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Sharia-compliant VS Conventional Mutual Fund in Indonesia: An Evaluation Based on Portofolio Performance

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Abstract: This study aims to compare performance between Sharia-compliant mutual funds and conventional mutual funds which classified as share mutual funds, fixed-income mutual funds and mixed mutual funds. It observes a 60-month period spanning from 2018 to 2022, evaluating mutual fund performance through key indicators, including return ratio, Sharpe Ratio, Treynor Ratio, Jensen Alpha, and Assets Under Management (AUM). The findings reveal notable differences in the performance of equity, fixed-income, and balanced mutual funds, with Sharia-compliant mutual funds consistently demonstrating superior average performance compared to their conventional counterparts. This study contributes valuable insights to the portfolio literature, offering investors and financial professionals critical information for informed investment decisions.

Abstrak: Studi ini bertujuan untuk membandingkan kinerja antara reksa dana syariah dan reksa dana konvensional yang diklasifikasikan sebagai reksa dana saham, reksa dana pendapatan tetap, dan reksa dana campuran. Studi ini mengamati periode 60 bulan mulai dari tahun 2018 hingga 2022, mengevaluasi kinerja reksa dana melalui indikator-indikator kunci, termasuk rasio pengembalian, Sharpe Ratio, Treynor Ratio, Jensen Alpha, dan Aset di Bawah Pengelolaan (AUM). Temuan menunjukkan perbedaan yang signifikan dalam kinerja reksa dana saham, reksa dana pendapatan tetap, dan reksa dana campuran, dengan reksa dana syariah secara konsisten menunjukkan kinerja rata-rata yang lebih unggul dibandingkan dengan reksa dana konvensional. Studi ini memberikan wawasan berharga dalam literatur portofolio, memberikan informasi penting bagi investor dan profesional keuangan untuk keputusan investasi yang lebih terinformasi.

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INTRODUCTION

Investment is the act of deploying money or capital into a company or project with the aim of gaining profit. One form of investment that is currently attracting significant attention among the public is investment in the capital market. There are various investment instruments in the capital market, one of which is mutual funds. Mutual funds are among the available investment instruments in the capital market. The reason mutual funds are an appealing investment option for the public is that individuals with limited capital can still invest without requiring expertise to assess the risks associated with their investments, and there is no need for constant monitoring of market movements (Manurung, 2008). According to Law No. 8 of 1995 on the Capital Market, mutual funds are vehicles used to pool funds from the investing public for subsequent investment in a portfolio of securities by Investment Managers.

Similar to other investment instruments, mutual funds also come with risks that need to be considered by investors.

In the case of mutual funds, the risks inherent in mutual fund investments can be minimized through diversification conducted by the fund manager, known as the investment manager. The performance of the investment manager in managing the mutual fund portfolio affects the level of risk faced by investors.

Every investment option carries an element of risk for investors because it involves the future, which is inherently uncertain. Nevertheless, every investor aims for maximum profit. However, in practice, significant profits from an investment are usually accompanied by significant risks as well. As time progresses and interest in mutual funds grows in countries with a predominantly Islamic population, Sharia-compliant mutual funds have been introduced on several global stock exchanges. Sharia-compliant mutual funds are introduced to cater to the interests of investors who wish to invest based on Islamic principles. Similar to other forms of Sharia-compliant investments, Sharia-compliant mutual funds operate in accordance with Islamic regulations and principles, both in terms of the contract between investors as capital owners and the investment manager as the representative of the fund users. With the introduction of Sharia-compliant mutual funds, there are now more options available to investors. On the other hand, investors are faced with the dilemma of choosing which mutual fund instrument to invest in. A common question that often arises is whether Sharia-compliant mutual funds are more profitable compared to conventional mutual funds that have been available for a longer time.

Mutual funds come in various types, including equity mutual funds, money market mutual funds, fixed-income mutual funds, and balanced mutual funds (Manurung, 2007). Investors can allocate their capital in accordance with their desired level of return and risk. Investments in mutual funds are highly liquid since mutual fund units can be bought and sold on every working day. Equity mutual funds are often chosen by investors to invest their capital due to their high return potential, although they are also associated with higher risks compared to other types of mutual funds.

Mutual funds are popular among investors because they can invest with small amounts of capital and do not need to spend time monitoring and managing their assets, as everything is professionally handled by the investment manager, commonly known as a fund manager. Investment managers allocate funds differently across various investment instruments based on their calculations to achieve the expected level of return. Investment managers play a vital role in determining whether an investment yields a profit or not.

