

CHAPTER SIX
DISCUSSIONS AND CONCLUSION, LIMITATIONS AND SUGGESTIONS
FOR FUTURE RESEARCH

This research measures the effects of Islamic leverage on the performance of continuously listed *shari'ah*-compliant companies in Malaysia using separated debt data and it also attempts to investigate the optimal level of total Islamic leverage at which a *shari'ah* company may maximise its performance. The focus is on the interest-bearing debt ratios and Islamic debt ratios vs. *shari'ah* firm's performance. The panel data econometric approach was adopted as the main analytical method to re-examine the relationship in context of Malaysian Islamic capital market. The research also employed threshold regression model and descriptive statistics to determine the optimal leverage ratio and to study the behaviour of continuously listed *shari'ah*-compliant companies towards the type of debt and its length respectively.

The rest of this chapter is organized as follows. Section 6.2 provides the key findings while section 6.3 introduces the research implications. Section 6.4 discusses the contribution of this study. Finally, Section 6.5 concludes the chapter and offers suggestions for future related research.

6.1 The Key findings

The capital structure of a firm and the firm's performance area has attracted much attention and yielded a large body of theoretical and empirical studies. However, the primary purpose of this research is to focus on the effect of total Islamic leverage, interest-bearing debt ratios and Islamic debt ratios on the performance of continuously

listed *shari'ah*-compliant companies using separated debt data, which have been generally neglected in the existing literature. The study also examines the optimal level of Islamic leverage ratio at which a *shari'ah*-compliant company may maximize its performance. The key findings are presented below.

6.1.1 Total Islamic leverage and the performance of *shari'ah*-compliant companies

The results of fixed effects show that total Islamic leverage negatively and insignificantly affect *shari'ah*-compliant companies' performance under both performance measures. This negative effect may arise due to the realisation that high debt ratio increases high agency costs and the default rate, which consequently leads to the risk of losing control of the company (Yazdanfar & Öhman, 2014). This is unlikely to occur in this study as the descriptive analysis suggests. Other reasoning is that the use of debt may exceed the threshold limit at which a firm can maximise its value. In addition, high growth opportunities suggest that debt financing negatively affects firm performance, while the opposite is true for firms with fewer opportunities (Mishra & Dasgupta, 2019). This is in respond to the first of objective of the current study, which is to investigate the effect of total Islamic leverage on the performance of *shari'ah*-compliant companies. Based on the reported findings, it is negative and insignificant , therefore it fails short compare to most of the studies concluded that the debt would have a negative and significant impact on firm performance (Yazdanfar & Öhman, 2015, Asimakopoulos et al., 2009, Kebewar, 2013, and Dawar, 2014), while some studies reported positive and significant relationships between debt and firm' performance due to adopting different types of performance or debt measurements (Sheikh & Wang, 2013, Ebaid, 2009, and Abor, 2005).

On the other hand, the result of nonlinear relationship between the squared total Islamic leverage and the performance of continuously listed *shari'ah*-compliant companies is negative and insignificant meaning it has failed to establish the existence of nonlinear relationship between total Islamic leverage and the performance of listed *shari'ah*-compliant companies under both adopted performance measures.

6.1.2 Interest-bearing debt ratios and the performance of *shari'ah*-compliant companies

The interest-bearing debt ratios namely short-term interest-bearing debt, long-term interest-bearing debt and total interest-bearing debt negatively affect the performance of continuously listed *shari'ah*-compliant firms' performance under both performance measures, namely, ROE and ROA, but it is not significant. This is in part to respond to the second objective of this study, which is to examine the effect of interest-bearing debt ratios on the performance of shariah compliant companies and the results are negative and insignificant. The negative effect acts as a sign that encourages *shari'ah*-compliant firms to use retained earning financing rather than debt financing due to high cost of financing (Khasawneh & Dasouqi, 2017).

6.1.3 Islamic debt ratios and the performance of *shari'ah*-compliant companies

The Islamic debt ratios produced mixed results. Under ROE as performance indicator, the result of short-term Islamic debt, long-term Islamic debt and total Islamic debt are similar to the finding of interest-bearing debt ratios, which is negative and insignificant. However, the interesting part is that the three types of Islamic debt ratios have a positive and insignificant correlation with the performance of continuously listed

shari'ah-compliant companies under ROA as performance measurer. This also in part attend to respond to the second objective of the current study. This could arise because the Islamic debt ratios of the *shari'ah*-compliant firms is smaller and below threshold ratio at which a company can maximise its value as the reported descriptive analysis implies. Another reason is that the growth opportunities are the major driver that determines the relationship between debt financing and firm performance (McConnell & Servaes, 1995). Therefore, in this case, *shari'ah*-compliant firms have experienced low-growth, in which, the Islamic debt ratios affect positively the performance of *shari'ah*-compliant firms.

It is worth noting that the combined Islamic leverage proxy namely total Islamic leverage resulted in a negative correlation with *shari'ah*-compliant firms' performance under both performance measures, while under separation of Islamic leverage into interest-bearing debt and Islamic debt, both are ended with different signs i.e., negative and positive under ROA as performance measure. This is due to the fact the ratio of Islamic debt is very small compare with its counterpart, interest-bearing debt, therefore in the case of combination of both types of Islamic leverage, the sign of interest-bearing debt will appear, which is in this case a negative sign.

