



**THE APPLICATION OF TRA IN UNDERSTANDING
THE INVESTORS' SELECTION BEHAVIOR IN
MALAYSIAN ISLAMIC CAPITAL MARKETS**

BY

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ABSTRACT

This paper aims to investigate the determinants of the investors' participation behavior in Malaysian Islamic capital market. The study employed the online survey method and collected 120 sample comprising different backgrounds in religious, race and roles in the capital market. Using the Theory of Reasoned Action (TRA) as the theoretical basis, Structural Equation Modeling (SEM) has been applied to analyze the outcome of the survey. From the original two basic construct of TRA, namely, Attitude and Subjective Norms, this study set to add another construct which is believed to be affecting the behavioral intention of investors in the Islamic capital market which is Religiosity. In general, this study found out that, both Subjective Norms and Religiosity have been statistically significant in affecting the behavioral intention and Attitude did not.

خلاصة البحث

تهدف هذه الورقة إلى التحقيق في محددات السلوك مشاركة المستثمرين في سوق رأس المال الإسلامية الماليزية. استخدمت الدراسة منهج المسح على الانترنت وجمع 120 عينة تتألف من مختلف الخلفيات الدينية في العرق والأدوار في سوق رأس المال. باستخدام نظرية الفعل المبرر (الهيئة) كأساس نظري، الهيكلية نمذجة المعادلة وقد تم تطبيق لتحليل نتائج المسح. من الأصل بناء اثنين الأساسية للهيئة، أي موقف وقواعدها الذاتية، (SEM) فإن هذه الدراسة تعيين لإضافة بناء أخرى والتي يعتقد أنها تؤثر على النية السلوكية للمستثمرين في سوق رأس المال الإسلامي الذي هو التدين. بشكل عام، وجدت هذه الدراسة أن كلا المعايير الذاتية والتدين كانت ذات دلالة إحصائية في التأثير على نية السلوكية والموقف لم يفعل ذلك

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a research paper for the degree of Master of Science in Islamic Banking and Finance.

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Muhamad Abduh
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DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at the IIUM or other institutions.

Tuan Muhd Taufik Tuan Hussin

Signature

Date.....

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CHAPTER ONE

INTRODUCTION

1.0 BACKGROUND OF THE STUDY

Islamic finance, which is touted as one of the fastest growing industries on the planet, has currently gained attention from the Muslims and the non-Muslims around the globe. Policy changes and relaxation of certain rules and regulations in many countries proved the huge interest that lies within the industry. Started as an effort by groups of Muslims striving to do banking Islamically (without the element of interest/usury), the Islamic finance industry has grown to dominate the financial system. The interconnected laws and implementation of the industry has forced special acts to be declared thus moving its status higher in the legislation of a country.

Since its inception in the 1970s, the Islamic finance industry has been growing steadily at an average rate of 15% annually. The industry currently stands at \$1.3 trillion in total assets comprising of almost 1% of the total assets in the world financial system. The growth has been tremendous in recent years, this can be seen in the rapid expansion of Islamic finance reach in the Muslims and non-Muslims dominated countries and the huge increase in assets. The sustainability of Islamic finance has yet to be proven but recent financial turbulence has shed some lights on the real potential for the industry. Unlike conventional finance, Islamic finance has yet to gain full acceptance from the majority of the people in the financial system. The conventional norm encrypted inside the financial system makes it even harder for the Islamically oriented financial services industry to gain trust and loyalty especially from the non-Muslims. Recent studies shows, even the Muslims are still trying to make apple to

apple comparison between the Islamic and the conventional financial services when in reality, both are incomparable to one another because one is permissible and another is not under the tenets of the Islamic law.

The Islamic finance exists on the premise of excluding the prohibitions mentioned in the Qur'an. Among those prohibition are the interest paid and interest gained from a financial transaction, because this is known as *riba'*. The Shariah guidance covers the physical and the spiritual aspects of any financial transaction.

