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**Performance of Initial Public Offerings (IPOs): Shariah and non-Shariah
Compliant Companies**

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Abstract

The company undertakes initial public offerings (IPOs) to establish a public market and raise equity financing. IPO issued by Shariah-compliant companies claimed to be performed differently than those without the certification. The purpose of this research is to compare the performance of Shariah and non-Shariah compliant companies through their IPOs initial returns and to examine whether the market capitalization and size of the offer could significantly affect the variance in IPO initial returns. The data used in this paper were from 32 companies listed in Bursa Malaysia between 2015 and 2021, of which 18 of them are Shariah-compliant and 14 are non-Shariah compliant. The result shows that Shariah-compliant IPOs have higher initial returns of 14.37% as compared to non-Shariah with initial returns of 6.29%. As for the variables, the size of the offer has more influence on IPO initial return compared to market capitalization irrespective of whether the status of the company is Shariah or non-Shariah. This study is to assist researchers, developing companies, and investors to seek knowledge on the impact of Shariah-compliant status regardless of its industry.

Keywords: Shariah-compliant; non-Shariah compliant; initial public offering; initial return; the size of the offer; market capitalization

1. Introduction

1.1 Background

An initial public offering (IPO) is issued for companies to create a public market and raise equity capital for the company (Ritter and Welch, 2002). This motivates the companies to build a strong base as going public also implies an increase in publicity, creating a stable image for the company. Underpricing of IPOs was a major factor for investors to forecast profits from investment activities (Naiborhu, 2019). This paper focuses on the performance of initial public offering (IPO) between Shariah and non-Shariah compliant companies.

Shariah is not a new term in the finance world. "Shariah" is an Arabic word that carries the meaning of divine law, Islamic law, or the Law of God (Rashid, Ullah and Bhuiyan, 2020). A company must comply with the Islamic

ideology that has strict regulations on business activities to be qualified as a Shariah-compliant firm (Ho, 2015). Islamic investment shall be free from usury, uncertainty, gambling as well as other prohibited elements in Islam such as non-halal foods and immoral activities (Yaakub and Sherif, 2019). The status of Shariah-compliant is proven to attract more shareholders both internationally and locally as it can improve the reputation of a firm (Tajuddin, Mohd Rashid Lee and Che Yahya, 2019). Contradictory, non-Shariah compliant companies do not follow Islamic regulations. This means that there is no set of restrictions for pork and alcohol, gambling, interest-based financial contracts, tobacco and trading of gold and silver as cash on a deferred basis, pornography, and weapons (Ho, 2015).

According to Hussin et al. (2016) as cited in Yaakub and Sherif (2019), since the start of the global financial crisis in 2008, the Islamic finance industry, including Islamic capital markets, has risen by an average of 17.5%. As the investments required and the Muslim population increase, the opportunities to establish Shariah investments increase (Sherif and Erkol, 2017). However, it was stated that the research on the Islamic portion of the IPO market is still scarce, and receiving little attention (Abdul and Yong, 2010). Although Malaysian public listed companies (PLC) owners are largely non-Muslim, Shariah-compliant status appears to be a major concern for the Securities Commission (SC). Moreover, Shariah-compliant IPOs in Malaysia had greater initial returns than their conventional equivalents (Hiau and Mohd, 2004). In addition, referring to Abdul and Che's study (2013), an IPO with a Shariah-compliant status performs differently than those without the status.

1.1 Objective

The objectives of this paper are, firstly to identify the performance of IPO between Shariah-compliant companies and non-Shariah compliant companies through IPO initial return, secondly, to investigate the relationship between the company's market capitalization and size of the IPO offer with their IPO initial return.

2. Literature Review

2.1 Background theory

The term "IPO" refers to an initial public offering, the procedure by which a private firm offers its initial shares of stock for public sale. Every company aspires to go public to raise equity capital and create a public market where founders and other shareholders can convert a portion of their value into cash on the following date (Ritter and Welch, 2002).

"Shariah" is an Arabic word that carries the meaning of divine law, Islamic law, or the Law of God (Rashid, et al., 2020). Practicing Shariah gives benefits to individuals and the community where it aims on keeping the faith, life, progeny, intellect, and wealth, leading Muslims to the religious purpose of the afterlife (Masruki, et al., 2020). Shariah-compliant companies also refer to companies that follow strict Islamic guidelines for business activities (Ho, 2015). Furthermore, having the title Shariah-compliant reduces both financial and business risks compared to conventional companies (Ho and Mohd-Raff, 2019).

