

The Impact of Shari'a Compliance Advices (SCAs) on the Saudi Capital Market: Evidence from the IPO Market

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"هذا المستند وما يحتويه من معلومات ووجهات نظر يعبر عن وجهة نظر معده ولا يعبر عن وجهة نظر هيئة السوق المالية، لذا تخلي الهيئة مسئوليتها عن ما ورد فيه من معلومات و بيانات، ولا يمكن تحميل الهيئة أو منسوبيها المسئولية عن أية خسائر أو أضرار تنشأ عن استخدام هذا المستند، مع الأخذ بالاعتبار أن المعلومات والبيانات ووجهات النظر قابلة للتغيير دون إشعار مسبق."

* Any errors or omission are the responsibility of the authors alone and not the institutions involved.

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هذه الدراسة تم تمويلها من هيئة السوق المالية

Abstract

This report documents the findings of our investigation on how investors in Saudi Arabia react to Shari'a scholars' advices, known in Arabic as *Fatawa*, about the compliance of an investment to Islamic teachings they adhere to. The unique setting of Saudi Arabian initial public offerings (IPOs) market enables us to map the decisions of individuals to subscribe into an IPO with the Shari'a compliance advices (SCAs), or Fatawa, Shari'a scholars announced about that particular IPO. Exploiting this setting, we hand collected the text of 76 SCAs of influential Shari'a scholars about the compliance status of the firms that were planing for initial public offering (IPO) in Saudi Arabia (a total of 103) during the period from 2005 to 2017. We then study the implication of the SCAs content on the number of individual subscribers into these IPOs.

We found that the number of individuals subscribing to an IPO is expected to drop by 80% if Shari'a scholars agree all to reject the IPO firm as a Shari'a compliant firm in their compliance advices announced during the IPO subscription period. Moreover, and interestingly, if Shari'a scholars disagree about the Shari'a compliance status of a firm, individuals tend to react to the scholars who approved the IPO as a Shari'a compliant investment while show no significant reaction to the advice of the ones who rejected it.

JEL Classification: A13, D14, D91 and G41

Key Words: Religion, Social responsibility investments; Islamic finance; Initial public offering (IPO); Saudi Arabia

1 Introduction

Ligature on the significant influence of social- or faith-based norms on asset allocation preference and hence on asset pricing is vast. For example, Fabozzi et al. (2008) and Hong and Kacperczyk (2009) show that the negligence of sin stocks makes them significantly outperform other stocks on a risk-adjusted basis. Kumar et al. (2011) finds that in regions with higher Catholic-Protestant ratios in the United States, investors exhibit a stronger propensity to hold lottery-type stocks.

Regarding the impact of Shari'a compliance, Godlewski et al. (2016) studied the impact of the characteristics of Sharia scholars' who certified the issue of 131 Islamic Bonds (known as *Sukuk*) from eight countries and found that scholars' reputation and geographical proximity to the issuer exert a positive cumulative abnormal returns (CAR) around the announcement of the issue. Shafron (2017) assessed the difference in prices between *Sukuks* and conventional bonds over an 8-year period from 2005 to 2013 and found that firms issuing Shari'a compliant bonds pay between 15 and 103.6 basis points less coupon than companies issuing comparable conventional bonds¹.

With particular reference to Saudi Arabia, there are five important studies we believe deserve to be highlighted here:

- Canepa and Ibnrubbian (2014) studies Dr. Mohmad Al-Osaimi's² list for the period 2005-2008 and examines the proportion of stock type in each sector. The study finds the Agriculture sector is the most Shariah compliant sector. The Service appears to be the second best, with Industrial, Cement and Bank ranked the third, fourth and fifth, respectively. Using daily closing prices for Saudi stock market general index (TASI) and these sector indexes, the study obtains that sector indexes with high proportion of Shariah-compliant stocks have higher return and higher volatility than their sector indexes with high proportion of non-Shariah.
- Merdad et al. (2015), in a comprehensive empirical investigation of Dr. Al-Osaimi's list, concludes that investors holding Saudi Islamic stocks experience lower returns than investors holding Saudi conventional stocks during the period from January 2003 to April 2011. These results indicate that there is a significant negative (positive) relationship between Saudi Islamic (conventional) firms and average returns.
- Alqahtani and Boulanouar (2017) finds that, after controlling for size, age of the firm, offer risk, offer price, block-holding, market condition and the effect of the Global Financial Crisis (GFC), number of subscribers in 80 IPOs conducted in the Saudi Arabian market between 2004 and 2011 increases if the company is approved by Al-Rajhi bank. The study also finds that over-subscription ratio (the money collected over the offer size) is *negatively* impacted by being a Shari'a compliant firm. They then infer that the negative impact of Shari'a compliance on the over-subscription ratio is due to the intentional investors favoring non-Shari'a firms as they may be under-priced³.
- Al-Awadhi (2017) follows the screening list of the Al-Mashora and Al-Raya Financial Consultancy firms to identify the Islamic-listed stocks in GCC stock markets during the period 2004-2014. The study finds significant returns, liquidity and liquidity risk differences between

¹Al-Awadhi (2017) and Alzahrani and Megginson (2017) cites many papers on how "Islamic" stocks risk-return profile may be different from their conventional counterparts.

²A widely regarded expert in Shari'a Compliance issues and known for his yearly list of compliant firms in the Saudi stock market.

³We believe that this interpretation is questioned as the paper scaled the over-subscription ratio by the number of subscribers. That is, number of subscribers appears in the denominator of the dependent variable. Thus, if Shari'a compliance increases number of subscribers, it is expected to reduce the "scaled" over-subscription ratio and, hence, the negative sign is expected.

non-Islamic and Islamic stocks. Specifically, neglected non-Islamic stocks have higher returns, less liquidity and more liquidity risk in comparison to Islamic stocks.

