Creation of an Islamic stock index in West Africa

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A R T I C L E   I N F O

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- Ecowas Shariah Index
- Islamic screening
- West Africa
- Ghana stock Exchange
- Nigeria stock exchange
- Regional stock Exchange

A B S T R A C T

Islamic finance, which has become inescapable has entered into financial markets by offering solutions consistent with the precepts of the Shariah. The objective of this paper is to propose the creation of an Islamic stock index in West Africa. The choice of market values requires extra financial and financial screening system. The results show that 10% of the securities in Nigeria Stock Exchange, the Regional Stock Exchange (Brvm) and the Ghana Stock Exchange (Gse) were selected to form the Islamic index “Ecowas Shariah index.”

1. Introduction

West Africa's specificity in Islamic finance is mainly due to the big Muslim community. This Community represents more than 119 million believers, almost 51% of the population of the area (WAEMU, Ghana, and Nigeria). This is a major element in the development of Islamic finance within the Economic Community of West African States (ECOWAS). Islam is a religion practiced in Africa since the 11th century and sub-Saharan Africa has now more than 250 million Muslims. Most of them live in West Africa and according to previsions in 2030, this region will have more than 257 million Muslims or 67% of its population.

By 2050, Nigeria will be the third most populous country in the world and eventually will surpass Indonesia as the first Muslim country in the world. The creation of an Islamic index in West Africa will attract international funds (British, American and Emirati) which are specialized in the acquisition of Shariah compatible Islamic instruments. In order to take full advantage of this opportunity, the creation of a compatible Shariah stock index would be an asset to enhance competitiveness and contribute to the integration process of ECOWAS capital markets.

The Islamic index in West Africa may encourage African fund managers to market “Shariah compatible” investment products. The main objective is to build an Islamic stock index in West Africa.

The rest of the paper is structured as follows. First we will describe the methodology for constructing and calculating the Islamic index of West Africa. Finally, we will present the results.

2. Creation and composition of the Islamic index

To select the compatible Shariah stocks which compose the West African Islamic Index, we use companies which compose the following indices, WAEMU (BRVM10, BRVM composite) Ghana (GSE Financial stock index) and Nigeria All Shares Index. We use the S & P methodology guide which consists of selecting securities according to industry sector using the screening system.

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1 West African economic and monetary union (WAEMU) including eight countries: Benin, Burkina Faso, Côte d'Ivoire, Guinea Mali, Niger, Senegal, Togo.

2 ECOWAS includes 15 countries: Benin, Burkina Faso, Cap Vert, Côte d'Ivoire, the Gambia, Ghana, Guinea, Bissau Guinea, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, Togo.

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2.1. Creation of the Islamic index

The Shariah Board plays a very important role at this level. It is comprised by Shariah scholars who are Ulemas (scholars) with very specific theological, legal and financial knowledge, recognized internationally.

- The various steps of Islamic screening

It is up to the Shariah scholars to carry out screening of values in accordance with the Muslim law principles. There are two types of screening: sectoral (or extra-financial) screening and financial screening.

- Sectoral screening

It consists of removing from the index companies which are in the following sectors: alcohol, tobacco, pig industry, non-Islamic banking and financial services, entertainment (hotels, casinos/gambling, Cinema, pornography, music, etc.).

- Financial screening

The financial screening uses a series of ratios and the respect of criteria helps integrate the Shariah compatible index. According to Derigs and Marzban (2008), El Khamlichi et al. (2014) quantitative screens differ from one Islamic index to another and do not make the Shariah Board unanimity; they are only doors of tolerance. Screens are: the level of debts, receivables and interest-bearing securities. Violation of one of these levels results in the company exclusion from the index. The methodology adopted is that proposed in Table 1.

### Table 1
Data relating to the free float of the companies composing the Ecowas Shariah Index calculated close on December 31, 2012.