Contradictory, non-Shariah compliant companies do not follow Islamic regulations. This means that there is no set of restrictions for pork and alcohol, gambling, interest-based financial contracts, tobacco and trading of gold and silver as cash on a deferred basis, pornography, and weapons (Ho, 2015). Hence, conventional companies are exposed to more risks than Shariah-compliant does since having strict regulations reduces the business and finance risk (Ho and Mohd-Raff, 2019).

2.2 Previous studies

In this study, the initial return represents the performance of IPO for Shariah and non-Shariah compliant companies. The variances between an IPO's offer price and its first-day closing price account for the majority of the fluctuations in IPO is known as initial return (Sundarasan, 2018). Under-pricing refers to a positive first return, whereas overpricing refers to a negative initial return (Wei Leong and Sundarasan, 2015). According to Yaakub and Sherif (2019) as well as Rahim and Yong (2010) as cited by Yaakub and Sherif (2019), Shariah-compliant IPOs are more under-priced than conventional IPOs. The initial return is also influenced by market risk, and a high market risk raises the volume of the IPO's initial return (Bayliss et al., 2021). According to Abdul and Yong (2010), the status of Shariah does not have a significant influence on the initial returns of IPOs in Malaysia. The results of their studies show that the initial returns of IPOs issued by Shariah-compliant and non-Shariah compliant companies do not differ significantly.

Market capitalization and the size of the IPO offer are the factors said to influence the performance of the IPO. Market capitalization is the total market price for all stocks currently possessed by all the shareholders (Fernando, 2021). According to Donaldson (2015), the result of market capitalization can be an indicator to show a firm's economic development and the earnings for shareholders. The price of IPO specifically IPO under-pricing or over-pricing can affect the market capitalization of firms which will indirectly reflect the investors' perception of the company's worth in the market (Donaldson, 2015; Little, 2021). Furthermore, market capitalization is used to

represent the firm size. However, firm size does affect the IPOs' initial returns and their instability due to investors having the impression that bigger firms are economically stable and have few uncertainties (Wei and Sundarasan, 2015). According to Wei and Sundarasan (2015) firm size has a negative association with IPO's initial returns and its unpredictability. The research conducted by Yaakub and Sherif (2019) found that initial return, IPO size, firm size, firm age, time lag, and market return have a low correlation.

The size of the offer is the amount of issued capital stock under the sales offer multiplied by the face value of per share (Abu Bakar, 2013). Numerous studies previously such as Abu Bakar (2013), Yaakub and Sherif (2019), Abdul and Yong (2008), and Tajuddin, et al. (2018) have highlighted a few variables that influenced the common level of IPO under-pricing among the Shariah and non-Shariah compliant firms in Malaysia. There is a negative relationship between the IPOs' size of offer and initial return (Yaakub and Sherif, 2019). An early study conducted by Abdul and Yong (2010) shows that size of the offer does affect the initial return of IPOs for the Shariah-compliant firms. The result of the existing finding disclosed that the size of the offer has a substantial influence on the IPOs initial returns and Shariah investors should observe and pay heed to the internal elements such as the size of the offer (Abdul and Che, 2013). A hypothesis from a past study indicated that a small offer size of an IPO will cause more conjectural activities while on the other hand, a bigger offer size will have a negative correlation with conjectural activities (Yong, 2009).

2.1. Conceptual framework

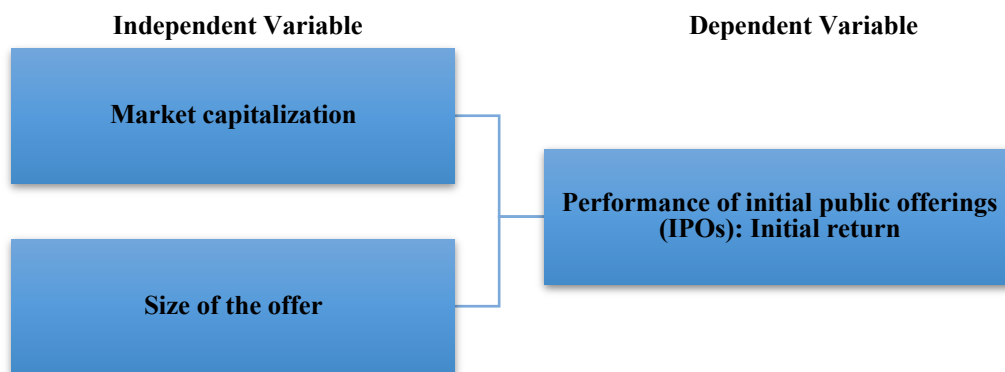


Figure 1. The conceptual framework.

