

CHAPTER 6

CONCLUSION AND RECOMMENDATIONS

6.1 Introduction

This chapter aims to present the summary of findings, discussions and suggestions for future studies. The summary of the findings is discussed in Section 6.2. Discussion about the future research is elaborated in Section 6.3. Finally, Section 6.4 concludes the study.

6.2 Summary of the Findings

The summary of the findings is organized into two-fold; Descriptive Analysis and Quantitative Analysis using Logistics Regression and A Tree Analysis.

6.2.1 Summary on Descriptive Analysis

Based on analyses in Chapter 5, this research has determined other pertinent knowledge pertaining to *sukuk* defaulted firms which were discussed accordingly as found in the following tables; Table 5.1: Analysis on *Sukuk* Defaulted and Non-Defaulted Firms; Table 5.2 Analysis on Type of *Sukuk* Defaulted Firms and Amount from 2006-2011; Table 5.3 Analysis on *Sukuk* Ratings of the *Sukuk* Defaulted Firms; Table 5.4: *Sukuk* Type and Number of *Sukuk* Type Default; Table 5.5 Analysis on Average Number of Years Before Default and Before/After 2007-2008 Financial Crisis; and Table 5.6: Type of Industries and Economics Sector. This findings are very useful and should be beneficial for further references.

Table 5.1 in Chapter 5 shows the dataset of 60 *sukuk* defaulted and *sukuk* non-defaulted firms. The datasets consist of various sectors such as property (21.67 per cent), securitisation (1.67 per cent), consumer products (13.33 per cent), construction (1.67 per cent), industrial (26.67 per cent), exchange (1.67 per cent), trading service (6.67 per cent), printing and publication (3.33 per cent), special purpose vehicle or SPV (6.67 per cent), investment (13.33 per cent), shipping (1.67 per cent) and port (1.67 per cent). The dataset of 60 firms were represented by 12 types of industries and economics sector as in Table 5.6.

Industrial and property were the type of businesses that seem to dominate this sample size (48.34 per cent), followed by investments and consumer products (26.66 per cent), then trading services and special purpose vehicles or SPV (13.34 per cent), suggesting that it might be these particular industries and economic sectors that create more chances for *sukuk* firms to default in between 2006 to 2011.

This can conclude that the choice of business activities of *sukuk* issuing firms that venture into must also look at the type of industries and economic sectors the firms wanted to invest. However, under normal circumstances, when the economy and world financial systems are stable, the default event could have been avoided.

Table 5.2 describes the type of *sukuk* defaulted firms which were mostly *Bai’Bithaman Ajil* Islamic Debt Securities (BaIDS) and *Murabahah*. From the table, it showed that mostly the type of *sukuk* issued were the mixture of one type of *sukuk* issued or more than one types of *sukuk* being issued. Therefore, the amount from the mixture of *sukuk* type *murahahah* were RM110 million. The highest amount issued from one type of *sukuk* was *sukuk* type *Bai’Bithaman Ajil* Islamic Debt Securities (BaIDS) which was RM986 million and the lowest was *sukuk* type *Murahahah*

Multi-Option Notes Issuance Facility (MONIF) which was RM40 million. *Sukuk* type *Bai’Bithaman Ajil* Islamic Debt Securities (BaIDS) recorded the highest amount which was RM2,506 billion, *Murabahah*. Referring to Table 5.2 and Table 5.4, the total cost lost and incurred to the Government were more than RM4.12 billion.

Table 5.3 shows the initial rating and final rating of the 34 *sukuk* default firms under study. Some of the firms’ initial rating was high, $AA+_{ID(bg)}$ down graded to $D_{ID(bg)}$ the final rating, some of the firms’ initial rating was, $A+_{ID}$ down graded to D_{ID} the final rating, some of the firms’ initial rating was $A+_{ID}$ down graded to D_{IS} the final rating, some of the firms’ initial rating was $A+_{ID}/MARC-1_{ID}$ down graded to $D_{ID}/D-_{ID}$ the final rating. Some of the firms’ initial rating was $A+_{IS}$ down graded to D_{IS} the final rating, and some of the firms’ initial rating was AA_{ID} down graded to D_{ID} the final rating. RAM’s and MARC’s rating symbols and definition are as shown in Appendix I.