<table>
<thead>
<tr>
<th>Name of company</th>
<th>Number of shares</th>
<th>Price</th>
<th>Free float factor</th>
<th>Capitalization</th>
<th>Weighted capitalization</th>
<th>Free float market capitalization</th>
<th>Weighted free float market capitalization</th>
<th>Capping factor</th>
<th>Weight retained</th>
</tr>
</thead>
<tbody>
<tr>
<td>African Champion Limited</td>
<td>36 500 260</td>
<td>26</td>
<td>0.14</td>
<td>953 009 399</td>
<td>0.01</td>
<td>129 609 278</td>
<td>0.005</td>
<td>1</td>
<td>0.01</td>
</tr>
<tr>
<td>Ayrton Drugs Manufacturing</td>
<td>215 000 000</td>
<td>47</td>
<td>0.59</td>
<td>10 104 438 642</td>
<td>0.08</td>
<td>6 002 036 554</td>
<td>0.21</td>
<td>1</td>
<td>0.23</td>
</tr>
<tr>
<td>Benso Oil Palm</td>
<td>34 800 000</td>
<td>366</td>
<td>0.99</td>
<td>12 720 626 632</td>
<td>0.1</td>
<td>12 631 582 245</td>
<td>0.45</td>
<td>1</td>
<td>0.49</td>
</tr>
<tr>
<td>Fan Milk limited</td>
<td>116 207 288</td>
<td>927</td>
<td>1</td>
<td>107 711 716 031</td>
<td>0.83</td>
<td>107 711 716 031</td>
<td>3.84</td>
<td>1</td>
<td>4.2</td>
</tr>
<tr>
<td>Starwin Products</td>
<td>259 810 000</td>
<td>13</td>
<td>0.94</td>
<td>3 391 775 457</td>
<td>0.03</td>
<td>3 191 660 705</td>
<td>0.11</td>
<td>1</td>
<td>0.12</td>
</tr>
<tr>
<td>Unilever Ghana</td>
<td>62 500 000</td>
<td>2225</td>
<td>1</td>
<td>139 033 942 559</td>
<td>1.08</td>
<td>139 033 942 559</td>
<td>4.96</td>
<td>1</td>
<td>5.42</td>
</tr>
<tr>
<td>African Paints</td>
<td>368 461 038</td>
<td>9</td>
<td>0.48</td>
<td>3 354 016 896</td>
<td>0.03</td>
<td>1 593 158 026</td>
<td>0.06</td>
<td>1</td>
<td>0.06</td>
</tr>
<tr>
<td>Dangote Cement</td>
<td>17 040 507 405</td>
<td>408</td>
<td>0.09</td>
<td>6 947 671 786 437</td>
<td>53.8</td>
<td>619 037 556 171</td>
<td>22.09</td>
<td>0.83</td>
<td>20</td>
</tr>
<tr>
<td>Aluminium</td>
<td>219 956 000</td>
<td>34</td>
<td>0.99</td>
<td>7 420 775 964</td>
<td>0.06</td>
<td>7 346 568 204</td>
<td>0.26</td>
<td>1</td>
<td>0.29</td>
</tr>
<tr>
<td>Austin Laz &amp; Company</td>
<td>1 079 860 000</td>
<td>6</td>
<td>0.2</td>
<td>6 873 929 788</td>
<td>0.05</td>
<td>1 374 785 958</td>
<td>0.05</td>
<td>1</td>
<td>0.05</td>
</tr>
</tbody>
</table>

- Financial screening

The financial screening uses a series of ratios and the respect of criteria helps integrate the Shariah compatible index. According to Derigs and Marzban (2008), El Khamlichi et al. (2014) quantitative screens differ from one Islamic index to another and do not make the Shariah Board unanimity; they are only doors of tolerance. Screens are: the level of debts, receivables and interest-bearing securities. Violation of one of these levels results in the company exclusion from the index. The methodology adopted is that proposed in Table 1.
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