RELATIONSHIP BETWEEN RISK AND RETURN IN SUKUK MARKET

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RELATIONSHIP BETWEEN RISK AND RETURN IN SUKUK MARKET

By

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In Fulfillment of the Requirement for the Degree of Doctor of Philosophy
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ABSTRACT

This study attempts to identify the different types of risk embedded in the sukuk structure and to determine the relationship between the risks and the returns of sukuk. Data were collected from seven groups of the sukuk market from 2005 to 2013 on a periodic monthly basis and analyzed using correlation analysis and multi-regressions analysis. The test results confirm the significant influence of market risk, credit risk, operational risk and liquidity risk on the sukuk returns in different ways. The results of the analysis on the basis of maturity indicate that the longer the period of maturity the higher is the risk exposure. The results of the analysis on the rating indicate that the impact of risk is very high on lower-rated sukuk. The sectorial-based analysis indicate that the corporate sukuk return is highly exposed to risk compared to other sectors. Analysis on the Gulf countries’ sukuk market indicates that the corporate sector is more exposed to risk than the financial sector. The analysis of risk impact on the basis of selected country indicates that Bahrain’s sukuk market is highly exposed to risk when compared to the sukuk markets of the UAE and Malaysia. Although, there are some limitations, the findings pave ways for a number of recommendations, among others are; maintaining inflation-rate risk at an optimal level, hedging their interest-rate risk with Libor, replacing the conventional interest rate with the Libor rate, using a common currency in the Gulf region, forming a risk-steering committee to monitor and mitigate risk, formulating a common shari’ah board at the international level, and taking necessary measures to provide a conducive environment to promote secondary markets for sukuk.

Key word: market, performance, return, risk, sukuk.
ABSTRAK


Kata kunci: pasaran, prestasi, pulangan, risiko, sukuk.
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AAOIFI : Accounting and Auditing Organization for Islamic Financial Institutions
ABS : Asset Backed Security
AESI : HSBC/ Nasdaq Dubai UAE US Dollar Sukuk Index
AFIB : Alternative Finance Investment Bond
AUM : Assets Under Management
BHSI : HSBC/ Nasdaq Dubai Bahrain US Dollar Sukuk Index
CCASG : The Corporation Council for the Arab States of the Gulf
CRA : Credit Rating Agency
DIFX : Dubai Islamic Finance Exchange
DMS : Dimson-Marsh-Staunton
E&Y : Ernst & Young
EURO : The Euro exchange rate
FZCO : Free-Zone-Company
GCC : The Gulf Cooperation Council
GLS : Generalized Least Squares
GSKC : HSBC/ Nasdaq Dubai GCC Corporate US Dollar Sukuk Index
GSKF : HSBC/ Nasdaq Dubai GCC Financial Services US Dollar Sukuk Index (GSKF)
GSKI : HSBC/ Nasdaq Dubai GCC US Dollar Sukuk Index
HASI : HSBC/ Nasdaq Dubai Amanah US Dollar Sukuk Index
HQRs : Dow Jones Sukuk Higher Quality Total Return Index
IDB : Islamic Development Bank
IFI : Islamic Financial Institutions
IFIR : Islamic Funds & Investment Report
IFSB : Islamic Financial Services Board
IIF : The Institute of International Finance
IMF : International Monetary Fund
IPO : Initial Public Offering
IRRs : Dow Jones Sukuk Interest Return Index
JAFZ : Jebel Ali Free Zone
KPMG : Klynveld Peat Marwick Goerdeler
KSA : Kingdom of Saudi Arabia
LIBOR : London Interbank Offered Rate
M3TRs : Dow Jones Sukuk 1-3 Year Total Return Index
M5TRs : Dow Jones Sukuk 3-5 Year Total Return Index
M7TRs : Dow Jones Sukuk 5-7 Year Total Return Index
MARC : Malaysia Rating Corporation Berhad
MENA : The Middle East and North Africa
MISC : Malaysia International Shipping Corporation
MYSI : HSBC/ Nasdaq Dubai Malaysia US Dollar Sukuk Index
OIC : The Organization of Islamic Cooperation
OLS : Ordinary Least Squares
PPP : Public Private Partnership
RAA : Ram Rating Agency
Rf : Risk Free Rate
RIRs : Dow Jones Sukuk Total Return Index (ex-Reinvestment)
SABIC : Saudi Basic Industry Corporation
SAR : Saudi Arabian Riyal
SDLT : Stamp Duty Land Tax
SDR : Special Drawing Right
SESRIC : The Statistical, Economic and Social Research and Training Centre for Islamic Countries
SKBI : HSBC/ Nasdaq Dubai US Dollar Sukuk Index
SKIX : HSBC/ Nasdaq Dubai US Dollar Nasdaq Dubai-Listed Sukuk Index
SMB : Size Risk Factor
SPV : Special Purpose Vehicle
SUCI : HSBC/ Nasdaq Dubai Corporate US Dollar Sukuk
SUFI : HSBC/ Nasdaq Dubai Financial Services US Dollar Sukuk Index
SUSI : HSBC/ Nasdaq Dubai Sovereign US Dollar Sukuk Index
TID : The Investment Dar
TOL : Tolerance
UAE : United Arab Emirates
UK : United of Kingdom
USA : United State of America
VaR : Value-at-Risk
VIF : Variance Inflation Factor
WIFFMC : The World Islamic Funds & Financial Markets Conference
ΔCCI : Change in Consumer Confidence Rate
ΔCPI : Change in Inflation Rate
ΔDOR : Change in Dollar Rate
ΔHQR : Change in Operational Risk
ΔIRD : Change in Interest Rate
ΔMPR : Change in Maturity Risk
ΔRIR : Change in Liquidity Rate
ΔSMB : Change in Credit Risk
tn : Trillion
mn : Million
bn : Billion
CHAPTER ONE

INTRODUCTION

1.1 Introduction

The first chapter provides the introduction of this thesis. Section 1.2 presents the background of a study which explains the importance of Islamic financial markets and its growth and the global evolution of sukuk market and its related problems. Section 1.3 presents problem statement of this study based on supporting previous empirical evidences. Research question and research objectives are provided in Section 1.4 and Section 1.5 respectively. Then, the significances of the study in several ways are discussed in Section 1.6. Finally, section 1.7 covers the scope and limitations of this study are also included in this chapter.

1.2 Background of Research

The Islamic financial market is fast growing and expanding despite the recent financial crisis that swept through the global financial market. In the past, even Muslim countries were reluctant to accept Islamic finance, but, now the situation has changed (Oakley, 2009).

According to SESRIC1, the 57 Muslim countries are growing at a higher rate than the rest of the country in the World. As these countries grow and modernize, banking and financial sector will grow as well, but in line with the Islamic principles. Woodruff (2007) reported that major financial centers around the world have also adopted the Islamic financial system. They are in competition among them to accommodate

1. Organization of Islamic cooperation (OIC) has a subsidiary of the statistical, economic and social research and training center for Islamic countries (SESRIC) that has started its work in Tripoli in 1977 and Ankara 1978.
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