The results of F values indicate there is no significant effect for interest-bearing debt ratios on the performance of *shari'ah*-compliant firms before and after its adoption of 33% criteria of conventional debt in November 2013 as financial ratio benchmark.

6.1.4 The threshold regression results

The threshold regression suggests that there is no threshold ratio of Islamic leverage, which is statistically significant between the total Islamic leverage and the

performance of *sha'riah*-compliant companies under both models. The finding is in line with the results of nonlinear relationship between the squared total Islamic leverage and the performance of *shari'ah*-compliant companies. This aims to respond to the third research objective, which is to investigate the optimal level of Islamic leverage at which a *shar'iah*-compliant company can maximise its performance. The results of threshold regressions imply that asset turnover and firm size are the key predictors of *shar'iah*-compliant companies' performance, while current ratio acts as a predictor under model 2, because these DVs have resulted in a positive and significant relationship with *shar'iah*-compliant companies' performance.

6.1.5 Descriptive analysis

Regarding the behaviour of *shari'ah*-compliant companies towards the preferred type of debt and the debt period, the descriptive analysis implies that the sampled *shari'ah*-compliant firms prefer total interest-bearing debt as a source of financing over total Islamic debt at the rate of 13.9% to 1.60% of total financing respectively and within the interest-bearing debt, the short-term debt is likely to issue, which represents 9% of total financing. One of the reasons for choosing interest-bearing debt over Islamic debt is that the cost of Islamic debt financing is higher compared to the borrowing rate due to high default premium and overheads per capital ratios in Islamic banking and finance (Beik & Arsyianti, 2008). Within interest-bearing debt, the short-term debt is issued first and it represents 56% of total Islamic leverage.

It is worth noting that *shari'ah*-compliant companies rely on equity financing at 84.6 % of total financing, while the total Islamic leverage contributes only 15.6% of total financing.

Asset turnover ratio (AT) is defined as “an efficient measure. It is the only dependent variable that has a positive and significant effect on *shari'ah*-compliant firms' performance under both measures, such as ROE and ROA as the descriptive analysis suggested. This implies that the *shari'ah*-compliant firms have efficiently managed their assets, which at the end contributes positively to the overall performance level of sampled *shari'ah*-compliant firms in this study.

Current ratio is deemed as “a liquidity proxy” in this research. The average cash ratio of sampled *shari'ah*-compliant firms stands at 2.70%, which is greater than 1 implying that *shari'ah*-compliant firms have a tendency to prefer internally-generated funds over borrowing as a source of financing. This positive effect is accordingly observed relationship in the existing literature (Zainudin et al., 2017, Alina Zeb, Sher Khan & Muhammad Iqbal, 2016, and Dawar, 2014). Therefore, it is worth noting that firm managers should find a fine line dealing with liquidity, because in some cases, high ratio of current assets may lead to lower profitability (Asimakopoulos et al. 2009).

The descriptive analysis indicates 72.13% of the sampled firms are originated from three major sectors out of eight selected economic sectors, which are industrial products, trading/services and consumer products representing 33.44 %, 19.67% and 19.02% respectively. Infrastructure (IPC) sector maintains the lowest ratio in overall the sample size at the rate of 0.66%, followed by technology sector at the rate of 4.26%. Because, the Infrastructure (IPC) is a small sector with total number of five companies. The percentage change ratios indicate the Islamic debt ratios have increased after implementation of financial ratio benchmark in 2013 across the three debt levels namely short-term, long-term and total Islamic debt at a rate of 26.9%, 74.32% and 64.17% respectively. On the other hand, the ratios of interest-bearing debt have experienced a

decreasing rate at short-term, long-term and total debt levels with the ratios of -12.32%, -5.25% and -9.64% respectively. Moreover, the total Islamic leverage, which contains both Islamic debt and interest-bearing debt, have grown negatively at the rate of -4.37% meaning the gains from the Islamic debt are still far less from the losses of interest-bearing debt due to the newly adopted financial ratio benchmarks.

6.2 Implications of the Research

The outcomes of this research have important policy implications. The descriptive results reveal an astonishing fact that the total Islamic leverage represents only 16% of total financing of continuously listed *shari'ah*-compliant firms on Bursa Malaysia. It implies that equity financing accumulates 84% of total financing. This can be due to a number of reasons, i.e., lower growth opportunities, exceeding the debt optimization ratio, and lack of development of capital market (McConnell & Servaes, 1995, and Govori, 2014).

However, the capital markets have played a major role in innovation and in economic growth (IFC, 2017). The efficient capital market provides two important elements: sufficient financing fund, and low-cost financing, which affects the performance level of the firms (Govori, 2014). This is in fact one of the major reasons that led the high cost of Islamic debt financing compared to the borrowing rate in Malaysia (Beik & Arsyianti, 2008).