The above conceptual framework was used to find the relationship between the dependent and independent variables from the perspective of Shariah-compliant and non-Shariah compliant companies. It is recommended to incorporate market capitalization into the independent variable as it has an influence on the performance of IPOs (Andrade and Lucena, 2017). The variable shows the correlation between the company's IPO market capitalization and the performance of IPO as represented by the initial return is carried out. In addition, the size of the offer is set as another independent variable since Xinping and Yixia (2003) discovered that the size of the offer influenced the initial performance of IPOs.

3. Methodology

The main purpose of this research is to identify the performance of Shariah and non-Shariah compliant companies through their IPOs initial returns and to examine whether the market capitalization and size of the offer could significantly affect the variance in IPO initial returns. The target population in this research was 35 listed companies in the main market of Bursa Malaysia from 2015 until 2021. According to Krejcie and Morgan (1970), cited in Sekaran and Bougie (2013), the sample size needed is 32 companies based on 35 total listed companies that were selected as the whole population. Moreover, this paper chose simple random sampling as a probability sampling design that allows every element in the population to be known and sampled equally (Sekaran and Bougie, 2013). Simple random sampling provides that every case of the population has an equal probability of inclusion in the sample (Taherdoost, 2016).

Secondary data is used in this research. The Bursa Malaysia, Securities Commission Malaysia, the company's website, and the IPO prospectus are the main sources of information for this study. The closing price on the first trading day and the market capitalization were collected directly from the Bursa Malaysia Knowledge Centre. Meanwhile, the offered price and the size of the share offered are retrieved from the prospectus published on Bursa Malaysia's website.

Referring to the Kwaghkor (2020), the calculation of the initial return for the performance of IPO is adapted as shown in the formula below:

(1)

where IR is the initial return of IPO for the first trading day, $P0$ is the offer price for an IPO and PI is the closing price on 1st day of trading.

The social sciences statistical package (SPSS) was used to obtain statistical analysis results. Firstly, descriptive statistical analysis was applied to identify the performance of IPO between Shariah-compliant companies and non-Shariah compliant companies. Then correlation analysis was utilized to investigate the relationship between independent and dependent variables (Samithamby, 2019). Finally, the regression analysis was used to anticipate the influence of independent variables on dependent variables, allowing the researchers to make predictions (Sarstedt and Mooi, 2014).

4. Results and Analysis

4.1 Descriptive analysis

The below analysis is used to identify the performance of IPO between Shariah compliant companies and non-Shariah compliant companies through initial return.

Table 9. The result of descriptive analysis.

Variable	Mean	Standard Deviation	Minimum	Maximum
<i>Panel A: All samples n= 32</i>				
Initial return	10.84	22.87	(40.59)	70.73
Market capitalization	1,855,296,325.32	4,012,595,963.65	0.1568	19,582,992,000
Size of offer	251,704,200	421,126,543.05	13,500,000	2,153,459,200
<i>Panel B: Shariah-compliant IPOs n= 18</i>				
Initial return	14.37	27.18	(40.59)	70.73
Market capitalization	1,749,430,851.43	3,003,846,331.95	0.1568	10,846,620,050
Size of offer	222,483,072.22	265,946,483.10	15,842,000	1,000,000,000
<i>Panel C: Non-Shariah compliant IPOs n= 14</i>				
Initial return	6.29	15.55	(25)	30.30
Market capitalization	1,991,409,077.46	5,153,602,410.85	15,463,440	19,582,992,000
Size of offer	289,274,221.43	572,462,672.78	13,500,000	2,153,459,200

The initial return of the Malaysian IPOs is 10.84%. Shariah-compliant IPOs show a higher average on the initial return of 14.37% in comparison to the non-Shariah compliant IPOs of 6.29%. The highest initial return is from a Shariah-compliant IPO with a return of 70.73% which leads to a higher average of initial return for Shariah-compliant IPOs.

The market capitalization for the samples shows an average of MYR1,855,296,325.32. The non-Shariah compliant IPOs show a higher average of MYR1,991,409,077.46 while the Shariah-compliant IPOs show a lower average of MYR1,749,430,851.43 on market capitalization. The largest market capitalization in the sample is by MR D.I.Y Group Berhad which contributes to the higher mean for the non-Shariah compliant market capitalization.

Furthermore, the average size of the offer in the sample is 251,704,200 units. On average, the non-Shariah compliant IPOs offer a bigger size of 289,274,221.43 units when compared to Shariah-compliant IPOs of 222,483,072.22 units. This is due to the largest size of offer from Eco World International Berhad which plays a role in the higher mean of non-Shariah compliant IPOs.