- Alhomaidia et al. (2017) hypothesizes that the wide acceptance of Islamic stocks between individual investors facilitate the circulation of firm related information among certain group of investors and, therefore, it is expected that stock classified as "Islamic" will show extra comovement in their trading activities. Indeed, using Dr. Mohamad Al-Osaimi's list and examining the sample of daily Saudi Arabian-listed stock returns from 2002 to 2015, the study concludes that classifying a stock as an Islamic stock increases its price comovement with other Islamic stocks and increases its commonality in liquidity indicators.

The above studies indicate that understanding Shari'a compliance is critical for better understanding of the capital markets functioning in Muslim countries. Contributing to this understanding, this report document a full analysis about the impact of Shari'a compliance advices issued by Shari'a scholars on the investors' preferences in Saudi Arabia taking the IPO market as our field of experiment. In the following, we answer two important questions then we dive into our empirical investigation where we explain the data collection process, provide detailed analysis and give some concluding remarks.

1.1 Why Studying the Impact of SCAs

For an investment to be Shari'a compliant, the ultimate determinant is the SCAs of Shari'a scholars. Thus, examining the "market" of SCAs (the topic of this study), where Shari'a scholars represent the supply side and individual investors represent the demand side, deserves a great deal of attention. The Saudi Arabian context, in particular, gives the question even a greater importance:

- First, according to official statistics provided by Tadawol Incorporation, the company that runs the Saudi stock exchange, around 80% of traders are individuals. Individuals are more likely to adhere to Islamic rules reflected in SCAs than institutions ⁴.
- Second, there is a high demand for Shari'a compliant investments among Saudi individuals. According to the "Islamic Finance Bulletin"⁵, Saudi Arabian investment funds account for \$22.1 billion (44.3%) of the global funds classified as Shari'a compliant in 2016. Moreover, 75% of the mutual funds offered in Saudi Arabia (there are around 283) are classified as Shari'a compliant where funds managers commit to subscribers to invest only in Shari'a compliant stocks according to certain screening rules.
- Third, in Saudi Arabia, the supply of SCAs is fairly un-regulated except for certain matters like very sensitive political matters and medical matters where the state might restrict issuing SCAs to certain qualified scholars. Also, it is up to individuals to chose whomever they deem qualified for addressing their concerns about Shari'a compliance of their acts or decisions. Being widely followed Shari'a scholar is usually correlated with having high respected educational degree, long history of expertise and consistency in their Shari'a advices.

1.2 Why the IPO Market?

Having said that, we believe that, within Saudi capital market, the settings of the IPOs market enable us to isolate the impact of SCAs from other factors that affect individual investment decisions.

⁴Barber et al. (2008) suggests that small investors are more subject to cultural and language biases as well as the disposition effect

⁵Can be accessed here: <http://cim.kfupm.edu.sa/ibf2017/documents/Bulletin.pdf>

Planning for an IPO, firms have to make publicly available a prospectus, a document contains all relevant formation about its business and the planned IPO features. Many individual investors considering to subscribe into the IPO seek advices from Shari'a scholars about the compliance status of the firm before they subscribe. Those scholars study the company prospectus and announce publicly if the company is Shari'a compliant and thus subscribing to its IPO is considered a legitimate investment from the perspective of Shari'a law⁶. Interestingly, in many cases, Shari'a scholars disagree about the compliance status of the firm and thus the legitimacy of subscribing into its IPO. This great deal of disagreement is exploited to create a measure of Shari'a compliance that is used in this study. Knowing the number of individual subscribers by the end of the IPO process and obtaining the text of SCAs during the IPO subscription period, one can investigate the influence of Shari'a scholars' advices on the decision of individuals to subscribe. The next section explains the process of data collection and variables construction.

2 Data Collection and Descriptive Analysis

From 2005 until the end of 2017, a total of 103 corporations in Saudi Arabia completed their IPOs. We restrict the study to post 2005 because we don't have reliable data on those IPOs which were offered before 2005. For each IPO, we collect data on the IPO characteristics, the text of influential Shari'a scholars where they announce the compliance status of the IPO firm and post-IPO statistics about the result of the subscription process.

From the prospectus of each firm, we collect data about the characteristics of the IPO including total size of offering, the offering price, the size of offering allocated to individual subscribers, the period of subscription and the sector the firm belongs to. The prospectus also lists the banks that are participating in receiving subscription applications. It is at the discretion of each Saudi bank to participate in an IPO as a receiving bank and, thus, number of receiving banks varies across IPOs. All IPOs prospectuses are obtained from the website of the Saudi capital market authority (CMA), the institution that regulates the capital market in Saudi Arabia⁷. The IPO subscription results, including data number of individual subscribers and the amount of money subscribed with, have been provided by the Saudi capital market authority (CMA).

Data about Shari'a scholars' compliance advices, or SCAs, was hand collected by a process explained in details in the Appendix. The result of this process yields only two Scholars who actively give SCAs for firms IPOs. The emergence of these two scholars is not surprising for several reasons. (1) The two scholars are usually the ones that local or regional financial news agencies seek to report their SCAs. (2) The two scholars are widely known for their annual list of Saudi compliant stocks where they screen all Saudi stocks according to the analysis they conduct from firms last annual audited financial statements. Therefore, we focus only on the two scholars. Table 1 presents the profile of the two scholars including names, expertise and the channels thorough which they communicate their SCAs. Interestingly, the table shows also that the guiding principles the two scholars follow are different. We exploit this difference to create a measure of Shari'a compliance for each firm. The measure take a "high" level if both approve the firm as a Shari'a compliant firm, a "low" level if both don not approve it or a "medium" level if only one approves it.