Many have said that the most distinct characteristic of Islamic finance is the prohibition of the four elements, namely *riba'* (interest), *gharar* (uncertainty), *maysir* (gambling) and what are considered *haram* (prohibited) in Islamic teachings. These differences, though some may considered as minor and insignificant, but looking at the current implementation of the Islamic finance, these traits differentiate the core principle of the Islamic finance industry from the conventional counterpart. Leaving the discussion of the similarity in practice to the conventional finance or better known as “substance over form” intellectual discourse, this research was done to garner opinion and understanding of the public on what they perceive as Islamic finance. The arguments over how the real Islamic finance should be implemented shall be reserved to other research.

The term conventional finance, having been known to exist long before the academic discussion of Islamic finance, has been the incumbent and hard to ignore system. Heavily rooted in giving and taking interest on monetary transaction, it also has evolved drastically ever since the “financial engineers” started to explore the vast possibilities that financial instruments have to offer. The globalization and cross border financial transaction also contributed heavily in the rapid development of various types of financial instruments to cater and serve the ever expanding businesses

around the globe. The latest global economic downturn has exposed the fragility of the incumbent system and thus the presence of Islamic finance has been sought after to provide solution to the worst economic downturn in the history of mankind.

The banking activity has been known to be the process of facilitating the surplus and the shortage of liquidity in the economics. Finance works in similar manner but with different objectives. Banking is meant to create savings and indebtedness. Savers earn interest and debtors pay interest. This activity is called passive investment. Finance focuses more on creating values, or like the famous definition of finance, maximizing wealth. In this paper, finance is viewed as investment by individuals in the economy. The market place (place where there will be products offering and buyers) differs depending on the type of investment. The Islamic capital market is the main focus of this paper.

The process of developing and exploring the knowledge and finally implementing any financial instruments in the system shall require extensive knowledge of the components mentioned above. The core knowledge that one must never neglect shall be the Shariah, as it is the driver of the development of Islamic finance.

People are naturally tempted by the lure of women, children, treasures of gold and silver, horses of mark, cattle and plantations. These are the enjoyments in the life of this world; but with Allah lies a goodly abode to return to (Al Imran: 14)

In the Holy Qur'an, Allah the Almighty reminds men that these are the things that will tempt them in their life in this world. Men were created to know and love the world and Allah has created these enjoyments for men to learn how to be closer to Allah.

Knowing men would pursue those luxuries and enjoyment, the world as is now, is the product of human's greed and lust. The financial crisis that looked to be never ending is the product of unlimited drive to pursue wealth and financial gains at the expense of everything else. Rules and guidelines were manmade, and are meant to be broken and breached. In the US alone, the financial history has shown that there are two sides of the coins, financial strict regulation which some may perceived as the reason hampers the rapid progress of the whole economy and the new era of financial deregulation that saw many huge companies collapsing in the past few years.

While in the Qur'anic verse above, Allah mentions that men will pursue the enjoyment of the world, Allah did not forbids any of those. Instead, Allah, through the Nobel Prophet Muhammad (praised be upon him) guides mankind to the right path including earning wealth. In pursuit of prosperity and wealth, the world today has grown rapidly to provide mankind with a better place to live in. In the history of Islam, the Muslims have proven themselves to be skillful in commerce and the Prophet Muhammad (PBUH) himself was known as a trader. This period in history provided the proof of the existence of Islamic way of managing and conducting business in the early days of Islam.

The research was done to garner opinion and understanding of the public on what they perceive as Islamic finance in specific the Islamic Capital market. The development of Islamic capital market is an integral part of the development of capital market as a whole is the reason to support the importance of this study. Capital market itself is a robust marketplace, offering a wide range of financial instruments of various sizes and it is essential for efficient resource mobilization and allocation. The process of matching those instruments on sale and the buying price will determine the price.

Among the financial instruments traded are bonds, shares (equities), derivatives and unit trusts.