4.2 Correlation analysis

Correlation analysis in this study aims to identify the relationship between the companies' market capitalization and size of offer with their IPOs' initial return.

4.2.1 Shariah-compliant companies

Table 10. The result of correlation analysis for Shariah-compliant companies.

	Initial return	Market capitalization	Size of offer
Initial return	1.000		
Market capitalization	-0.380	1.000	
Size of offer	-0.454	0.869**	1.000

The above table shows the result of correlation analysis between variables of the Shariah-compliant companies. According to Pallant (2020), there is medium negative correlation between initial return and market capitalization, $r = -0.380$, $n = 18$, as well as initial return and size of offer, $r = -0.454$, $n = 18$. Concurrently, the correlation between market capitalization and size of offer indicates significant large positive relationship, $r = -0.380$, $n = 18$, $p < 0.01$.

4.2.2 Non-Shariah-compliant companies

Table 11. The result of correlation analysis for non-Shariah compliant companies.

	Initial return	Market capitalization	Size of offer
Initial return	1.000		
Market capitalization	0.034	1.000	
Size of offer	-0.205	0.057	1.000

Next, as referred to Table 3, shows the result of correlation analysis for non-Shariah compliant companies. The correlation between initial return and market capitalization demonstrates no relationship between variables, $r = 0.034$, $n = 14$. Meanwhile, there is a small negative correlation between the initial return and the size of the offer, $r = -0.205$, $n = 14$. Lastly, there is no relationship between market capitalization and size offer, $r = 0.057$, $n = 14$.

4.2.3 Shariah and non-Shariah-compliant companies

Table 12. The result of correlation analysis for Shariah and non-Shariah compliant companies.

	Initial return	Market capitalization	Size of offer
Initial return	1.000		
Market capitalization	-0.179	1.000	
Size of offer	-0.280	0.269	1.000

Table 4 shows the results of the correlation analysis for all companies. The initial return and market capitalization, $r = -0.179$, $n = 32$, as well as the initial return and the size of offer, $r = -0.280$, $n = 32$, has a small negative relationship between the variables. Finally, there is a small positive relationship between market capitalization and the size of the offer, $r = 0.269$, $n = 32$.

4.3 Regression analysis

The following analysis examines the variance in IPO initial return which can be explained by market capitalization and the size of the offer.

4.3.1. Shariah-compliant companies

Table 13. The result of regression analysis for Shariah-compliant companies.

	R	R ²	Sig. F	Coefficient		p-values, Sig	
				Market capitalization	Size of offer	Market capitalization	Size of offer
Initial return	0.456	0.208	0.174	0.053	-0.501	0.910	0.297

Table 5 presents the result of regression analysis for Shariah-compliant companies. $R = 0.456$ represents a moderate association between the dependent and independent variables. Meanwhile, $R^2 = 0.208$, showing that market capitalization and size of offer contribute to 20.8% of the variance in initial return. Therefore, it was proven

that the market capitalization and size of the offer are strong to describe the initial return since 20.8 % is greater than 20%. Relating to this, Davis, (2020) stated that the higher the value, the bigger the company. Because p is higher than 0.05 ($p > 0.05$), the total equation was deemed to be insignificant. According to the coefficients, each unit increase in market capitalization increases the initial return by 0.053, whereas each unit rise in the size of the offer decreases the initial return by 0.501 units. The relationship between market capitalization and initial return, as well as the size of the offer and initial return, is statistically insignificant since the p-value is higher than 0.05 ($p > 0.05$).

4.3.2 Non-Shariah compliant companies

Table 14. The result of regression analysis for non-Shariah-compliant companies.

	R	R ²	Sig. F	Coefficient		p-values, Sig	
				Market capitalization	Size of offer	Market capitalization	Size of offer
Initial return	0.220	-0.125	0.762	0.049	-0.217	0.872	0.477

As shown in Table 6, R = 0.220, shows that there is a positive small relationship between dependent and independent variables. Adjusted R² = 0.125 indicates that market capitalization and size of the offer explain 12.5% of the relationship hence the variance in initial return for non-Shariah. Therefore, the independent variables are capable to explain the initial return of non-Shariah because 12.5% is higher than 10%. The overall variable contribution was found to be statistically insignificant because p is higher than 0.05 ($p > 0.05$). The coefficient infers, that for each unit increase in market capitalization, the initial return for non-Shariah will increase by 0.049, while for each unit increase in the size of the offer will decrease the initial return by 0.217 units. The interrelation between market capitalization and initial return non-Shariah, and size of offer and initial return non-Shariah are statistically insignificant because the p-value is higher than the level of significance of 0.05 ($p < 0.05$).