The rapid development of mutual funds in Indonesia is marked by the increasing number of active mutual fund companies registered with the Financial Services Authority (Otoritas Jasa Keuangan). For comparison, in 2018, there were 130 mutual fund companies, including both Sharia-compliant and conventional mutual funds. Each year, this number has continued to rise, reaching a total of 199 mutual fund companies in 2022.

Alongside the increasing number of mutual fund companies in Indonesia, there has also been a consistent growth in the Net Asset Value (NAV) of mutual funds from year to year. As depicted in the graph below, this indicates an improvement in the performance of mutual funds in Indonesia as measured by their NAV. However, for the purposes of this research, the focus will be on and performance comparison will be made among mutual funds in the capital market, namely equity mutual funds, fixed-income mutual funds, and balanced mutual funds.

Currently, individuals who wish to invest in mutual funds are facilitated by the emergence of various online platforms that offer buying and selling services for mutual funds. Applications such as Bareksa, Bibit, and Tokopedia Reksa Dana have emerged to promote mutual fund investment in Indonesia. With easy registration requirements and a low initial investment, these applications are attracting investors, especially newcomers with limited funds. For instance, individuals can start investing in mutual funds with just IDR 10,000, making it possible for people to invest with just a few clicks on their smartphones.

In selecting a mutual fund, it is essential to conduct a performance assessment of the chosen fund. Mutual fund performance refers to its ability to generate a certain level of return relative to a specific level of risk. One way to measure this is by calculating the ratio that compares the fund's return to its risk level. There are two methods commonly used to measure the performance of a mutual fund: using the fund's return itself and employing a Risk Adjusted Return model. The method of measuring performance solely through the fund's return is referred to as 'raw return.' It assesses the return without considering risk. On the other hand, the Risk Adjusted Return model calculates the return adjusted for the level of risk involved (Hartono, 2010). Some of the methods for Risk Adjusted Return include the Treynor Ratio, Sharpe Ratio, Jensen Alpha, Roy Safety First Ratio, M2, Sortino Ratio, MSR, FPI, and Information Ratio (Hartono, 2010).

This research employs the Risk Adjusted Return model using the Sharpe Ratio, Treynor Ratio, Jensen Alpha, as well as the measurement of Asset Under Management (AUM) growth to assess the mutual fund's performance. The selection of the Risk Adjusted Return model is based on the understanding that measuring mutual fund performance solely based on its return may not yield accurate results. Hence, it is essential to measure both return and risk to obtain more accurate performance results.

The Sharpe Ratio is a method for assessing portfolio performance by measuring the difference between the mutual fund's average performance and the average performance of a risk-free investment. Total risk in this method is reflected in the standard deviation value, encompassing both systematic risk and the risk associated with the mutual fund's asset portfolio.

In the Treynor Ratio, the measurement of mutual fund performance is similar to the Sharpe Ratio, but the key difference lies in comparing only systematic risk or market risk, which is reflected in the beta (β) value. The Jensen Alpha measurement evaluates mutual fund performance by comparing the excess return generated by the mutual fund's portfolio against market performance. Similar to the Treynor Ratio, the Jensen Alpha method considers systematic risk or market risk. The results from these three calculation methods provide a comprehensive overview of the performance of each mutual fund portfolio because they differ in how they assess the mutual fund's performance. In addition, the calculation of AUM growth for the mutual fund is conducted to gauge investor confidence in the mutual fund's performance.

In addition to measuring the performance of conventional mutual funds and Sharia-compliant mutual funds, this research also assesses mutual fund performance against benchmarks. This measurement is conducted to determine whether the mutual fund is categorized as outperforming or underperforming. If a mutual fund's performance exceeds that of the benchmark, it is considered to be in an outperforming condition and may be a suitable investment instrument. Conversely, if a mutual fund's performance is lower than that of the benchmark, it is categorized as underperforming and should be avoided when selecting investment instruments. The benchmarks used to measure the performance of conventional mutual funds are the Composite Stock Price Index (CSPI), while the Jakarta Islamic Index (JII) is used to measure the performance of Sharia-compliant mutual funds.