The history of Islamic capital market in Malaysia goes back to 1990 when the first issuance of Islamic corporate bonds by Shell MDS Sdn Bhd, and later in 1993 Arab Malaysian Unit Trust Berhad launched the first Islamic equity unit trust fund. The Malaysian capital market regulatory body, Securities Commission (SC) waited until 1995 to set an Islamic Capital Market unit and appoint the Shariah Advisory Council (SAC) in 1996 to guide and serve the apex ruling body in Shariah permissibility of financial products in the Malaysian Islamic Capital Market. For the first time, in 1997, SAC of SC issued an official list of Shariah compliant securities traded in the Kuala Lumpur Stock Exchange (KLSE), currently known as Bursa Malaysia (Bursa), and the list was updated using the new Shariah screening methodology introduced in 2013. To date, there are many Islamic financial products offered in the Malaysian Islamic capital market such as, sukuk, unit trust and mutual funds, stocks, real estate investment trust (REITs), and exchange traded funds (ETF).

With over 60% of the population are Muslims, Malaysia has the largest exchange listing in terms of global *sukuk* outstanding (IFIS). Malaysia prided itself as the undisputed leader in the *sukuk* market with 66% share of the total global *sukuk* outstanding in 2010. The Islamic capital market is expected to sustain annual double digit growth to reach almost RM3 trillion in 2020 (Securities Commission Malaysia, Capital Market Blueprint).

Bursa Malaysia stated that less than 30% of the active traders in Bursa Malaysia trading platform are Muslims. The social stigma of trading in shares as prohibited is still ingrained. The SC announced in the latest update that of all the equities traded in the Bursa Malaysia, 89% are Shariah-compliant. Random checks on

CPO Futures active participants revealed that quite a number of the active traders are Muslims. When scrutinized, apart from the Futures being very liquid, some remisiers claim that the reason for the active participation is due to the Shariah Committee of SC ruling that the trade is Shariah compliant.

This research focuses on examining the determinants Islamic capital market participatory behavior among the market players, namely the individual investors, the remisiers, the brokers and the dealers. The progressive growth of asset types and quantities in the Islamic banking and finance sector in Malaysia is the reason for this study to be conducted in the setting of Malaysia. The market players (samples) are classified into two groups as shown in the Table 1.2 below:

Table 1.1 List of Targeted Respondents

| Type of Participation | Group |
|------------------------------|--------------|
| Remisier | Retail |
| Individual | Retail |
| Company Dealer | Wholesale |
| Fund Manager | Wholesale |

Coupled with ethnic diversity and multi religiosity, Malaysia provides a good scenario for analyzing the Islamic finance in the broader perspectives and inclusive of all factors. Located in the middle of the fastest growing region in the Asia Pacific continent, Malaysia is seen as the next financial hub to the region (Bank Negara Malaysia, 2011). The various faiths and religious beliefs make Malaysia the best place to understand the determinants of behavioral intention towards Islamic finance where, it is not only a way of doing business but also tied to the religious teachings. The percentage of people embracing Islam consist of 61% of the population, while

Buddhist stands at 20%, Christians at 9%, Hinduism at 6% and other religious belief at 4% of the total population (refer Figure 1.1).