Table 5.4 shows that the highest number of types of *sukuk* default. They were *sukuk* type *Bai’Bithaman Ajil* Islamic Debt Securities (BaIDS) which were 16, followed by *Murabahah* Underwritten Notes Issuance Facility (MUNIF) and *Murabahah* Medium Term Notes Facility (MMTN)/*Murabahah* Commercial Paper (MCP) which were 4 and *sukuk* type *Musyarakah* were 2. The rest were the mixture type of *sukuk* respectively was 1. By referring to Table 5.2 and Table 5.4, *sukuk* type of *Bai’Bithaman Ajil* Islamic Debt Securities (BaIDS) which were 16, represented 59.98 per cent. Subsequently, for type of *Murabahah* Underwritten Notes Issuance Facility (MUNIF) and *Murabahah* Medium Term Notes Facility (MMTN)/*Murabahah* Commercial Paper (MCP) which were 8, represented 26.04

per cent. It is shows that *Bai'Bithaman Ajil* Islamic Debt Securities (BaIDS) and *Murabahah* were the dominant type of *sukuk* issued with 24 issuances, represented 86.02 per cent.

Table 5.5 depicts that 1 firm (2.8 per cent) came into default after 1 year. There were 6 firms (17.1 per cent) became default after 2 years followed by 10 firms (28.6 per cent) after 3 years. Then, 7 firms (20 per cent) were default after 4 years and 5 years. Another 3 firms (17.1 per cent) were default after 6 years and lastly 1 firm (2.8 per cent) was default after 8 years of issuance.

This research found that the statistics has indicated that the survival of *sukuk* issuer firms in Malaysia were in between 1 to 6 years. Mostly the survival rate were just 3 years which means that for public unlisted *sukuk* firms were exposed to default after just a few years of issuance.

The dataset used in this study was in between 2006 to 2011. From dataset, the year of *sukuk* issuance and the year of *sukuk* default varied among firms that led to difference in number of years to default. The observation periods of this research were three years before issuance and three years after issuance to the date of default. Table 5.5 indicates that the survival years of defaulted *sukuk* firms averagely were three years after issuances. Based on several studies (Ardiansyah et al., 2013; Zeytinoglu & Akarim, 2013; Lakshan & Wijekoon, 2013), predicting year of default occurred one year or three years after issuance. Therefore, these research findings support the previous research.

6.2.2 Quantitative Analysis by Using Logistics Regression and A Tree Analysis

Chapter 1 highlighted three main objectives of this study which are, (i) To determine the profile of defaulted *sukuk*, (ii) To investigate impact of liquidity risk, solvency ratio and corporate governance to the defaulted *sukuk* and (iii) To suggest appropriate policy to prevent *sukuk* default.

The first objective is to determine the profile of defaulted *sukuk*. The Profiling of *Sukuk* Defaulted Firms in Malaysia as stated in Chapter 2 is comprehensive as it covered the whole population of *sukuk* defaulted firms in Malaysia in between 2002 until 2014. This profiling consist of information which can be useful to researchers in *sukuk* and Islamic finance. The data contained *Sukuk* Issuer Firms and Activities, Type of Industries, Issuance Date, Date of Default, Rating Agency, Initial Rating, Final Rating and Type of *Sukuk* and Amount. Therefore, the first objective of this study is achieved when the Profiling of *Sukuk* Defaulted Firms in Malaysia from 2002 until 2014 has been determined as shown in Appendix 1.

The second objective is to investigate the impact of liquidity risk, solvency ratio and corporate governance to the defaulted *sukuk* is also achieved. This objective helps in answering the research hypotheses (H1, H2 and H3) as stated in Chapter 1.

Results on liquidity risk show that the quick ratio ($p = 0.006$) and cash to asset ratio ($p = 0.021$) have p value and less than 0.05 ($p > 0.05$). This means the quick ratio influences the *sukuk*'s default significantly. Thus H1a is accepted. Either cash ratio, the cash ratio influences the *sukuk*'s default significantly. Thus H1b is accepted. Liquidity risk influences the *sukuk*'s default significantly.

