, descriptive analysis revealed that Sukuk's legitimacy level was Sukuk average with disclosure of Shariah. The SD was .189. Besides, the minimum value was 33% while the maximum was 89% that refers to legitimacy of Sukuk. Also, the analysis shows that risk of Shariah is 11.0% as average with SD .050.

Table 01. Descriptive analysis

Variables of the study	Mean	Std. Dev	Minimum	Maximum
Sukuk Legitimacy	.620	.189	.33	.89
Shariah Risk	.110	.050	.02	.24

Table 02 shows legitimacy of Sukuk in the institutions that are Islamic. It reveals of Sukuk legitimacy percentage is from 0.33% to 0.89%. While, the descriptive analysis shows 0.33% is lowest level in the report.

Table 02. Statistics of *Sukuk*

Legitimacy	Level	Frequency	Percent
Valid .33 to .49	Low	27	32.9
.50 to .75	Medium	31	37.8
.76 to .89	High	24	29.3
Total		82	100.

Conversely, the table showed the highest level is 0.89. In this work, we divided legitimacy of *Sukuk* to be three levels, classified as ; low (from 0.33 to 0.49), also medium (from 0.50 to 0.75) and then the high (from 0.76 to 0.89). Form of index is used to converted levels about the real data of this study to get determination of the legitimacy level, as explained, that 27 of *Sukuk* with 0.33 to 0.49 of legitimacy rate. Also, 31 of *Sukuks* have 0.50 to 0.75 of legitimacy, while 24 have a rate between 0.76 % to 0.89 %. Issued of *Sukuk* is 29.3% from the year of 2005 to 2015 and that is by using content analysis. Further, 32.9% are facing lacking conformity of *Shariah*. Table 03 revealed the path coefficient and the findings show that risk of Shariah is negatively related to legitimacy of Sukuk.

Table 03. Path coefficient

Path	Path Coefficient	Standard Error	t-value
SHR -> LG		0.091	*1.957

6.1. Impact of *Shariah* risks on *Sukuk* market

The result of this study revealed that there is a significant link but negative between risk of *Shariah* the legitimacy of *Sukuk*. It is in line with the aim proposed by the current study that; a negative link with *Sukuk* legitimacy, that is ($t= - .181$, $p< .05$). That means the legitimacy of *Sukuk* has significant impact by risk of *Shariah*. This result is in line with some studies done previously, such as (Abdullah et al., 2014; Ahmed et al., 2014a; Casper, 2012; Ginena, 2014; Lahsasna, 2014; Nanaeva, 2010; Shafii et al., 2010). These studies tested the link between risk of *Shariah* and legitimacy *Sukuk*. As examples, Lahsasna (2014) and Casper (2012) demonstrated that in case of increasing risk of *Shariah* leads to have influence on IFI's credibility and thus this will reduce the owners' confidence. In the same line, Nanaeva (2010) studied the risk of *Shariah* impact on the noncompliance of *Shariah*-*Sukuk*. He finds the high risk of *Sukuk* needs further monitoring. Some theories such as Institutional theory reveal that *Shariah* boards to be controlled IFIs operations, it needs pressures by regulatory as mentioned by Ahmed et al. (2014b) and Aziah Abu Kasim (2012). Our results are in line to determinants literature. Such previous studies assumed the members' number in SSB support effectiveness of the legitimacy. This means, risk of *Shariah* might be limited via confirmation of SSB which will be validity on the operations' of *Sukuk* in order to accomplish *Shariah* demand of compliance. Thus, the link of supervisors of Shariah and monitoring of *Sukuk* will enhance the confidence of investors stay high. Similarly, a work done by by Ahmed et al. (2015) revealed a significant impact by risk of *Shariah* on legitimacy of *Sukuk*. Therefore, it might be established the explanation to reach these findings regarding fourth hypothesis that the noncompliance risk of *Shariah* might promote legitimacy of *Sukuk*. This refers that when there is no compliance risk of *Shariah*, there will lead to a high legitimacy. The findings show a negative link of risk of *Shariah* and legitimacy of *Sukuk*. Hence, when there is a low risk of *Shariah* for the *Sukuk*, there will be high legitimacy.

7. Conclusion

The current study has exclusively added value to literature through enriching newly arguments regarding risk of Shariah and measuring of Sukuk which refer to the level of legitimacy. And also via testing risk of shariah as an element on such a link that is exclusive if we make comparison with the literature review. The present study sheds light Markets of Islamic Capital and provide explanation on legitimacy index for more tests of the link of legitimacy and Shariah. Regarding Shariah's non-compliance is not without risk. In that, it needs a solution to be sustainable for Sukuk market and its development. To achieve this matter, it needs for cooperation from the side of financial experts and the board of Shariah supervisory. The important objective is Sukuk market especially after it was accepted by the international institutions therefore the compatibility between Sukuk and Shariah compliance is needed. A study model has tested by the present study through investigating the role of risk noncompliance and its link with Shariah in Sukuk market. This study revealed that the select risks have impact on market securities.

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