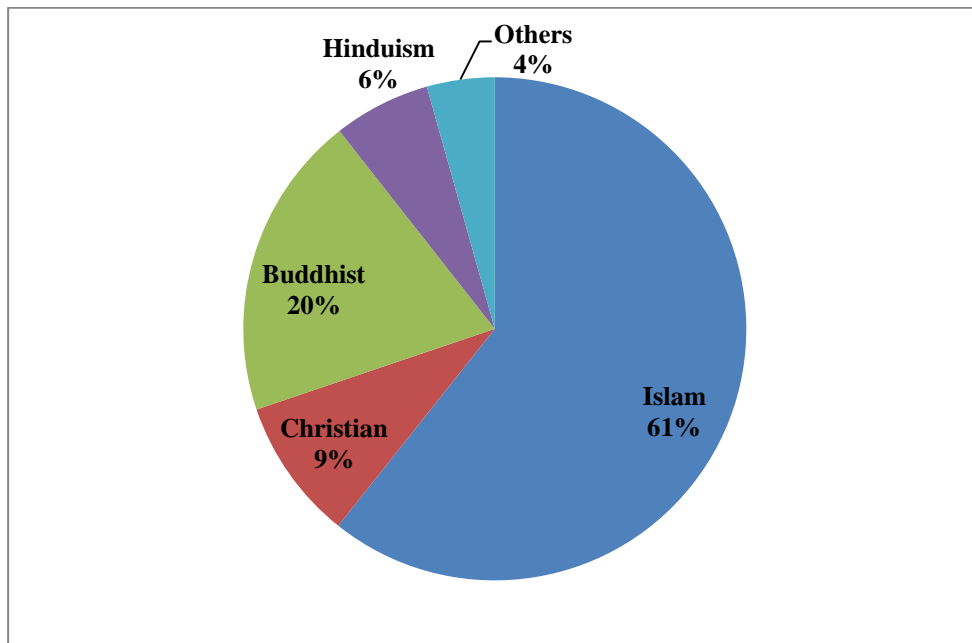


Figure 1.1 Malaysian Religion Demographic

(National Statistics Department, Population Census 2012)

The Financial System Blueprint (FSB) highlights the government’s continuous effort in promoting the Internationalization of Islamic Finance. The Islamic finance coexistence with the conventional finance (financial system duality) helps market players and practitioners compare the cost and benefits of the two seemingly contrasting system and ultimately helps to enhance the knowledge gained from this research.

Islamic financial products in the Islamic capital market are attractive due to certain features and are best known for the “ethical” reason and the faith-based characteristics. The main factors driving decision making process in the capital market

are profit and risk. With the introduction of Islamic capital markets alternatives, individuals are forced to rethink their investment preferences. This paper sets to address the investment behavior – in occasions inconsistent with the rational choice theory.

To the best of this author's knowledge, there are very few researches that were conducted in the past to uncover the Islamic behavioral finance phenomenon. Since the Islamic finance is driven by immaterial factors, behavioral studies in Islamic finance is seen as crucial in shedding light to those stakeholders.

Extensive literature survey has shown that current research trends in relation to Islamic capital market put much emphasis on the empirical research evolving around performance and risk/return evaluation studies. Thus, there is very little literature that explores the behavioral factors even in the Malaysian Islamic finance research. Again, Malaysian experience in the Islamic finance can provide the preeminent ground to evaluate the behavior of investors, brokers, regulators, and dealers. With the assistance of extensive body of knowledge from Socially Responsible Investments (SRIs), the application of Theory of Reasoned Action (TRA) in Islamic finance and Islamic behavioral finance can benefits a lot in terms of guidance and exemplary assistance.

To promote trading among retail investors, Bursa Malaysia has come up with a lot of incentives, such as the establishment of Bursa Malaysia Derivatives (BMD) to promote active trading to derivatives instrument to the public. One of the most actively traded instruments currently in BMD is the Crude Palm Oil (CPO) Futures. Active participation from the Muslims investors of CPO Futures trading goes along with the endorsement from Shariah Committee of the Securities Commission (SC) of the permissibility of CPO Future contract.

Most researches in Islamic finance focus heavily on the numerical analysis which relates to performances and efficiencies. Consequently, the behavioral aspect of Islamic finance is scarcely studied and this has created a huge void in the literature. Over the years, the Islamic finance research has expanded and the scope of studies has widened. Studies and researches have focused in the area of comparing the performance or resilience of the Islamic finance, but little effort was made on the behavioral aspect of Islamic finance.

The closest studies in relation to behavioral attitude of the market participants were done on ethical investment. Various researches were conducted to study the relationship between faith and investment attitude, specifically the Christian faith. (Shu, Sulaeman, & Yeung, 2010) studied the effects of local religious belief to participants' investment appetite. Indeed, religious belief did have an impact to investment appetite of the local capital market participants. Another research by Peifer (2011) proved that social actors tend to balance their moral commitments against monetary interests and investors moral orientation did influenced their financial market behavior. Both researches mentioned above are heavily connected to the ethical and socially responsible investing thus differs in certain principles to the Islamic finance scope. These two researches have one (1) aspect in common to this research which is the impact of human moral to their behavior in the capital market. While Islam acknowledges the existence of morality, Islamic principles might differ from what been considered as ethical and moral in the western concept.

Peifer (2011) began his research by mentioning the biggest dilemma faced by the average Christian American, "You can't serve both, God and Money" (Luke 16: 13). This dilemma of choosing between God and Money really push Christians into two different directions either to be really religious and stayed away from wealth, or

pursuing money at whatever price. The dilemma faced by the Christians has surfaced in the various researches done to connect and discover the real factor and the effect of religious belief in the Christian community towards their involvement in the capital market. In the Islamic scene, this kind of research seems to be rare or close to none.