The result of this process is the text of SCAs announced by the two scholars for 76 IPOs. First three columns of Table 2 shows the result of such encoding process. Interestingly, the difference in the guiding principles each scholar follows manifests clearly in the number of firms approved by

⁶It is beyond the scope of this paper to investigate the basis on which Shari'a scholars issue positive or negative compliance advices. For more on that, refer to Alzahrani and Megginson (2017), El-Gamal (2008) and Uusmani and Usmānī (2002)

⁷www.cma.org.sa

each one. Since Al-Shubali follows less strict guiding principles, he rejected fewer firms than did Al-Osaimi who follows more strict guiding principles. Moreover, there is no case where the firm is approved by Al-Osaimi but not approved by Al-Shubail.

Table 2 shows the distribution of Shari'a scholars SCAs, or "Fatawa". 34 firms have not been approved as Shari'a compliant by the two scholars and 26 firms gained the approval of both Scholars. 16 firms have been approved by the less strict scholar (Al-Shubaili) but not approved by the more strict one (Al-Osaimi). There is no case where a firm IPO is approved by the more strict but not approved by the less strict because the more strict scholar requires more conditions to be met on top of those required by the less strict one. There are 26 IPOs where we can not find SCAs of either both scholars or one of them.

Table 3 gives general statistics about the Saudi IPO market. A total of 103 IPOs were completed in the period from 2005 to 2017. The average number of individual subscribers is around 2 million Saudis. The minimum number of individual subscribers was 105 thousand Saudi. It was for the IPO of a small insurance company (IPO size of 40 million SR) that went public in 2007. It was also given a Shari'a non-compliant status according to SCAs of both Shari'a scholars. The largest number of subscribers was 10.2 million Saudis for a real estate company that went public in 2006. It was given a Shari'a compliant status by both Shari'a scholars and its size was around 2.2 billion SR. All IPOs in our sample have been over-subscribed. The lowest level of over-subscription was 1.11 for a retail company that went public in 2006 which also was offered with the largest premium of 100 SR. The largest level of over-subscription was about 23 times and was for the IPO of the National Commercial Bank (NCB) in 2014, the largest IPO in term of value in our sample. Though was highly over-subscribed, both scholars announced that NCB is non-complaint firm as it deals with conventional, rather than, shari'a compliant financial products.

Table 4 shows the distribution of IPOs across sectors. Insurance sector has the largest number of IPOs. Construction, retail and industrial sectors also have sizable number of IPOs as compared to other sectors. The table also shows that there is a large variation in the average number of subscribers across sectors which could be partially explained by the offering size as it is clear by comparing column 3 and 4 of the table.

Figure 1 is a scatter plot to show the relation between number of individual subscribers and the retail offer size (amount of money to be raised only from individuals rather than institutions or funds) of an IPO for different Shari'a compliance status according to SCAs given by both scholars. The figure shows that Shari's compliant firms (triangular and squared ones) are occupying the upper portion of the chart for a given level of the IPO size. This indicates that firms approved by Shari'a scholars are seeing more individual subscribers. Interestingly, the chart fails to show any trend between those approved by one scholar versus those approved by both. However, one needs to be cautious to take firm conclusion from the chart as it masks wide differences hidden in other variables as we will see when we conduct further analysis.

3 Analysis

We begin our analysis by hypothesizing that if the firm is not approved by Shari'a scholars, number of individual subscribers attracted by its IPO drops significantly relative to the number of individual subscribers attracted by the IPO of firms approved by Shari'a scholars.

In the sample of the IPOs we are able to collect, there were 34 firms that were not approved by both scholars (refer to Table 2). However, a close look at the data revealed that only five IPOs of these fall outside the insurance sector while 29 belong to the insurance sector. One of these five belong to the banking sector which is the IPO of National Commercial Bank (NCB) in 2014. Before

turning to the regression model specification, we run simple matching analysis to investigate the NCB case, the insurance sector and the rest of four IPOs, outside the insurance sector, where both scholars didn't approve.

- *NCB Case*: NCB bank is the oldest national bank in Saudi Arabia and it is the largest bank by the value of assets at the time of its IPO in 2014. The bank, before being offered to the public, was owned mainly by the government through its investment arm, the Public Investment Fund (PIF). Because of being a conventional bank dealing with interest bearing conventional products, both (in fact most of Shari'a Scholars in the kingdom) did not approve the NCB IPO as a Shari'a compliant investment. Table 6 shows simple matching exercise for NCB IPO with two other Shari'a compliant banks. Clearly, NCB was able to attract only one million subscribers compared to more than 8 million subscribers the other two Islamic banks were able to. A drop of such size is unlikely to be attributed to other factors such as size, premium, year of the IPO and so on. Moreover, the over-subscription ratio is way higher in NCB than its value in the other two banks, indicating that drop is also hardly attributable to the perceived risk-return profile of the bank. The remaining explanation is that large number of potential individual investors turned away from that IPO because the SCAs given by Shari'a scholars. This case, therefore, gives initial strong support to our hypothesis.
- *Insurance Sector*: Table 7 shows how Shari'a compliant IPOs compare with non-compliant ones in the insurance sector. There are only 3 Shari'a compliant firms stated so by both scholars in their SCAs. The table shows that, on average, compliant firms get much higher subscribers than non-compliant ones. However, the average retail offering size of compliant firms is higher than non-compliant ones. Thus, a careful analysis that controls for other relevant variables is needed.
- *Other Sectors*: Table 8 shows the IPO characteristics of the four other firms that are advised to be non-compliant by both scholars. To ease the comparison, we run a simple matching exercise where, for each of the four firms, we search for matching firms that are compliant by both or one of the two scholars. Given the limited sample we have, we do the matching exercise using only two variables. We search for match(es) using the IPO retail offering size. Then, we search for a match from the pool of the previous matching IPOs using the year of the IPO. The limited sample size makes us unable to go beyond these two variables. The result is shown in Table 8. In all cases, the matching firms receive higher subscribers. In some cases, like in *Research and Marketing* IPO and *The Kingdom* IPO, the over-subscription ratio is even higher than the ratios of the matching IPOs yet the number of subscribers are much lower. Therefore, the result gives, in general, initial support to our hypothesis.