4.3.3 Shariah and Non-Shariah compliant companies

Table 15. The result of regression analysis for Shariah and non-Shariah compliant companies.

	R	R ²	Sig. F	Coefficient		p-values, Sig	
				Market capitalization	Size of offer	Market capitalization	Size of offer
Initial return	0.304	0.092	0.246	-0.110	-0.255	0.554	0.176

In Table 7, R = 0.304 indicates a moderately significant association between dependent and independent variables. R² is 0.092 which indicates that market capitalization and size of the offer explain 9.2% of the variance in overall initial return. Therefore, the independent variables are unreliable to explain the overall initial return since 9.2% is lower than 10%. The variable contribution was found to be statistically insignificant because p is higher than 0.05 ($p > 0.05$). Based on the coefficients, for each unit increase in market capitalization, the overall initial return will decrease by 0.110, while for each unit increase in the size of the offer will decrease the initial return by 0.255 units. The interrelation between market capitalization and overall initial return, and size of offer and overall initial return are statistically insignificant because the p-value is higher than the level of significance of 0.05 ($p < 0.05$).

4.4 Analysis

The descriptive analysis compares the performance of IPO between Shariah-compliant and non-Shariah compliant companies through the initial return. Based on the result, the average initial return of Shariah-compliant is higher than non-Shariah compliant IPOs as concurred by Yaakub and Sherif (2019) as well as Rahim and Yong (2010) cited by Yaakub and Sherif (2019). The finding shows that Shariah-compliant IPOs not only provide positive but also higher initial returns that indicating Shariah-compliant is a factor that influences IPO performance. This contradicts Abdul and Yong (2010) that stated, in Malaysia, the Shariah status has no substantial impact on the initial return of IPOs. Nevertheless, the standard deviation of the initial return of Shariah-compliant IPOs shows a greater figure than non-Shariah compliant IPOs. This however is against Ho and Mohd-Raff (2019) as the risk for Shariah-compliant IPOs are higher than non-Shariah compliant IPOs.

Correlation analysis identifies the relationship between the companies' market capitalization and size of offer with their IPOs' initial return is identified. The result varies between Shariah-compliant and non-Shariah compliant. Non-shariah shows that there is no relationship between market capitalization and the initial return of

IPOs. Fortunately, in accordance with Wei and Sundarasan (2015), there is a negative correlation between market capitalization and initial return for Shariah-compliant IPOs, as well as when the researchers analysed all IPOs. In addition, as agreed by Yaakub and Sherif (2019), for Shariah and non-Shariah companies, the size of the offer shows a negative relationship with the initial return of IPOs. These findings suggest that as market capitalisation and the size of the offer for the IPOs increase, the initial return will decrease. However, none of these relationships is significant including the size of the offer which opposes the result in Abdul and Che's study (2013) shows that the size of the offer has a significant impact on the initial return.

As for the regression analysis, to examine the variance in IPO initial return that can be explained by the company's market capitalization and the size of the offer. The result shows that the market capitalization and the size of the offer are insufficient to explain the variation of IPOs initial return as represented by the coefficient of determination (R^2). As compared to the market capitalization, IPOs' initial returns were affected the most by the size of the offer. Therefore, the investor should pay attention to the size of the offer when they want to invest in the company as agreed by Abdul and Che (2013). Furthermore, the size of the offer has a negative relationship with the IPO's initial return as stated by Yaakub and Sherif (2019). The relationship between market capitalization and the size of the offer with the initial return is statistically insignificant.

5. Conclusion

This research shows a comparison between Shariah and non-Shariah compliant IPOs holistically, not just to a specific industry. The 32 companies listed in Bursa Malaysia from 2015 to 2021 show that investing in Shariah-compliant IPOs achieved a higher initial return, implying a higher return on investment as compared to non-Shariah compliant. Besides, this research proved that the initial return is influenced by the size of the offer regardless of whether the status of the firm is Shariah or non-Shariah. The findings of this research contribute to the literature on IPOs' performance to guide future researchers, developing companies, and investors to gain more evidence about the effect of Shariah and non-Shariah compliance on companies' IPO.

One avenue for recommendation to future researchers is first, to discover other independent variables besides market capitalization and size of offer that associated with the initial return of IPOs. Furthermore, future researchers are recommended to increase their sample size by including IPOs of companies from the Access, Certainty, Efficiency (ACE) market, and Leading Entrepreneur Accelerator Platform (LEAP) market to improve the reliability and accuracy of future findings.

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