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Creation of an Islamic stock index in West Africa



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ABSTRACT

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,¹ Ghana, and Nigeria). This is a major element in the development of Islamic finance within the Economic Community of West African States (ECOWAS).² 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.

Table 1

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

Name of company	Number of shares	Price	Free float factor	Capitalization	Weighted capitalization	Free float market capitalization	Weighted free float market capitalization	Capping factor	Weight retained
African Champion Limited	36 500 260	26	0,14	953 009 399	0,01	129 609 278	0.005	1	0.01
Ayrton Drugs Manufacturing	215 000 000	47	0.59	10 104 438 642	0.08	6 002 036 554	0.21	1	0.23
Benso Oil Palm	34 800 000	366	0.99	12 720 626 632	0.1	12 631 582 245	0.45	1	0.49
Fan Milk limited	116 207 288	927	1	107 711 716 031	0.83	107 711 716 031	3.84	1	4.2
Starwin Products	259 810 000	13	0.94	3 391 775 457	0.03	3 191 660 705	0.11	1	0.12
Unilever Ghana	62 500 000	2225	1	139 033 942 559	1.08	139 033 942 559	4.96	1	5.42
African Paints	368 461 038	9	0.48	3 354 016 896	0.03	1 593 158 026	0.06	1	0.06
Dangote Cement	17 040 507 405	408	0.09	6 947 671 786 437	53.8	619 037 556 171	22.09	0.83	20
Aluminium Extrusion	219 956 000	34	0.99	7 420 775 964	0.06	7 346 568 204	0.26	1	0.29
Austin Laz & Company	1 079 860 000	6	0.2	6 873 929 788	0.05	1 374 785 958	0.05	1	0.05
Cap	700 000 000	71	0.99	49 906 107 769	0.39	49 407 046 691	1.76	1	1.93
Cadbury Nigeria	1 878 202 040	144	0.25	270 082 332 879	2.09	66 170 171 555	2.36	1	2.58
E-Tranzact International	4 200 000 000	12	0.99	51 331 996 563	0.4	50 839 209 396	1.81	1	1.98
Glaxo Smithkline Consumer	1 195 876 488	115	0.54	137 328 443 576	1.06	73 608 045 757	2.63	1	2.87
Lafarge Africa	4 554 901 810	186	0.3	848 526 060 471	6.57	251 163 713 899	8.96	1	9.79
Mcnichols Plc	297 000 000	2	0.2	699 513 034	0.01	139 902 607	0	1	0.01
Nestlé Nigeria	792 656 252	2228	0.37	1 765 999 479 296	13.68	644 589 809 943	23	0.796	20
Nigeria Ropes	263 668 295	25	0.14	6 587 721 174	0.05	919 645 876	0.03	1	0.04
Okumu Oil Palm	953 910 000	68	1	64 516 972 214	0.5	64 516 972 214	2.3	1	2.52
Unilever Nigeria	3 783 296 250	148	0.5	559 926 400 029	4.34	278 843 347 214	9.95	1	10.87
Union Home Ream Estate	250 019 781	159	0.62	39 787 991 502	0.31	24 469 614 774	0.87	1	0.95
CFAO Motors CI	1 813 719	46 000	0.04	83 431 074 000	0.65	3 437 360 249	0.12	1	0.13
Saph	5 111 601	39 000	0.21	199 352 439 000	1.54	41 644 724 507	1.49	1	1.62
Servair Abidjan	545 600	9500	0.14	5 183 200 000	0.04	743 270 880	0.03	1	0.03
Setao	134 400	8400	0.21	1 128 960 000	0.01	241 484 544	0.01	1	0.01
Sogh	2 160 184	65 000	0.2	140 411 960 000	1.09	27 675 197 316	0.99	1	1.08
Sonatel	100 000 000	14 500	0.22	1 450 000 000 000	11.23	325 815 000 000	11.63	1	12.71
Total	38 412 898 411			1.29E+13	100	2.80E+12	100	0.915118725	100

Nb: The prices of listed companies in Nigeria and Ghana are converted into FCFA, the BRVM's prices are already in FCFA.

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

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