Guest editorial

Islamic behavioural finance editorial

The essence of "rationality in financial markets" derived by neo-classical economists has been severely criticised as more and more assumptions are questioned by behavioural scientists since the beginning of 1980s. The long-standing belief that prices did not have memories (Bachelier, 1964; Fama, 1970) was put on test by the innovations in market anomalies (Basu, 1977; Banz, 1980; De Bondt and Thaler, 1985; Jegadeesh, 1990). Today, those anomalies are often considered normal phenomena, considering the changes in human perception towards financial planning and management. The emerging area – behavioural finance – builds upon three blocks: heuristics, framing and market inefficiencies (Shefrin, 2002) and upon two pillars: cognitive psychology and limits to arbitrage (Ritter, 2003). At large, investors' behaviour in financial markets is controlled by individual differences and capacity to manage information for decision-making (Kahneman and Tversky, 1979). Since the days of "Know Thyself", "Elements of Psychophysics" (Gustav Fechner, 1860), the first major work on psychology by Sigmund Freud (1895) or the movement from psychology to behaviourism explained by John B. Watson (1878-1958), until the most recent papers on investor (economic) psychology, the Gurus put forward a common hypothesis – "observation is the best way to experience".

In this special issue, researchers observe the influence of behavioural finance and relevant theories in Islamic finance. Leveraging on a massive growth of the oil rich Muslim countries during the early 1960s, Islamic finance has transformed itself from an "alternative" to a "demanding" financial system. Islamic finance is now a dominant financial system in several geographical areas, which include countries in the Middle East, North Africa, Southeast Asia and South Asia. The industry has shown profound resilience to global financial crisis of 2007-2008, and it has offered more than decent return to investors globally (Boo *et al.*, 2017). In the recent period, several studies have identified performance differentials between conventional and Islamic equities, behavioural biases in Islamic fund market and sentimental investment in short- and long-term assets. Accepted manuscripts of this special issue have shed light on these biases and, in many angles, have helped to extend the scope of Islamic behavioural finance in other relevant areas. This is also the first issue dedicated to Islamic behavioural finance. The special issue includes nine papers in three areas: attitude and perception, theoretical and policy contribution and Islamic market behaviour. From several dimensions, it is evident that the issue does not only cover a holistic ground for understanding behaviourism in markets but also provides suggestions and policy implications.

Mezghani and Boujelbene investigates the transmission of oil shock between Islamic and conventional markets in GCC countries. They find a strong connection between oil price shocks and the performance indicators of these markets. Their study provides contributions of herding behaviour to explain such connection. Similar in context, Chaffai and Medhioub go at the core of herding behaviour in GCC countries. Their study shows stronger down-market herding compared to a weaker raising market herding behaviour among Islamic investors. Jaziri and Abdelhedi investigate the impact of several Islamic (holy) occasions on financial market performance of the Middle East. Their study reports significant positive connection between the (positive) market sentiment during those events and market performance. These papers clearly indicate a non-fundamental nature of financial market behaviour of Islamic investors.

International Journal of Islamic and Middle Eastern Finance and Management
Vol. 11 No. 2, 2018
pp. 154-156

1753-8394
DOI 10.1108/IMEFM-06-2018-307

As Islamic behavioural finance is emerging, an increased number of researches are directed towards observing the attitude and perception of various stakeholders towards Islamic financial system. These studies often carry theories from economic psychology in the background. Kaakeh *et al.* investigate determinants of intention to use Islamic finance/financial products among the minority Muslims of Spain. In a similar way to a plethora of past studies on similar issues, their study reports finding mixture of religious and non-religious factors as the determinants of intention to use Islamic finance. Thaker *et al.* consider the crowdfunders' intention to fund liquidity shortage of *waqf* institution in Malaysia. Their study found perceived ease of use and perceived usefulness of new *waqf* investment in physical assets as significant determinants influencing decision of crowdfunding agencies. Profit and loss sharing (PLS) has been one of the core promises of Islamic financial systems. Badaj and Radi investigate the intention to use PLS of the SMEs from Morocco. Aside from religious beliefs, their study finds (higher) cost, loss of control and access to conventional funds as the major impediments to adoption of PLS system. Also, attitude towards PLS and perceived behavioural control affect the quick acceptance of PLS system. Rafay and Farid investigate the influence of attributes related to *Shari'ah* supervisory board on behaviour of Islamic investors. Even though not statistically significant, their study shows the presence of primacy effect, and that investors placed greater importance on information relevant to the *Shari'ah* supervisory board.

A third group of papers has theoretical and policy implications. Zainuldin *et al.* critically discuss agency theory and relevant issues from an Islamic ethical standpoint. Their study argue that a better ethical framework of Islamic organisation helped reduce the agency problem. Elhaj *et al.* offer empirical support for agency theory and stakeholder theory in the context of board attributes affecting Sukuk rating in Malaysia. CEO duality, board size and board independence have positive connection with Sukuk rating. Their findings carry significant policy implications for corporate governance practices of Sukuk issuers and Islamic capital market regulators.

In the near future, there would be more studies on Islamic behavioural finance covering the contexts of emerging Islamic markets and investors. As Islamic finance fundamentally promotes a system where decision based on rumours or noise is prohibited, future studies should come up with models to investigate impact of behavioural attributes on Islamic financial activities and decisions. While developing new models, we urge the researchers to go back to the core principals of Islamic economic teachings and practices.

Mamunur Rashid
Nottingham University Business School,
University of Nottingham Malaysia Campus, Semenyih, Malaysia, and
Andrea Paltrinieri
University of Udine, Udine, Italy

References

Bachelier, L. (Ed.) (1964), "Theory of speculation", in Cootner, P.H. (Ed.), *The Random Character of Stock Market Prices*, The MIT Press, Cambridge, MA.

Banz, R.W. (1980), "The relative efficiency of various portfolios: some further evidence: discussion", *Journal of Finance*, Vol. 35 No. 2, pp. 281-283.

Basu, S. (1977), "Investment performance of common stocks in relation to their price-earnings ratios: a test of the efficient market hypothesis", *Journal of Finance*, Vol. 32 No. 3, pp. 663-682.

Boo, Y.L., Ee, M.S., Li, B. and Rashid, M. (2017), “Islamic or conventional mutual funds: who has the upper hand? Evidence from Malaysia”, *Pacific-Basin Finance Journal*, Vol. 42, pp. 183-192.

De Bondt, W. and Thaler, R. (1985), “Does the stock market overreact?”, *Journal of Finance*, Vol. 40 No. 3, pp. 793-805.

Fama, E.F. (1970), “Efficient capital markets: a review of theory and empirical work”, *Journal of Finance*, Vol. 25 No. 2, pp. 383-417.

Jegadeesh, N. (1990), “Evidence of predictable behaviour in security returns”, *Journal of Finance*, Vol. 45 No. 3, pp. 881-898.

Kahneman, D. and Tversky, A. (1979), “Prospect theory: an analysis of decision under risk”, *Econometrica*, Vol. 47 No. 2, pp. 263-291.

Ritter, J.R. (2003), “Behavioural finance”, *Pacific-Basin Finance Journal*, Vol. 11 No. 4, pp. 429-437.

Shefrin, H. (2002), *Beyond Greed and Fear: Understanding Behavioural Finance and the Psychology of Investing*, Oxford University Press, New York, NY.