The analysis results on solvency ratio show that DTER has sig. less than 0.05 ($p = 0.001$). ICR have sig value more than 0.05. Thus, debt to equity ratio influences the *sukuk* default. ICR does not influence the *sukuk*'s default. These results show that debt to equity ratio contributes to the default non-default *sukuk* firms. Thus, hypothesis H2 that the solvency ratio influences the *sukuk*'s default is accepted. Hypothesis H2a that debt to equity ratio influences the *sukuk* default is accepted. However, hypothesis H2b that ICR influences the *sukuk*' default is denied.

Results on corporate governance show that only Audit Committee (AC) has significant relationship towards default non-default *sukuk* firms.

The first hypothesis is (H1) liquidity risk influences the predictability of *sukuk* default. For the study on *sukuk* default and *sukuk* non-default firms, liquidity risk is measured by liquidity ratios that are below the threshold of 1 (ratio by convention between 1:1 or 1:1.5) that contributed to the default. Liquidity ratios used in this study are quick ratio and cash to asset ratio. Both ratios are standard financial ratios that most business firms use to measure liquidity ratios.

Moyer et al., (1992) stated that immediate liquidity is measured by quick ratio. This is because quick ratio is more stringent measure of liquidity than the current ratio. Firm that intends to remain a viable business entity must have enough cash in hand to pay its bills as they come due. In other words, the firms must remain liquid. In addition, Moyer et al., (1992) raised that liquidity ratios are the quick measures of a firm's ability to provide sufficient cash to conduct business over the next few months. For some practices, it is a common precursor to financial distress or bankruptcy if liquidity is low or declining therefore liquidity ratios are good leading indicators of cash flow problems.

From accounting practices, one way to determine the state of liquidity is by examining the relationship between the firm's current assets and approaching obligations. Therefore, quick ratio is calculated by deducting inventories from current assets and dividing the remainder by current liabilities. The quick ratio is similar to the current ratio except that it excludes inventory, which is usually the least-liquid current asset. The generally low liquidity of inventory results from two factors:

- i. Many types of inventory cannot be easily sold because they are partially completed items, special-purpose items, and the like;
- ii. Inventory is typically sold on credit, and so it becomes account receivables before being converted into cash.

Generally, quick ratio provides a better measure of overall liquidity only when a firm's inventory cannot be easily converted into cash. If inventory is liquid, the current ratio is a preferred measure.

Quick ratio shows the extent of cash and other current assets that are readily convertible into cash in comparison to the short term obligations of an organization. A quick ratio of 0.5 would suggest that a firm is able to settle half of its current liabilities instantaneously.

In contrast, a quick ratio that is greater than industry average may suggest that the firm is investing too many resources in the working capital of the business which may be more profitable to be used elsewhere. If a firm has too much spare cash, it may consider investing the surplus funds in new ventures and in case firm is out of investment options, it may be prudent to return the excess funds to shareholders in the form of increased dividend payments. Quick ratio which is lower than the industry average may suggest that the firm is taking too much risk by not maintaining an

appropriate buffer of liquid resources. Alternatively, a firm may have a lower quick ratio due to better credit terms with suppliers than the competitors. When analyzing the quick ratio over several periods, it is important to take into account seasonal variations in some industries which may cause the ratio to be traditionally higher or lower at certain times of the year as seasonal businesses experience irregular bursts of activities leading to varying levels in current assets and liabilities over time.

Quick ratio must be assessed in the context of the specific industry of an organization. In some business environment, quick ratio is more reliable measure of liquidity for manufacturing firms and construction firms that have relatively high levels of inventory, work in progress and receivables.

Certain business sectors traditionally have a very low quick ratio such as the retail sector. Firms leading the retail sector are able to negotiate very favorable credit terms with suppliers due to their dominance in the market leading to relatively high current liabilities in comparison to their liquid assets. The business environment is also relatively stable in the retail sector and the expansion of operations is incremental which allows such firms to maintain lower quick ratios without taking too much risk.

