International Economics 137 (2014) 73–87

Contents lists available at ScienceDirect

International Economics

journal homepage: www.elsevier.com/locate/inteco

Conventional and Islamic stock price performance: An empirical investigation ☆

Fredj Jawadi [a,*], Nabila Jawadi [b], Waël Louhichi [c]

[a] *University of Evry & France Business School—Campus Amiens & EconomiX, Université d'Evry, 2 rue Facteur Cheval, Evry 91025, France*
[b] *IPAG Business School, IPAG LAB, France*
[c] *ESSCA School of Management, France*

A R T I C L E   I N F O

Available online 21 November 2013

JEL classification:
G01
G10
C20

Keywords:
Financial performance
Islamic finance
Financial crisis

A B S T R A C T

The present paper studies the financial performance of Islamic and conventional indexes for three major regions: Europe, the USA and the World. The study covers the period 2000–2011, enabling us to capture the impact of the recent global financial crisis. To this end, we computed different performance ratios and estimated the CAPM-GARCH model to take into account the financial risk time-variation in order to provide precise performance evaluations. Our findings offer some interesting results and have diverse economic and policy implications. First, while conventional investments seemed promising before the crisis and during periods of calmness, Islamic funds have outperformed them since the subprime crisis began and in turbulent times, but this result is specific to the region under consideration and to the performance criterion. Second, the heterogeneous conclusions in terms of performance may reflect the different states of development of the Islamic finance industry in these regions. Third, we show that the impact of the 2008–2009 global financial crisis on Islamic markets is less significant than for conventional markets, suggesting that by keeping their eye on Islamic finance products, investors can expect some interesting investment opportunities.

☆ This paper has been presented at the workshop “Islamic Banking and Finance: Trends and opportunities for International and Regional Trade and Finance” held in Paris on October 19, 2012.

* Corresponding author. Tel.: +33 1 69 47 78 98.
E-mail addresses: fredj.jawadi@univ-evry.fr, jawadi@univ-evry.fr (F. Jawadi), nabila.jawadi@ipag.fr (N. Jawadi), wael.louhichi@univ-rennes1.fr (W. Louhichi).

http://dx.doi.org/10.1016/j.inteco.2013.11.002

1. Introduction

The global financial crisis 2008–2009 has been the subject of a large number of theoretical and empirical studies that focus on two particular aspects: the sources and the consequences of the financial downturn (Shiller, 2008; Aglietta, 2009; Foster and Magdoff, 2009, among others). These studies overwhelmingly suggest that the subprime crisis, the Federal Reserve monetary policy in 2000,[1] the bankruptcy of Lehman Brothers, and a range of innovative financial products were at the root of the crisis. Many authors have also noted the main outcomes linked to the liquidity crunch, namely, financial market losses, public debt crises and a general economic recession in most developed and emerging countries, pulling down investment, employment, income, spending, consumption, etc.

Thus, a key question for academics, professionals and policy makers is how to end this Great Financial Crisis and how to limit similar financial downturns in the future. In spite of various seminal essays and propositions (Soros, 2008; Shiller, 2008; Fitoussi and Stiglitz, 2009), as yet there is no unanimous solution. It seems however that the renovation of finance, the restructuration and regulation of financial markets, and the modernization and reorganization of the financial systems are among the urgent reforms needed in order to reassure investors, while better controlling speculation, trading and financial risk, and providing stable returns (Aglietta, 2009; Aglietta and Rigot, 2009).

In this context, alternative finance strategies, including Islamic finance, are central features of the present debate (Jouini, 2009). The framework of Islamic finance is based on the principles of *Shariah* or Islamic law, which offers a specific business climate marked by ethically-oriented trade, social and responsible investment, sustainable finance and banking, and a highly regulated finance system. The latter prohibits interest rates when lending money to householders, or investment in businesses that deal with the production of alcohol, pork-related products and ammunition. It also prohibits speculation and excess risk, and recommends that business banks should share their profit and losses with investors. Furthermore, Islamic finance rules impose asset-backed security and equity participation, and the limiting of investments to assets that comply with Islamic Law. This means the development of low-risk and modest-return instruments such as *Murabaha* or short-term secured commodity and trade finance and structured medium-term investments.[2] The ethical and moral rules together with the high degree of caution of Islamic investments make Islamic finance a promising alternative for improved performance, especially in turbulent times with high conventional financial risk.

We should recall that the Islamic investment market originally developed in the Gulf Council and some Muslim countries before it began to spread to other regions. Overall, we can note considerable growth in Islamic equity funds over recent years and a large increase in the volume of capital managed by Islamic finance institutions that can be explained by the strong participation of private Muslim investors. During the 1990s, it expanded at about 12% a year, offering exceptional growth and encouraging several western investment banks to offer added-value niche services, compatible with *Shariah* (Causse, 2009). Furthermore, several Islamic financial products rapidly reached the US, European, Middle Eastern and Asian-Pacific markets. In addition, since the latest crisis, several banks and financial institutions in developed and emerging countries have begun reviewing their legislation and regulations to adopt these products. However, the risk associated with Islamic communitarianism delayed the development of Islamic finance in some countries and regions.

At this level, we are not questioning this issue or looking to see whether Islamic finance can be a good substitute for conventional finance or not. Instead, the study aims to operationally investigate the issue of the performance of Islamic finance compared with conventional finance during periods of calmness and crises. The issue is especially interesting as it constitutes the key to investment. It can also have important implications for bankers, investors, managers and policy-makers wishing to develop optimal portfolios and to adapt their investment strategies to market phases. To this end, the

[1] According to Shiller (2008), the Federal Reserve lowered its rate 11 times—from 6.5% in May 2000 to 1.75% in December 2001.

[2] See Kuran (2004), Ayub (2007) and Visser (2009) for more details of Islamic finance characteristics, principles and rules.