Based on these grounds, there is an urgent demand for financial regulatory authorities in Malaysia, such as Bank Negara Malaysia and the Securities Commission Malaysia to review the Malaysian capital market and improve the efficient level of equity-bond market, particularly debt securities and Islamic debt instruments, which in

part, participate in offering lower cost of financing and as well as borrowing rate. This, to some extent, will improve the participation of Islamic leverage of *shari'ah*-compliant firms in Malaysia in overall debt-equity structure and enhance the performance level of *shari'ah*-compliant firms particularly and generally the economic growth of Malaysia.

Another important fact is the total Islamic debt contributes 1.607% of total Islamic leverage ratios of *shari'ah*-compliant firms, which is a very low percentage. With this in mind, it is worthwhile to know that the total Islamic debt has resulted in positive effect with ROA as performance indicator, rationalising that the *shari'ah*-compliant firms may fall beyond the debt optimisation level at which a firm may maximise its performance level. In addition, the data indicate that roughly 20% of continually *shari'ah*-compliant firms have utilised both interest-based debt and Islamic debt, while the remaining 80% adopted only interest-bearing debt at a ratio which is within the criteria of 33% of firm's total assets in order to maintain the *shari'ah* status. This is another reason that draws the attention of the Securities Commission Malaysia and other financial regulatory authorities in Malaysia to study the factors that discourage most of the *shari'ah*-compliant firms to adopt Islamic debt as part of their financing policies.

6.3 The Contribution of the Research

It is divided in three categories i.e., body knowledge / academic community, contribution for industry and policy makers.

6.3.1 Body knowledge / academic community

In terms of body of knowledge, it is considered as the first study which has investigated Islamic leverage and continuously listed *shari'ah*-compliant firms' performance using separated debt data and adopted very restricted sampling requirements. Besides, from its pioneering research implications, the findings of this study enrich the body of knowledge in the field of Islamic debt financing and continuously listed *shari'ah* firm's performance. The biggest contribution of this study is applying separated debt data, which intends to avoid potential biased results and misleading findings.

In contrast, the existing literature adopted the common standard debt as it is reported in Datastream and Bloomberg databases, which use a combined debt data without defining/separating the proportion of interest-bearing debt from Islamic debt.

Another contribution of this study is that in terms of sample requirements, the study demands each *shari'ah*-compliant should be continuously reported in every semi-annual report of the Securities Commission Malaysia, particularly during the selected study period in order be part of the study's sample.

Finally, the research is the first in its kind to study separately the effect of interest-bearing debt ratios and total Islamic debt ratios on the performance of continuously listed *shari'ah*-compliant firms on the Main Market of Bursa Malaysia.

6.3.2 Contribution for industry

For the industry contribution, the study emphasizes the role of Islamic leverage in Islamic capital market namely *shari'ah*-compliant securities, which are representing an average of 57% of the total Malaysian Islamic capital market and 35% of overall the

size of the Malaysian capital market. Based on panel analysis, the overall results indicate that Islamic leverage has insignificant effect on *shari'ah*-compliant firms, while the descriptive analysis suggests its ratio stood at 16% of total financing. This requires to re-visit the overall debt-equity structure of *shari'ah*-compliant securities.

6.3.3 Policy makers

Finally, policy makers have to address the factors that discourage the adoption of Islamic leverage in *shari'ah*-compliant securities' debt-equity structure and provide intensives to improve the ratio of Islamic leverage in debt-equity structure of *shariah* firm, which may participate in the performance of *shari'ah*-compliant firms.

6.4 Suggestions for Further Studies

The research examines the effect of interest-bearing debt ratios and Islamic debt ratios on the performance of continuously listed *shari'ah*-compliant firms in Malaysia using separated debt data. Given the scarcity of the type of study on this issue, further research is needed.

The research is based on accounting-based performance measures. Therefore, the study encourages future studies to further investigate the impact of Islamic leverage on the performance of *shari'ah*-compliant firms applying market-based performance measures and following the same method of analysis and the sampling criteria

Secondly, applying other econometric analysis is highly encouraged. In particular, there is a need to enhance the model specifications for measuring the effect of interest-bearing debt ratios and Islamic debt ratios on performance of *shari'ah*-compliant firms in Malaysia and globally.

Thirdly, the research recommends the future studies to conduct compare and contrast studies, which sample the two types of listed companies on Bursa Malaysia, i.e., *shari'ah* and non-*shari'ah*-compliant companies. They provide useful insights, which shields light on the shortcomings of the existing system and provide suggestions to the financial regulatory authorities.

Fourthly, the models developed in this study are applicable in countries, which particularly have a developed *shari'ah* screening method and produced the list of *shari'ah*-companies. To ensure the comparability of the data, the positional studies should be highly encouraged following the sampling requirements and adopting panel data analysis.

Finally, a case study approach based on the analytical framework will provide in-depth understanding of Islamic leverage and firm performance. Moreover, interviews with officials of the Securities Commission Malaysia, some members of the *shari'ah* Advisory Council and *shari'ah*-compliant companies' executive management team would be an appropriate channel to facilitate the understanding of the issues from different perspectives.