Quick ratio is also an indicator of solvency of an entity and must be analyzed over a period of time and also in the context of the industry the firm operates in. Firms should maintain a quick ratio that provides sufficient leverage against liquidity risk given the level of predictability and volatility in a specific business sector among other considerations. The more uncertain the business environment, the more likely that firms would maintain higher quick ratios. Conversely, where cash flows are stable and predictable, firms would seek to keep quick ratio at relatively lower levels. In any

case, firms must achieve the right balance between liquidity risk arising from a low quick ratio and the risk of loss resulting from a high quick ratio.

Analyzing a coverage ratio depends largely on how much risk the creditor or investor is willing to take. Depending on the desired risk limits, a bank might be more comfortable with a number than another. If the computation is less than 1, primarily it translates that the firm in question is not earning sufficient money to fund its interest payments, thereby neglecting to pay back the principal payments of the debt. Based on this, it is clear that a firm with a calculation of less than 1 would not be capable of even paying the interest of its debt. This kind of firm is beyond risky and probably would never found any nature of bank financing.

Conversely, if the coverage equation equals to 1, it also translates that the firm is making an adequate fund to pay its interest. Thus, this scenario is not much better than the last one as the firm is still unable to fund the principal payments. Therefore, it can only cover the interest on the current debt when the due comes.

Also, if the coverage measurement is above 1, it translates to the fact that the firm is profiting more than enough fund to pay its interest obligations with some extra earnings left over to carry out the principal payments. In this case, most creditors search for a coverage that is at least 1.5 prior to accepting any loans. To put it differently, the primary objective of banks is to guarantee that a firm makes at least 1.5 times the amount of their current interest payments.

Since corporate governance is a categorical data, Balance of Board is used in this study to map the dataset as in Appendix 6. As discussed in the previous chapters, the composition of Independence Directors was composed as follows, One-third of the

Board's membership = 1; and Not One-third of the Board's membership = 0. Meanwhile, for existence of Audit Committee was scaled as follows, Yes = 1; No = 0

The findings as in Chapter 5 indicate that firm that had no board meetings followed by existing of audit committee was most significant indicator toward *sukuk* non-default. If the firms had board meetings, non-default *sukuk* was influenced significantly by existence of audit committee.

In terms of corporate governance, this study aims to build research framework to help interpret the *Shariah* governance mechanisms in Islamic Financial Institutions (IFIs). After a review of the existing theories that have been used to describe the phenomena of corporate governance, it is found that the most common theory used in corporate governance as well as the Islamic governance field are Agency Theory and Stakeholder Theory. Both theories are integrated based on interconnected concepts and their relationship with *Shariah* governance.

Asian Development Bank (2017) reported that Malaysia occupied third place after Thailand and Singapore in the entire corporate governance score card. Although both countries are developing, Thailand has set higher governance needs compared to Malaysia. According to Sitthipongpanich and Polsiri (2013), the Thai board of companies require at least five members. This is a fairly large board size compared to Malaysia at least two members (Companies Act 2016, 2016). Further, the Independency board in Thailand is higher by having at least one-third of the board and not less than three directors who are assigned as independent directors. In Malaysia, the independency minimal board has two or one-third of the Board.

In Malaysia, there are a number of cases of bad corporate governance, such as Renong, Perwaja Steel and Malaysian Airlines System (MAS). This situation has led

many scholars to observe that lack of good corporate governance to a certain degree contribute to a major cause of the economic crisis in the East Asian region, where corporate governance weakness has been considered as one of the causes of the East Asian Financial Crisis (Roshima et al., 2014). Solomon (2004) also stated that Malaysia typifies the insider-based model of corporate governance, with most companies owned and controlled by the founding families. Some studies blamed corporate governance problems as the reason why Malaysia (and other East Asian economies, such as South Korea) succumbed to the financial crisis of 1997.

Subsequently, the Security Commission of Malaysia had published the development process, where it focuses on strengthening board structure and composition are recognising the role of directors as active and responsible fiduciaries. It further stated that the duty to be a guardian of the company as well as effective steward on the directors, therefore not limited to just overseeing the conduct of business and making strategic decisions, but as well as making sure that the company operates in accordance with ethical values and laws, by maintaining an effective governance structure that will bring appropriate management of risks as well as the level of internal controls.