To further investigate the hypothesis, we employ the following regression model,

$$y_i = \alpha + \beta_1 D_{one_i} + \beta_2 D_{both_i} + \gamma X_i + u_i, \quad (1)$$

where y_i is the natural logarithm of the number of individual subscribers for the IPO i . D_{one_i} is an indicator variable that takes on 1 if only one scholar (i.e. the more strict one) stated the company i is *not* Shari'a compliant and zero otherwise. D_{both_i} is another dummy variable that takes on 1 if both scholars stated that company i is *not* Shari'a compliant and zero otherwise. Note that since one scholar is more strict than the other, as shown in section 2, D_{one_i} and D_{both_i} creates three groups: (1) firms whose Shari'a compliance were approved by both scholars, (2) firms whose Shari'a compliance were rejected by both scholars, and (3) Firms whose Shari'a compliance status

were approved by one scholar, the less strict one (i.e Al-Subali). Group (1) (i.e. $Done_i = 0$ and $D_{both_i} = 0$) is chosen to be the reference group.

For our hypothesis to be supported, β_1 and β_2 should be negative and significant. We also expect that β_2 , in absolute value, is significantly larger than β_1 . That is, IPOs rejected by both scholars attract significantly fewer subscribers than those rejected by only one which, in turn, attract significantly fewer subscribers than those approved by all scholars.

X_i is a set of controlling variables which we describe in Table ...

The model in 3 is estimated by OLS using the 76 IPOs which we were able to obtain their SCAs of both scholar as we show in Table 2. The estimation result is shown in Table 10. Column (1) and (2) show that, as predicted, retail offer size and number of receiving banks have great impact on the number of subscribers. The more banks participating in the subscription process, the more convenient is for individuals to participate and thus increase the number of subscription. Other variables do not seem to have impact. Interestingly, government ownership has no significant impact on the number of subscribers an IPO can attract. In column (3), we add the variables of interest, namely D_{one} and D_{both} . The results show that individuals respond significantly to Shari'a scholars only if they agree the firm is not compliant. This is indicated by the negative sign and the significance of β_2 . In particular, the results show that a drop of around 80% is expected in the number of individual subscribers if both scholars agree that the company is not compliant. Interestingly, the results show that β_1 is not significant. That is, if one scholar states the company is not compliant while the other approves it, subscribers don't react significantly. Given the degree of strictness we explained, the result implies that if the less strict scholar approves the company, individual subscribers do not show significant reaction to the more strict one. R^2 values reported in column (3) implies that the model explains great deal of variation in the dependent variable. Moreover, the F-stat for comparing model (2) and (3) shows that model (3) add significant contribution to model (2) (F value is 8.9637 with p-val of 0.00036) showing that SCAs content has a significant power in explaining variation in individuals' participation in IPOs.

In Table 11 we run two robustness checks. First, we add an indicating variable for the insurance sector ($D_{insurance}$). As we saw above, insurance sector has the largest number of Shari'a non-compliant IPOs and the result may be just a reflection of the insurance sector. Column (1) of Table 11 shows that controlling for insurance sector does not alter the result. Second, we check whether number of Islamic banks participating in receiving individual subscriptions may explain all or part of the result. Islamic banks have Shari'a boards that approve their activities in term of being compliant with Shari'a laws. Since most of religious individuals are clients to Islamic banks, they may not participate because their banks do not participate in receiving individual contributions to the IPO. In order to check for that we create a variable that measures the ratio of number of Islamic banks to the total number of receiving banks (i.e. $IslamicReceiving/NoReceiving$). Column (2) of Table 11 report the results. Again, the results still hold.

4 Concluding Remarks

All in all, the result of this section and the previous section implies that individual subscribers react significantly to Shari'a scholars' compliance advices when they decide to subscribe in an IPO and once a less strict trusted Shari'a scholar approves the investment, individuals don't show much reaction to the other more strict scholar. However, our analysis has some limitations. First, the sample size (73 observations) is relatively small compared to related studies in literature which may weaken the generalization of the results. However, given the small size of IPOs pool in the Saudi Arabia (a total of 103), one can give some reliability of the results at least within the context of Saudi

Arabia and similar highly conservative Muslim countries. Moreover, there is no reason why the role of Shari'a scholar is specific to the IPO of the equity market. As we show in the introduction, Islamic bond market is not immune from the influence of different views of Shari'a scholars. Thus, the results of this paper may shed some light to understand the role of Shari'a scholars in bond markets as well. Second, Saudi Arabia is known to be a conservative Muslim country relative to other countries. Therefore, the generality of the study results may also be questioned. However, the influence of Shari'a scholars is found not to be restricted to their countries of residence. Godlewski et al. (2016) found, on average, that around half of Shari'a scholars certifying an issuance of Islamic bonds are not from the same country where the issuer is based on. Moreover, the size and the importance of Saudi Equity market makes our findings of particular importance to the rapidly growing pool of international and regional investors who target the Saudi equity market. In June, 2018 MSCI Inc. announced the addition of Saudi Arabia to its group of emerging markets which is expected to attract regional and international capital.

