WEALTH EFFECT OF ISLAMIC BOND OFFERING ANNOUNCEMENT

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In this study the wealth effect of Islamic bond offering announcement was investigated using a firm's data from 2001 to 2005. Three types of Islamic Bonds were examined: Mudharabah, Al-Bai Bithamin Ajil and Ijarah.

The results show that there no significant positive abnormal return occurs following an Islamic bond offering announcement. The findings revealed that Malaysian investors respond positively to these announcements, perceiving them as good, thus creating a positive wealth effect. This positive effect is consistent with the findings of Chang et al (2004) and suggests that Islamic bond financing is a means of minimizing the cost and increasing the opportunity of investment when value and timing are uncertain.

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LIST OF ABBREVIATIONS

ABBA	**Al-Bai Bithamin Ajil**
AAR	**Average Abnormal Return**
CAAR	**Cumulative Average Abnormal Return**
CAPM	**Capital Asset Pricing Models**
ICM	**Islamic Capital Market**
IDB	**Islamic Development Bank**
IPDS	**Islamic Private Debt Securities**
KLCI	**Kuala Lumpur Composite Index**
NMBC	**National Bond Market Committee**
RAM	**Rating Agency Malaysia**
PN	**Primary Notes**
SAC	**Shariah Advisory Board**
SC	**Securities Commissions**
SN	**Secondary Notes**

CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Study

The main goal of a firm is to maximize the value of the firm or to maximize the wealth of the shareholders and this is done through increase in stock prices. Stock prices will only increase if the value of firm has improved. There are two ways to enhance the value of a firm: through investing in new projects, both short and long-term projects and through different financing methods to reduce the cost of capital. The type of long-term financing instrument employs by a firm affects its capital structure. Capital structure refers to the manner in which a firm's assets are financed by debt, preferred stock and common equity. The cost of each capital component together with the their respective weights will determine the cost of capital. The lower the cost of capital, the higher the net present value of the projects. This means that higher value will be added to the firm, which will then enhance the stock prices.

Can capital structure affect the value of the firm? This question has created a lot of interests among the academicians. Modigliani and Miller (MM) (1958) using various assumptions, contented that capital structure is irrelevant to corporate value under perfect capital market and world with no taxes. In another paper by MM (1963), they came out with another proposition that firm should use as much debt as possible to achieve maximum value for the firm. They contended that the debt has advantage over equity because interest on debt is tax deductible which help to reduce cash outflows. The advantage of this tax shield will improve the value of the firm.

The propositions of MM have further created tremendous interests among the researchers. According to their theories, firms should use as much debt as possible to take advantage of the tax shield. However, based on the observations, firms do employ much debts in their financing and in fact there are firms do not use any leverage at all. The empirical evidence appears to be contrary to the theories.