In practice, the Board in a firm is composed of board of directors which comprised of a chairman and possibly a deputy chairman, CEO, senior independent director (who may also be the deputy chairman), executive directors, and NEDs, where the board will be supported by the company secretary. In Corporate Governance and Voting Guidelines (November 2007), NAPF stated that all the directors are responsible for the strategy and governance of the company. Also, the executive directors are responsible for the successful implementation of that strategy,

and independent NEDs have a special responsibility for overseeing the performances of the executive directors, but the size of the board will vary from one company to another. The ideal size is one that balances the need to avoid the board being so large that it becomes unwieldy, and the need to have a board that is large enough to contain individuals with a balance of skills and experience appropriate for a company of its size and business.

Whether the board were consulted to give advice on the decision or not the consequences were fatal, defaulted. Firms should refer to Malaysian Code on Corporate Governance or MCCG (Code) and *Shariah* governance (the Guidelines on the Governance of *Shariah* Committee for the Islamic Financial Institutions issued in 2004 – in practise until 2011) and the current framework, *Shariah* Governance Framework (SGF). Therefore, this study was carried out to see the impact of corporate governance to these *sukuk* defaulted firms based on the Malaysian Code on Corporate Governance or MCCG (Code) and *Shariah* governance (the Guidelines on the Governance of *Shariah* Committee for the Islamic Financial Institutions issued in 2004 and the current framework, *Shariah* Governance Framework (SGF), that was announced in 2011.

From the findings of each independent variable, the liquidity risk (quick ratio and cash to asset ratio), solvency ratio (debt to equity ratio) and corporate governance (existence of audit committee) contributed to the *sukuk* default and defaulted *sukuk* firms. Meanwhile, the full model finding from WEKA revealed that existence of audit committee, debt to equity ratio and quick ratio effect to *sukuk* default and *sukuk* defaulted firms. Therefore, from the findings, it shows that liquidity risk, solvency ratio and corporate governance contributed to the *sukuk* default and *sukuk* defaulted

firms in Malaysia from 2006 to 2011. This findings have answered the second objective of the study.

Therefore, research objectives have answered three research questions which are; (i) Is there any impact of liquidity risk to the defaulted *sukuk* issuing firms under study? Is there any impact of solvency ratio to the defaulted *sukuk* issuing firms under study? Is there any impact of corporate governance to the defaulted *sukuk* issuing firms under study?

The fourth research question, 'What is proposed model of *sukuk* defaulted firm based on liquidity risk, solvency ratio and corporate governance? In order to answer the fourth research question above, here is the brief explanation on the study. In this study, predicting *sukuk* default is the dependent variable and it is a dummy variable, and is explained by firms' specific, financial ratio explanatory variables. If the default variable gets a value of 1 in some years, it means that it has failed in payments on that given year, or it has gone into bankruptcy in that given year. If the firm has gone into bankruptcy it doesn't have any more information after that year. The default variable is collected from years (t+2) and (t+3), if the financial ratio data is from year (t).

Predictability of *sukuk* default as a dependent variable was also conceptualised as default firm and non-default firm. The default firm measured was in a qualitative form categorised as '1' for default and '0' for otherwise. To enable these qualitative measures to be regressed in multivariate regression technique, logistic regression methods were used.

Logistic regression methods of analysis allow the use of a mix of continuous and categorical predictor variables to explain a categorical outcome or dependent variable. When the variables are categorical, the use of logistic regression is useful for

locating explanations between variables (Stearns et al., 1995). The main objective of logistic regression is to attain the highest predictive accuracy possible with the given set of predictors (Hair, 1995). The principle of logistic regression is to express the multiple linear regression equation in logarithmic terms and thus overcome the problem of violating the assumption of linearity. The values of the parameters are estimated using the maximum-likelihood method, a technique where coefficients that make the observed values most likely to have occurred are selected.

WEKA is the other method used in this study to conform to the data analysis and robustness of the results. Therefore, the proposed model of *sukuk* defaulted firm in Chapter 5 concludes the results as follows: (1) Co-efficient shows the strength of variable. It shows audit committee is the most influenced measure toward *sukuk* default non-default firm, followed by quick ratio, debt to equity ratio and cash to asset ratio. From the model, if there is no audit committee, thus *sukuk* default for firm; (2) Sign minus (-) in quick ratio shows higher quick ratio, the smaller risk firm to be defaulted; and (3) Cash to asset ratio has positive effect to the *sukuk* default firm. If a firm has higher cash to asset ratio, the firm has higher risk to be defaulted. So does debt to equity ratio. Higher debt to equity ratio, the higher risk the firm to be defaulted.