The results this investigation came to has important implications. It begs an important question about the efficiency of a capital market in the presence of such impact of SCAs market. Another important question is the optimal regulatory design of SCAs market. There is no clear answer, so far, to such question which may explains the variation in the governance framework we see in different Islamic countries. We hope that the analysis of this study sheds some lights for approaching those questions.

Appendix: Data Collection Process for SCAs

Data about Shari'a scholars' compliance advices, or SCAs, is hand collected as follows. We first search for all available SCAs of each IPO using Google search engine. We then collect the names of Shari'a scholars who participated in giving advices about that particular IPO. We combine the firm name, key words about IPO subscription and key words about SCAs. In most of the cases, these key words provide unique combination. Thus, it is unlikely that an SCA is missed during the search except those which are not written or aired through TV shows which we don't believe they have much influence.

The result of this exercise yields only two Scholars who actively give SCAs for firms IPOs. The emergence of these two scholars is not surprising for several reasons. (1) The searching for each firm usually yields the names of these two scholars appearing at the top search results. (2) The two scholars are usually the ones that local or regional financial news agencies seek to report their SCAs. (3) The two scholars are widely known for their annual list of Saudi compliant stocks where they screen all Saudi stocks according to the analysis they conduct from firms last annual audited financial statements. (4) The number of SCAs found for other scholars are way much lower than what the number found for the two scholars. For example, the two scholars gave SCAs for more than 70% of all Saudi IPOs in our sample while the scholar that comes next gave only less than 20% of the IPOs. Other scholars gave much fewer. Table 1 presents the profile of the two scholars including names, expertise and the channels thorough which they communicate their SCAs.

For these two scholars, we search for the text of their SCAs for each IPO in our sample. We search their own websites and their own accounts in social media sites like Facebook and Twitter. For the those IPOs that were not found in their websites or social media accounts, we turn to Google search engine and search for relevant key words. In most of the cases, using the combination of the scholar name and the firm name was enough. Some of SCAs appeared in TV shows of Islamic channels like Al-majd.tv. Example of Al-Osaimi compliance statement texts can be found here (in Arabic) <http://qa.halal2.com/stocks/ipo>. Example of A-Shubaili compliance statement texts can be found (in Arabic) in <http://www.islamtoday.net/fatawa/schques-60-346-1.htm>.

It is important to note that the two scholars have different degree of strictness in applying Islamic laws to study the compliance status of the firm. To explain how, a company has three main activities: operational, financing and investment. A full Shari'a compliant firm is the one that complies to Shari'a rules in all of the three activities. That is, it does not sell un-permissible products and services like pork, porno stuff or interest-based financial services and it has to raise funds only through Shari'a compliant financing products⁸. Also, if it does, it has to invest in Shari'a compliant financial or physical assets. This fully compliance is required by Al-Osami, the more strict Scholar. If the company maintains its Shari'a compliance in its operation but engaged in little non-compliant financing or investing activities, many Shari'a scholars and Shari'a boards accommodate the company as Shari'a compliant with the stress that the company has to find its way away from such activities. This partial compliance is followed by Al-Shubaili and hence, he becomes less strict in that sense.

In most of the cases, the scholar states explicitly whether the company IPO is Shari'a compliant or not. In insurance sector in particular, both scholars issued a statement where they state that any company in the insurance sector is non-compliant because the "Implementing Regulations" that governed insurance sector at the time contradicts with a Shari'a compliant insurance products. In 2011, Saudi Monetary Agency (SAMA), the regulator of the insurance sector, amended the relevant regulation in a way that allows insurance firms to sell Shari'a compliant insurance products.

⁸For a good overview on Islamic finance refer to El-Gamal (2008) and Uusmani and Usmānī (2002) for excellent review over Islamic finance products.

Accordingly, all of Shari'a compliant insurance IPOs were offered after 2011 and those offered before 2011 are considered non-compliant by both scholars