In the Malaysian perspective, the investors' participation in the Islamic capital market is heavily linked to fund performance, returns on fund, risk management and style of fund management. There are very little evidence in defining who Islamic investors are, how they behave and make decision, what their expectations are and whether or not the decision to participate in the capital market was influenced by the religious factor.

1.1 SIGNIFICANCE OF THE STUDY

1.1.1 Contribution towards the Body of Knowledge

This research acknowledges the role of behavioral finance in the setting of Islamic capital market. Relying heavily on the theory of reasoned action (TRA), this author believes that the inclusion of religiosity, attitude and subjective norms in explaining investors' behavior in the Islamic capital market scene will further enhance the understanding of the real motivational factors persuading investors to participate in the Islamic capital market. Secondly, it captures the qualitative and quantitative aspects of the market participants through the demographic and investment preferences in the survey. Thirdly, the research is structured in the latest development in the Malaysian economic setting where Islamic finance has been recognized and pursued by the government as one of the main agenda to further develop the nation's presence in the international financial scene. Finally, it employs the structural equation modeling (SEM) for analyzing the factors affecting investment decisions.

Behavioral finance suggests cognitive psychological aspects play a potentially important role in finance. The behavioral finance study expansion has been fueled by the inability of the traditional framework to explain the many empirical patterns, including the stock market bubble (Ritter, 2003). Kim & Nofsinger (2008) mentioned two good reasons for this research can help explore new possibilities in understanding determinants to investors' participation in the Islamic capital market, 1) the recent acceptance of the academic finance community towards the behavioral aspect plays significant role in affecting the financial market and 2) the Asian financial market are among the biggest in the world, and there are some evidences – anecdotal, theoretical, and empirical – suggesting that Asians possessed cognitive biased in relation to religion on a different level compared to others.

The main focus of this research lies in finding the determinants of investors' participation in the Islamic capital market in Malaysia with the existence of alternatives to it. The finance theory assumes that people are always rational and thus implies that information are taken into consideration before making any financial decision that leads to profit maximization. It also suggests that market information is conclusive and predicts the outcome of any investment decision.

1.1.2 Contribution Towards the Market Participants and Practitioners

Market participants and practitioners can benefit from the outcome of this research in supplementing their promotion, investment and development of Islamic financial products in the capital market. It is important that the products offering and advertisements, goes in line with needs of the investors, thus understanding the factors leading to investment decisions among the capital market participants will further enhance and effectively reached out to the audience in the capital market.

1.1.3 Contribution Towards the Policy Makers

It is crucial for the policy maker or regulator to understand the factors affecting investment choice to formulate the best regulatory and policies in governing the capital market. In thriving to be the frontrunner in the Islamic financial system advancement in the world, Malaysian regulator need to formulate the best set of policies and regulations to, firstly to be the catalyst for greater penetration of Islamic financial products offering and acceptance in the Malaysian Islamic capital market, and secondly to best exploit the existing financial infrastructure to propel Islamic capital market to a greater height and thus inviting the worlds' investors to come and invest in the Malaysian capital market.

1.2 OVERALL RESEARCH FRAMEWORK

This research examines the determinants affecting investors' investment selection. Past researches in the field of finance argue through the efficient market hypothesis (EMH) that all investors are rational and are making decisions based on information available at any given time. The author argues that EMH has limitations in explaining the irrational decision made by the investors. Thus, this research proposes three contributing factors in determining investors' investment decisions which are religiosity, attitude and subjective norms. In principle, the Islamically conscious investors' opt only for the Shariah compliant investment opportunities because of the faith that does not tolerate anything forbidden by the religion. In short, profit were not the ultimate pursuit and religious teachings guide the decision making process. Investors in the Malaysian financial system duality will have to choose between Shariah-compliant financial products and non Shariah-compliant financial products (refer Figure 1.1). This study tend to investigate the investment choice based on the

Theory of Reasoned Action (TRA) with the Malaysian financial system has been well-informed on the financial products especially equities traded in the Bursa Malaysia is differentiated with the Shariah compliance list issued by Securities Commissions (SC) Shariah Advisory Council (SAC).