6.2.3 Discussion on Economics Perspectives

From the economics perspective, economic growth is significant for the development of a country and *sukuk* capital market is one of the financing methods commonly used to accelerate a country's economic development (Musa et al., 2020)..

Sukuk issuances are needed for working capital or to refinance existing debt.

Sukuk financing is used mainly in the transportation sectors, building highways, infrastructures, shipping and aircraft sectors, real estates, constructions, as well as petrochemical projects that attract investments from major firms in the world. *Sukuk* issuances connect the local economy to the global arena. The 60 *sukuk* defaulted and *sukuk* non-defaulted firms in this study represented 12 types of industries and economics sectors.

The findings shows that industrial and property sectors were the type of businesses that seemed to dominate (48.34 per cent), followed by investment and consumer product (26.66 per cent), trading services and special purpose vehicle or SPV (13.34 per cent). It is proven that *sukuk* issuances firms were at high risk. Suggesting that it might be these particular industries and economic sectors that create more chances for *sukuk* firms to default in between 2006 to 2011. This can be concluded that the choice of business activities of *sukuk* issuing firms that venture into must also look at the types of industries and economic sectors the firms wanted to invest. However, under normal circumstances, when the economy and world financial systems are stable, the default events could have been avoided.

From the findings also indicate that *sukuk* defaulted were influenced by years of default events, sole activity or cross-activities, apart from types of sectors. Therefore, these various types of cross-activities associated with *sukuk* issuance for public unlisted firms were very risky for *sukuk* to default particularly when it falls during global financial crisis, as of 2007-2008 cycle. Many issues were raised regarding corporate governance as discussed in this thesis referring to Appendix 6. It is suggested that public unlisted firms should not be given financing by issuing *sukuk* as this act would disgrace the ability of *sukuk* which is immune to default. In fact, this

study has shown that total losses incurred by government were more than RM4.12 billion. This amount is quite substantial for the government to bear the losses. With the support from the government to prevent *sukuk* from becoming default, it demonstrates the significance of *sukuk* industry in the Malaysian economy.

6.2.4 Discussion on 2007-2008 Financial Crisis

The first cycle of financial crisis was the Asian Financial Crisis, which occurred in 1997 to 1998. The second cycle was the Global Financial Crisis of 2007-2008. The business cycle is hence observed to be 10 years, whereas the economic cycle is 5 years for the medium-term period. The years of 2002 to 2011 fell the in-between these two cycles of financial crises, which saw the occurrence of the Asian Financial Crisis in 1997/1998 and Global Financial Crisis 2007/2008.

Table 1.1 in Chapter 1 shows that the numbers of default cases increased tremendously in 2007 and 2009, with 8 to 9 cases. The number slumped to 3 in 2008. However, the number showed a downward trend in 2010 to 3 cases before dropping to just 1 default case in 2011. The table depicted an increasing trend three years prior to financial crisis and a decreasing trend three years after as the trend portrayed a significant decrease of the default cases in 2007-2008. The trend also indicated that the numbers of defaulted *sukuk* in 2007-2009 were related to the world's financial crisis. The paper concluded that there is tendency for the number of bankruptcies among private-own *sukuk* issuer firms in Malaysia to increase and this trend nevertheless will affect banking and financial institutions in Malaysia, particularly when year of the default occurrence correlates with the world financial crisis.

Intuitively, most of the familiar events in the financial crisis are linked more to movements in liquidity risk and corporate governance.

6.2.5 Sum up

In the course of this research, the significant questions are raised. They are: the relationship between *sukuk* default firms and liquidity risk, solvency ratio and corporate governance characteristics. In answering these questions, the investigations focused on the factors influencing liquidity risk and solvency ratio in terms of financial ratios, and corporate governance characteristics, based on balance of board.