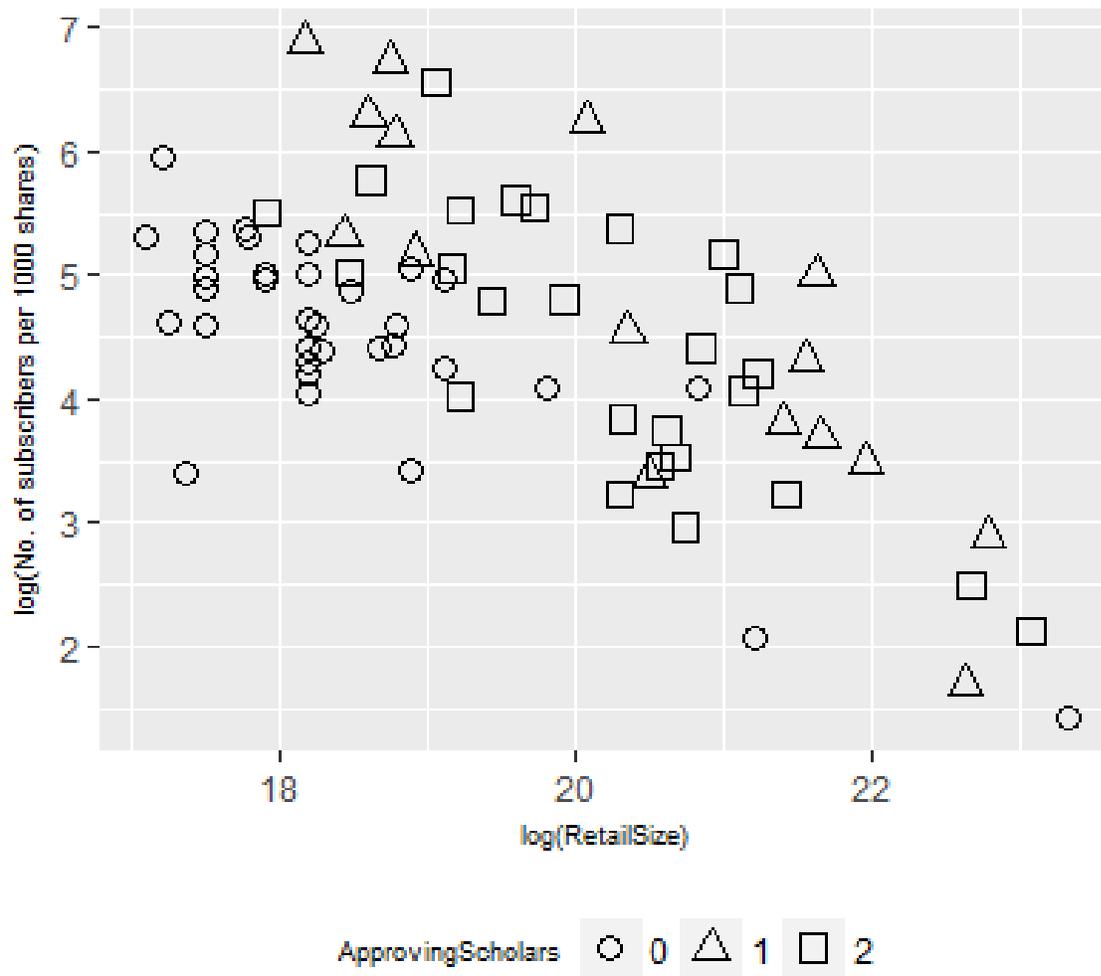


Figure 1: No. of Subscribers versus the No. of Approving Scholars for Different Level of Retail offering

The y-axis is calculated by dividing number of subscribers over the number shares (in thousands) available for individuals then natural logarithm is taken. x-axis is the natural logarithm of the retail offer size, the amount of money to be raised only from individuals rather than institutions or funds. The shape of the point, as shown by the legend, represents the number of scholars who approved the firm IPO as a Shari'a compliant investment

Table 1: Profile of the Two Shari'a Scholars

	Dr. Usef Al-Shubaili	Dr. Mohamed Al-Osaimi
Education	Has a Master degree and Doctorate in Islamic Comparative Jurisprudence from Imam Muhammad bin Saud University in Saudi Arabia.	Holds a Bachelor of Commerce in Islamic Economics from the Imam Mohamed Bin Saud Islamic University, Masters and PhD in Economics from the University of Colorado, Boulder, 1993
Experience	He is a full professor at Higher Institute of Judiciary in Imam Muhammad bin Saud University. He is also a Member of Shariah Board at Arbah Capital (Asset Management Company), a member of Al-Bilad Bank Shari'a Supervisory board, a member of Saudi Fiqh (Islamic Jurisprudence) Society and a member of Fiqh (Islamic Jurisprudence) Council of North America. He taught at the Institute of Islamic Sciences in America during 1420-1424 H.	He taught Islamic economics in Imam Mohamed Bin Saud University until retirement. He also served as a manager of Sharia Supervision at the Al-Rajhi Secretary of the Sharia Board and a Member of Sharia Board at Bank Albilad. He is also known of his yearly list of Shari'a compliant companies which was published first in 2006 and maintained until current time. He is also the general supervisor of Al-maqased Economics Advisory (http://www.almaqased.net/) a non-profit institution for promoting Islamic finance.
Source of Compliance Advices	www.shubali.com , www.islamtoday.com and his twitter account (@yalshubaily). Also, Al-Shubail appears frequently in on-air TV shows to address the audience concerns regarding Shari'a compliance of various matters including investment. TV channel he frequently appears at is CNBC Arabiya, Al-majd TV and Alresala TV	Most of his IPO compliance advices can be found in www.halal2.com , his personal website, http://www.almaqased.net and his twitter account (@MuhamadAlosaimi)
Guiding Rules for Shari'a compliance for corporations	A company stock is Shari'a compliant if the company core business is compliant. Financing through non-compliant tools can be accommodated if it not the dominating tools. More detailed rules can be accessed here : https://ar.islamway.net/fatwa/33915 .	For a company to be Shari'a compliant, all its activities have to be Shari'a compliant including financing. According to Al-Osaimi, no tolerance for using conventional non-compliant financing tools of any amount. More detail about his approach can be accessed here: http://halal2.com/docs/methodology2016.pdf

Table 2: Shari'a Scholars Compliance Advices (SCAs) and the Saudi IPO market: Descriptive Statistics

The table reports descriptive statistics of the Saudi IPO market from 2005 up to 2017 categorized by the Sharia'a compliance advices (SCAs) of the two Shari'a scholars considered in the study, Dr. Usef Al-Shubali and Dr. Muhamed Al-Osaimi. Numbers are averaged across sectors. Data is sourced from Saudi Capital Market Authority (CMA). For data on Scholars' SCAs, refer to the text. The (?) sign indicates that no SCA is found for the corresponding scholar.

Al-Shubali (Compliant?)	Al-Osaimi (Compliant?)	No. of Firms	No. of Subscribers (Average in thousand)	Retail Offering Size (Average in Million SR)	Premium (Average in SR)	No. of Receiving Banks (Average)	Over Subscription (Average of multiple)
No	No	34	943	560.04	3	4.29	7.54
Yes	No	16	4,164	1,882.13	25	8.88	5.20
Yes	Yes	26	3,069	1,339.17	19	8.35	4.59
Yes	?	11	1,052	310.96	31	7.36	3.94
?	No	3	999	267.74	30	5.00	6.20
?	?	13	1,039	310.47	23	7.85	2.93
All		103	2,005	895.47	17	6.83	5.40

Table 3: General Descriptive Statistics

The table reports general descriptive statistics of the Saudi IPO market from 2005 up to 2017. Data is sourced from companies prospectuses available in Saudi Capital Market Authority (CMA) website. Total number of IPOs is 103. Premium is the offer price minus the nominal price which is fixed for all IPOs at 10 SR.