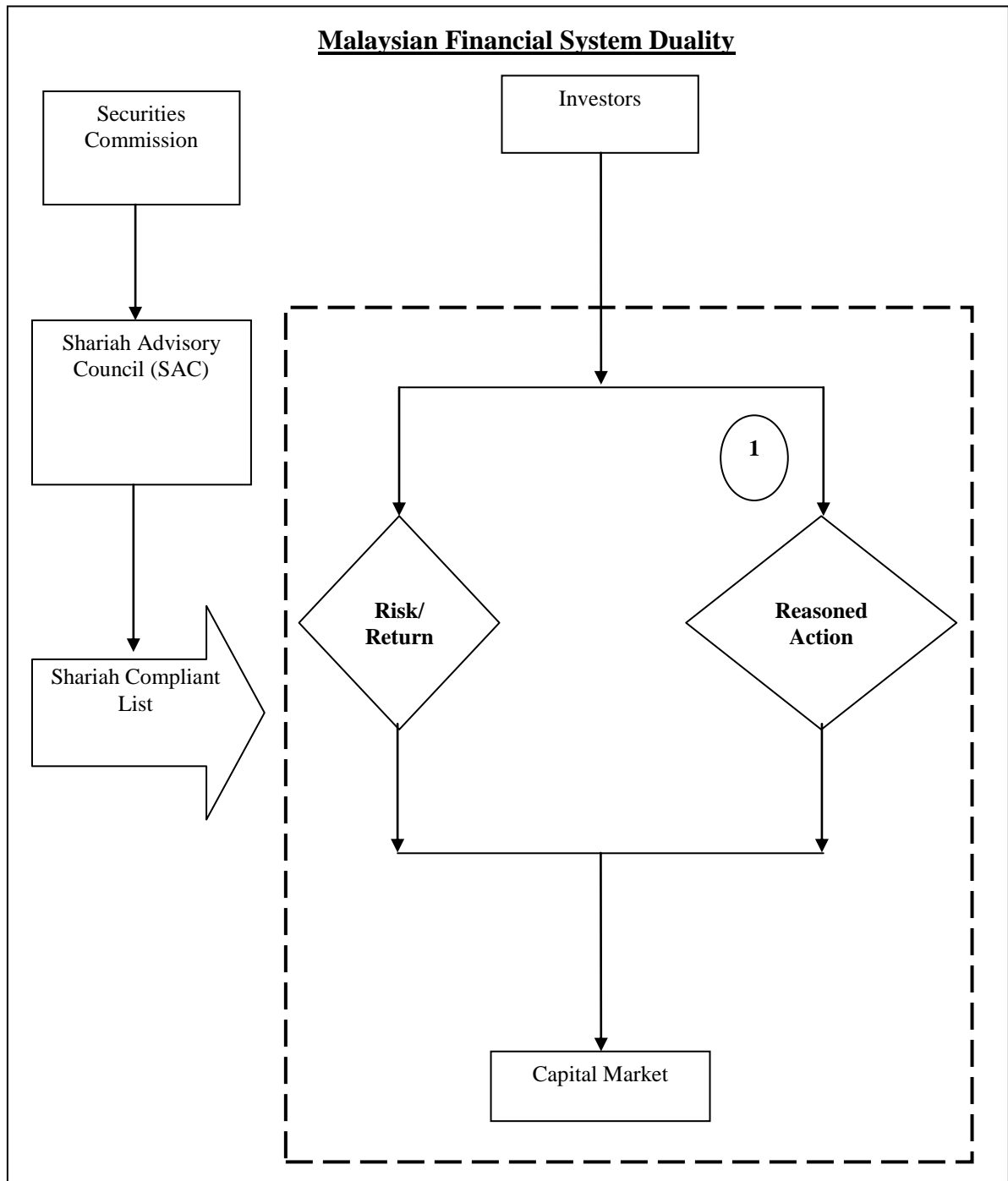


Figure 1.2 Overall Research Framework