Some of the *sukuk* firms had been operating their businesses as a sole activity but some other *sukuk* firms run their businesses as cross-activities. Sole activity is defined by researcher in this study as, “the *sukuk* firm had ventured into one industry and economic sector” whereas for cross-activities, “one *sukuk* firm had ventured into various types of industries and economic sectors”.

This study argues that *sukuk* is dissimilar to bond due to the latter represents the debt obligation of the issuer. However, Muhammad Taqi Usmani, who is Chairman of the *Shariah* Council, gave a brief definition to clear the misunderstandings on the differences between *sukuk* as compared to the conventional bonds. Usmani stressed that bonds are not regarded as ownership to the bond holders in companies where the bonds were initially issued. Instead, the bonds documented the interest-bearing debt owed to the bond holders. Other than that, there are also interest payments paid on a regular basis to the holders of the bonds. On the subject of interest, the amount is set on a particular percentage of the capital, but not calculated based on percentage of profits. Alternatively, the concept of bonds provide guarantee

upon redemption on the return of principal after bond maturity, despite the firm's financial performance. Another important characteristic of conventional bonds is that it is not essential for the issuer to pay back the money more than the principal as well as the interest that had been agreed by both sides. With that, any profits earned by the firm accrue exclusively to the issuer's side. In this case, the bond holders do not have any right to request their share in the profits made by the enterprise beyond the interest agreed before. Contrary to all these characteristics, *sukuk* in its initial stage of introduction is found to be different from the conventional bonds. However, as to date, many *sukuk* offered in the market has become almost the same characteristics of the conventional bond. The glaring difference of *sukuk* compared to bonds is that the *sukuk* contract must specifically abide by *Shariah* where *Shariah* board must be formed to observe the implementation (Oliver Ali Agha & Grainger, 2009).

Meanwhile, the Securities Commission of Malaysia understands that there is no size appropriate to all practices for all sectors. In MCCG 2017, Company's mandate to apply or clarify alternatives to how the company achieves revenue through the adoption of corporate governance practices. In comparison with MCCG 2012, MCCG 2017 provides an increase in the composition of the board by increasing the need for independence of the Board, the period of independent directors and diversity of gender. Although these new changes are mainly for large companies, other listed companies are encouraged to adopt practices to achieve corporate governance excellence.

In summary, the first *sukuk* default event in Malaysia was in 2002, and it occurred when *sukuk* firms failed to fulfill the monthly obligations. Since then until 2014, a total of 35 *sukuk* defaulted firms were recorded in which mostly were from

property investments that run cross-activities. Years of *sukuk* default fell between 2006 to 2009. These years coincided with the global financial crisis that struck between 2007-2008. Hence, it showed the link between default events and financial crisis as well as types of industries and sectors.

Some of the business activities were palm oil, property, investment, manufacturing, importers, exporters, and broker. In property development were construction activities and property development through investment holding. Broker activities include specialised heavy duty vehicles and assembling related products locally/manufacturing of specialised heavy duty and the provision of after sales services. Manufacturing activities include manufacturing of data storage products and steels. Data storage products such as video cassette tapes, computer diskettes, digital versatile disc recordable (DVD-Rs), compact disc recordables (CD-Rs).

Business activities like video cassette tapes, compact disc recordables (CD-Rs), digital versatile disc recordable (DVD-Rs), are worth for the firms to issue *sukuk*? The nature of the business of the firms, seems like there were no proper planning from management on the direction of the firms. Whether the management made the best decision by issuing *sukuk* for financing, obviously the decision was unwise. Majority of the firms were registered default only after two to three years after issuances.

Criticizing Islamic finance for *sukuk* defaults is both misperception and misleading, thus it is unfair to put the blame on Islamic finance. Hence, for the *sukuk* market to grow further in the global economy, correcting the perception and assumption of *sukuk* defaults is crucial. In conclusion, it is totally wrong to make an assumption that *sukuk* as among many Islamic financial instruments, to be impossible

to default, solely on the ground of *Shariah* issues. These instruments are also exposed to the credit risk as well as the other risks similar to other financial tools.