	Mean	StD	Median	Min.	Max.
No. of Subscribers (thousands)	2,005	2,089	1,253	105	10,200
Over-Subscription (multiples)	5.40	3.92	4.50	1.11	23.04
No. of Receiving Banks	7	3	6	3	12
Retail Offering Size (million SR)	895.47	2,050.70	206.55	26.45	13,500.00
Premium (SR)	16.84	21.85	0.00	0.00	100.00

Table 4: Saudi Initial Public Offering (IPO) Market: Sectoral Descriptive Statistics

The table reports descriptive statistics across sectors for the Saudi IPO market from 2005 up to 2017. Numbers are averaged over years. Data is sources from companies prospectuses available in Saudi Capital Market Authority (CMA) website.

Sector	No. of Firms	No. of Subscribers	Retail Offer Size (Saudi Riyal)	Premium (Saudi Riyal)	No. of Receiving Banks	Over Subscription (multiple)
banking	3	6,298	8,500,000,000	11.67	9.00	9.98
cement	6	2,601	685,083,333	0.00	7.83	3.64
construction	11	1,551	374,335,455	34.73	8.18	3.20
food	5	1,519	760,350,000	45.88	6.20	4.54
Industrial	8	2,083	1,242,781,250	25.75	8.63	4.90
insurance	34	950	90,629,254	0.00	4.29	7.68
itc	3	3,660	2,533,333,333	0.00	9.00	3.00
media	2	1,366	651,000,000	24.00	4.00	3.36
multi	2	2,306	1,134,046,326	16.13	6.00	4.24
petrochemical	7	5,063	2,399,167,143	8.29	11.00	3.63
real_estate	5	4,066	1,479,982,400	10.80	9.20	2.71
retail	13	1,424	303,750,769	40.08	6.92	5.42
tourism	2	1,359	548,250,000	43.50	8.50	2.86
transportation	2	1,555	635,370,000	41.00	8.00	4.82
All	103	2,005	895,473,391	16.84	6.83	5.40

Table 5: Saudi Initial Public Offering (IPO) Market: Yearly Descriptive Statistics

The table reports descriptive statistics per year for the Saudi IPO market from 2005 up to 2017. Numbers are averaged across sectors. Data is sources from companies prospectuses available in Saudi Capital Market Authority (CMA) website.

Sector	No. of Firms	No. of Subscribers	Retail Offer Size (Saudi Riyal)	Premium (Saudi Riyal)	No. of Receiving Banks	Over Subscription (multiple)
2005	4	5,100	1,569,937,500	34	7.00	4.49
2006	10	3,341	1,044,615,000	37	8.90	4.07
2007	26	1,154	539,068,140	9	4.73	5.81
2008	13	4,393	2,516,191,358	13	8.54	5.94
2009	11	1,172	175,068,182	4	6.09	6.54
2010	9	1,145	326,811,111	15	8.22	4.53
2011	5	593	262,650,000	14	7.80	2.11
2012	7	1,603	513,000,000	19	7.29	5.09
2013	5	2,036	301,950,000	9	5.40	6.77
2014	6	1,851	2,500,333,333	27	7.67	8.03
2015	4	1,342	415,200,000	32	7.50	4.75
2016	3	533	279,250,000	36	6.00	3.49
All	103	2,005	895,473,391	17	6.83	5.40

Table 6: Shari'a Scholars' Compliance Advice (SCAs) and IPO statistics of NCB Bank versus other banks

The table reports descriptive statistics for the NCB bank IPO versus other two banks. Data is sourced from Capital Market Authority (CMA) in Saudi Arabia. For data on Scholars compliance advices (SCAs), refer to the text.

	Al-Shubali (Compliant?)	Al-Osaimi (Compliant?)	No. of Subscriber	year of IPO	Retail Offering Size (in Million SR)	Over Subscription (in Multiple)
NCB Bank	No	No	1,245	2014	13,500	23.04
Albilad Bank	Yes	Yes	8,800	2005	1,500	5.17
Alinma Bank	Yes	Yes	8,850	2008	10,500	1.74

Table 7: Shari'a Scholars' Compliance Advice (SCAs) and IPO market: Descriptive Statistics for Insurance Sector

The table reports descriptive statistics for the insurance sector in Saudi of IPO market categorized by the SCAs of the two Shari'a scholars considered in the study, Dr. Usef Al-Shubali and Dr. Muhamed Al-Osaimi. Data is sourced from Capital Market Authority (CMA) in Saudi Arabia. For data on SCAs, refer to the text.

Al-Shubali (Compliant?)	Al-Osaimi (Compliant?)	No. of Firms	No. of Subscribers (Average)	Retail Offering Size in Million SR (Average)	Over Subscription Multiple (Average)
No	No	29	912	85.6	7.53
Yes	Yes	3	1,436	129.0	9.43
		32	961	89.6	7.72

Table 8: Non-compliant Firms versus Matching Compliant Firms

The table reports IPO statistics for four firms that were not approved by both scholar as a compliant firm along with their matching compliant firms. The matching variables are the year of the IPO and the size of retail offering. Data is sources from Capital Market Authority (CMA) in Saudi Arabia. For data on SCAs, refer to the text.

