Does The Ham Matter In My "Free" Lunch?

An Analysis of the Insights of the Islamic Corporate Social Responsibility in the Financial Markets and its Impact in Value Creation

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Motivations

- Lack of questioning about the moral principles that govern mainstream Corporate Social Responsibility
- Exponential growth of Islamic Finance

Objective

The main goal of this dissertation is to research on the technical singularities of the Islamic Finance Instruments and to investigate whether participants in the market assign different values to assets that comply with it.

Shari'ah Law: Principles of Islamic Morality

Islam offers a clear set of principles of what is acceptable or not in contrast with mainstream morality

Risk Sharing Principle

- Implication for the bringers of funds: They become investors rather than creditors
- Any further loses shall be split among the different parties involved in the transaction

The Prohibition of

- Translation of Riba: any unjustifiable mark up in a transaction regardless of the nature
- Definition: Any positive, fixed, predetermined rate tied to the maturity and the amount of principal
- Reason: Islam encourages partnerships and entrepreneurship as a basis for enterprise success and thus, risks should be shared.

Real Asset Backing Principle

- Every economic transaction, even if it is financial, must be directly linked to a real asset.
- This offers great contrast with mainstream derivatives.

Speculative Behaviour Ban P

- Any venture must be carefully planned before being undertaken, assessing potential risks.
- Any project that offers extreme uncertainty or risk must not be engaged regardless of the potential profits.

Wealth Accounting Principle

- Liquid cash is not a source of wealth.
- Only when this money is combined with further recourses such as human capital, other tangible or intangible goods or land becomes wealth.

Information Asymmetry Ban P

- The publicity of the entirely contractual arrangements must be public on a transaction to reduce information asymmetry among the different parties.
- No transaction shall go against any of the rights that the Islam grants to an individual, the society as a whole and the state as a gatekeeper

Islamic Financial Instruments: Semantic or Technical Differences?

The Concept of

Types of *Riba*

The action to increase, to augment, swellings, forbidden 'addition', to make more than what is given, the practicing or taking of usury or the like, an excess or an addition, or an addition over and above the principal sum that is lent or expended	The exercise of charging financial interest or a premium in surplus of the principal amount of a credit that has been determined ex ante

- ***Riba al-nasiah***. Any deferral, delay or split of payments shall not incur on an additional charge whether this further burden is fix, variable or absolute before during or after the payment has been made.
- ***Riba al-fadl*** **:** It is forbidden the exchange of goods among individuals or enterprises.

Sukuk:

	Sukuk al-Ijarah	*Sukuk al-Musharak*	*Sukuk al-Mudaraba*	*Sukuk al-Salam*	*Sukuk al-Istisna*	*Sukuk al-Murabahah*
Vanilla	Leasing	Join Venture	Bonds (Funds+ Know-How)	Reverse forward contract	Syndicated Loan	Futures
Main differences	Transfer of the ownership of the financed asset from the originator to the holder					

- Fundamental difference between conventional and Islamic bonds: the risk sharing between debt holders and issuers.
- Sukuk holders risks losing all its investment whereas the company and by extend its shareholders, can only lose the financed asset
- According to the Efficient Market Hypothesis (EMH), any risk difference will be adjusted using the required rate of profitability.

Assessing The Market Perception About Islamic C.S.R.

Hypothesis

(H1) Islamic Corporate Social Responsibility shall not affect value creation.

Model

$$R_{i,J} = S(\sigma_{i,J}) + Sharia(Dummy_i) + C \quad (1)$$

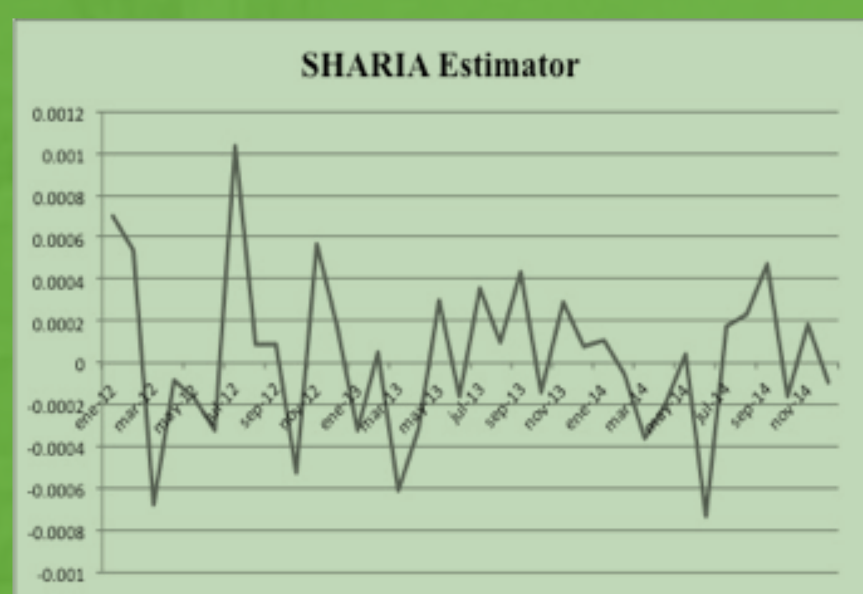
where Ri,J is the return of the asset i in the period J, S is the estimator for the risk, σi,J is the standard deviation of i's return in moment J, Sharia is the regressor for Sharia compliance. The dummy variable takes value of 1, if the company fulfils the Sharia, and 0, if not.

Sample

- Average daily closing price of the constituents of the S&P 500.
- January 2012 to December 2014.
- The data for the Sharia compliance was obtained from the S&P 500 Sharia Index.

Results

- T-test does not allow us to reject the main hypothesis that Islamic Corporate Social Responsibility does not create value in the financial markets.
- The regressor of the risk is consistent and significant for all the samples.
- The constant variable resembles the behaviour of the risk-free rate further enhancing the consistency with the mainstream literature.



Hypothesis

One Cannot Reject The Hypothesis That Islamic Corporate Social Responsibility Does Not Create Value In The Financial Markets.