Based on the achievements of more than thirty years in *sukuk* industry, and the announcement by the government in November 2014 that Malaysia was the leader (also presently) in Islamic finance and the main contributor to the world, *sukuk* market has strengthened the status of the country among other *sukuk* issuance countries. Apparently, the issue of *sukuk* default which hit the financial system in 2009 has changed the paradigm of the stigma of *sukuk* and makes it immune to default as *sukuk* is an Islamic equity that complies with *Shariah* and practice of profit sharing.

6.3 Challenges

As the market develops, it cannot be denied that the *sukuk* market faces many challenges. Initial challenges are the complexities of *sukuk* defaulted firms. The global financial crisis attracts attention to the dangers of highly complex structured products. In particular, such products are difficult to review as well as to unwind in the event of default. Many complex firms that suffer from significant deterioration and defaults during the financial crisis are also leaders in the *sukuk* business. Therefore, the complexity of the *sukuk* structure can continue to encourage participation from many investors and issuer involved before through structured products (Nor Fadilah Bahari et.al., 2016).

Other top challenges that are widely spoken and significantly debated within the circle of the *sukuk* industry are; the complexity of *sukuk* structure in the market, the differences on the acceptance and views on the *Shariah* concept of *sukuk*, its trading mechanisms and its tradability approaches among *Shariah* scholars. Lack of

liquidity in the secondary market, disparity in legal, tax and regulatory frameworks and latest one is the presence of socially responsible investment (SRI) or green *sukuk* in the market are the other challenges.

From the library research, most of the literatures are on bond and bond default. In Web of Science (WoS) database using the keyword - “Bond and bond default on 8 February June 2020, it was found that the number of publications on bond default and non-default is around 800, whereas using the keyword - “Islamic *Sukuk*”, only about 140 publications appeared (Rahman et al., 2020). Thus, it indicates that study and until now, there is no finance book written by well known writers on *sukuk*. The researcher discovered just a paragraph which mentioned very generally on Islamic finance and *sukuk*, it shows how critical and big gap in literatures on this subject. As for liquidity risk, so far merely two books were found. But none related to *sukuk* default and *sukuk* default firms. Government policy and support for the *sukuk* industry demonstrates the significance of *sukuk* industry in the Malaysian economy.

6.4 Future Research

There are many areas under this topic are open for future research. From this thesis, a lot have been discovered that calls for more research to be conducted in this field. Among others are the complexities of *sukuk* defaulted firm, highly complex structured products, the complexity of *sukuk* structure in the market, the differences on the acceptance and views on the *Shariah* concept of *sukuk*, its trading mechanisms and its tradability approaches among *Shariah* scholars, lack of liquidity in the secondary market, disparity in legal, tax and regulatory frameworks and latest one is the presence of socially responsible investment (SRI) or green *sukuk* in the market. Many complex

firms that suffer from significant deterioration and defaults during the financial crisis are leaders in the *sukuk* business. Further studies need to be explored in depths on the *sukuk*, liquidity risk and financial crisis.

6.5 Concluding Remarks

This study highlights that Malaysia is a well-known Islamic finance navigator and a key player in the *sukuk* industry. Moody's Investors Service (2014) noted that Malaysia is accounted for a nearly two-thirds share of local currency *sukuk*, and approximately 59 per cent of the global total *sukuk* issuances. Based on this track record, Malaysia has been put as the main contributor to the world *sukuk* market.

The findings indicated that *sukuk* defaulted events and *sukuk* defaulted firms that occurred coincided with the 2007-2008 world financial crisis. Since Malaysia is the prime *sukuk* issuer in the world, under this circumstances, it would affect the financial institutions in Malaysia when *sukuk* default events occurred particularly in relations to liquidity risk, solvency and corporate governance.

The findings presented in this study were the first exploratory study on *sukuk* defaulted and *sukuk* defaulted firms. It is meant to be a breakthrough under this scope of research and as referral for future researches. Apart from that, it is the effort from the researcher in order to contribute to the knowledge on *sukuk*, Islamic capital market and the current Islamic financial system in practice.

It is hoped that, the small contribution of this study will help to suggest appropriate policy makers to prevent *sukuk* default. In addition, this study helps to enhance the implementation of Islamic capital markets particularly on liquidity risk

management and corporate governance monitoring mechanisms. With that, it will further equip the Government of Malaysia as the hub in Islamic capital market in terms of *sukuk* at the local and global level.