Ticker	Name	Sector	No. of Subscribers	year of IPO	Retail Offering Size	Over Subscription	Al-Shubali Compliant?	Al-Osaimi Compliant?
4011	Lazordi	retail	385	2016	143.19	2.93	No	No
1304	Yammam	construction	807	2016	164.64	4.79	Yes	No
4280	Kingdom	multi	1251	2007	1,614.38	5.27	No	No
4300	Dar Alarkan	real estate	1995	2007	1,664.71	1.26	Yes	Yes
4250	Jabal Omar	real estate	5068	2007	2,014.00	3.09	Yes	Yes
4210	Research and Marketing	media	1432	2006	1,104.00	3.99	No	No
4240	Alhukair	retail	2100	2006	1,320.00	1.11	Yes	Yes
4270	Printing	media	1300	2007	198.00	2.73	No	No
2370	Cables	construction	1530	2007	220.80	4.03	Yes	No

Table 9: Description of the Controlling Variables

<i>Size_i</i>	measure of the size of the retail offering, i.e. the number of shares available to individuals. Larger offering size can accommodate more individuals, holding other factors constant. The value is transformed using natural logarithm.
<i>premium_i</i>	is the return on the firm <i>i</i> stock over the first week of trading. This variable, supposedly, measures the undervaluation of the IPO offer price. Higher return indicates that the offer price was undervalued and thus, if the undervaluation was anticipated, more subscribers are attracted. Controlling for undervaluation rules out the fact that a very much undervalued IPO may induce investors to bypass their faith-based norms for the sake of obtaining high expected profit.
<i>D_{gov_i}</i>	is a dummy variable that takes on 1 if there is a government stake in the firm <i>i</i> either before or after the IPO. The government control comes in different ways either thorough pension agencies (there are only two fund both are run by the government) or through some investment arms like Public Investment Funds (PIF). Controlling for government is important to rule out the possibility that the government may exert pressure on Shari'a scholars to approve the firm it has a stake in.
<i>NoReceiving_i</i>	to measures the number of receiving banks where individuals send their subscription orders. The higher the number of receiving banks, the more individuals are expected to subscribe.
<i>m2_i</i>	is the growth rate of money supply during the year of IPO of firms <i>i</i> . This variable controls for the overall macro performance of the Saudi economy which might affect people spending power. We expect that years of high growth in money supply to induce more investment spending especially in the capital market.

Table 10: Impact of Shari'a scholars' compliance advices (SCAs) on individual subscribers: OLS
Baseline Estimation Results

The table reports the results of OLS estimation of model 3 where the dependent variable is the logarithm of number of individual subscribers to the firm initial public offering (IPO). Independent variables are explained in the text. Dependent variable is the natural logarithm of the number of individual subscribers for the IPO i . Main independent variables are $D_{one,i}$ and $D_{both,i}$. The first is an indicator variable that takes on 1 if only one scholar (i.e. the more strict one) stated the company i is *not* Shari'a compliant and zero otherwise. The second is another dummy variable that takes on 1 if both scholars stated that company i is *not* Shari'a compliant and zero otherwise. Other controlling variables are explained in Table 9. Number of observations is 76.

	(1)		(2)		(3)	
	Coeff	p-val	Coeff	p-val	Coeff	p-val
(Intercept)	10.339	0.000	10.528	0.000	11.249	0.000
<i>size</i>	0.407	0.000	0.292	0.000	0.281	0.000
<i>premium</i>	0.007	0.100	0.005	0.172	0.000	0.989
<i>Rw</i>	-0.091	0.465	0.062	0.601	0.079	0.463
<i>D_{gov}</i>	0.082	0.731	-0.069	0.753	-0.115	0.575
<i>m2</i>	-0.306	0.787	-0.135	0.895	0.077	0.934
<i>NoReceiving</i>			0.120	0.000	0.067	0.025
<i>D_{one}</i>					0.202	0.240
<i>D_{both}</i>					-0.812	0.000
R-squared	0.575		0.659		0.731	
Adjusted R-squared	0.545		0.629		0.699	

Table 11: Impact of Shari'a scholars' compliance advices on individual subscribers: Robustness Analysis

The table reports the results of OLS estimation of model 3 where the dependent variable is the logarithm of number of individual subscribes to the company initial public offering (IPO) and independent variables includes those in table 10, a dummy variable that takes 1 if the company belongs to insurance sector ($D_{insurance}$) and the ratio of of the number of Islamic banks in the receiving banks over the total number of receiving banks ($IslamicReceiving/NoReceiving$). Number of observations is 76.

	(1)		(2)		(3)	
	Coeff.	p-val	Coeff.	p-val	Coeff.	p-val
(Intercept)	11.228	0.000	11.216	0.000	11.207	0.000
<i>size</i>	0.282	0.000	0.284	0.000	0.284	0.000
<i>premium</i>	0.000	0.967	0.000	0.970	0.000	0.962
<i>Rw</i>	0.076	0.494	0.071	0.520	0.070	0.540
<i>D_{gov}</i>	-0.116	0.576	-0.118	0.568	-0.118	0.571
<i>m2</i>	0.083	0.930	0.061	0.948	0.064	0.946
<i>NoReceiving</i>	0.067	0.026	0.064	0.038	0.064	0.040
<i>D_{one}</i>	0.204	0.243	0.209	0.231	0.209	0.237
<i>D_{both}</i>	-0.823	0.001	-0.802	0.000	-0.807	0.002
<i>D_{insurance}</i>	0.020	0.934			0.009	0.971
<i>IslamicReceiving/NoReceiving</i>			0.138	0.730	0.136	0.738
R-squared	0.731		0.732		0.732	
Adjusted R-squared	0.694		0.695		0.690	

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