Several studies have been conducted to determine whether there is a difference in performance between conventional mutual funds and Sharia-compliant mutual funds. According to Dariyus (2012), in his research, conventional mutual funds carry higher risk and exhibit better performance compared to Sharia-compliant mutual funds. However, Arief, Jahja, Jahja et al. (2012), and Ricke Yuliarti (2013) in their research argue that there is no difference in performance between Sharia-compliant and conventional mutual funds as measured by the Sharpe Ratio and Treynor Ratio methods. The study conducted by Putra and Fauzie (2014) did not find any difference in performance between Sharia-compliant and conventional mutual funds when using the Sharpe Ratio and Treynor Ratio methods, but significant performance differences were observed when using the Jensen Alpha calculation.

Since the mutual fund industry in Indonesia experiences fluctuations every year, both in the case of Sharia-compliant and conventional mutual funds, conducting research over longer periods can affect the accuracy of the resulting data. Considering the need for a reasonably sized sample, the researcher has chosen a time frame of 5 years, spanning from 2018 to 2022.

With the continuous increase in the number of mutual fund companies in Indonesia each year, both conventional and Sharia-compliant, as well as the growth in the Net Asset Value (NAV) of these mutual funds, reaching 32 percent in 2017 for conventional mutual funds and an 89 percent increase in 2017 for Sharia-compliant mutual funds, it does not necessarily reflect the true performance of these mutual funds. This is because it doesn't account for various risks, including systematic or market risks and the inherent risks associated with each mutual fund. Additionally, the proliferation of mutual fund applications for online fundraising can potentially lead prospective investors to make investment decisions without proper evaluation.

Based on the aforementioned background, the research questions can be formulated as follows:

1. Is there a difference in the performance between Sharia-compliant equity mutual funds and conventional equity mutual funds?
2. Is there a difference in the performance between Sharia-compliant fixed-income mutual funds and conventional fixed-income mutual funds?
3. Is there a difference in the performance between Sharia-compliant balanced (mixed) mutual funds and conventional balanced (mixed) mutual funds?

METHODS

This study is a quantitative comparative research aimed at comparing the performance of Sharia-compliant mutual funds with conventional mutual funds. In this research, sample selection is done using purposive sampling method, which involves selecting samples based on predetermined criteria. The criteria used in this study are as follows:

1. Mutual fund companies of fixed-income, equity, and balanced types that were registered with the Financial Services Authority (OJK) before the year 2018.
2. Mutual fund companies that remained active during the period from 2018 to 2022.
3. Mutual fund companies that have been in operation for at least 1 year counting backward from January 2018.

This research observes the performance of fixed-income, equity, and balanced mutual funds in both Sharia-compliant and conventional categories. The performance of these mutual funds is evaluated using several indicators, including mutual fund returns, Sharpe Ratio, Treynor Ratio, Jensen Alpha Ratio, and Asset Under Management (AUM).

RESULTS AND DISCUSSION

This study examines the performance of Sharia-compliant and conventional mutual funds over a 60-month period from 2018 to 2022. The following are the results of the analysis and findings in this research.

Table 1. Descriptive Analysis Share Mutual Fund.

	Mean
Conventional Sharpe	-65.220
Sharia Sharpe	22.429
Conventional Treynor	-.011
Sharia Treynor	.026
Conventional Jensen	530.075
Sharia Jensen	1168.810
Conventional AUM	-33.714
Sharia AUM	-51.330
Total average conventional share mutual fund	107.782
Total average sharia share mutual fund	284.983

Table 2. Difference Test ANOVA Share Mutual Fund.

	F	Sig.
Between Groups	99.628	.000
Within Groups		
Total		

The results in Table 2 indicate that there is a difference in the portfolio performance between Sharia-compliant equity mutual funds and conventional equity mutual funds. According to signaling theory, information about Net Asset Value per Unit (NAV/UP) and Assets Under Management (AUM) is provided by mutual fund companies to depict the fund's performance. Research conducted by Putra and Fauzie (2014) showed that there was a difference in the performance between Sharia-compliant equity mutual funds and conventional equity mutual funds in Indonesia during the period of 2011-2013. The findings from the study conducted by Desiana and Isnurhadi (2012) demonstrated differences in the performance between Sharia-compliant equity mutual funds and conventional equity mutual funds in Indonesia from 2005 to 2011, with conventional equity mutual funds outperforming Sharia-compliant ones. A study by Walkshauls and Lobe (2012), encompassing data from 35 countries, also found differences in the performance between Sharia-compliant and conventional equity mutual funds. However, the results of this research indicate that Sharia-compliant equity mutual funds outperformed conventional ones (see Table 1).

Table 3. Descriptive Analysis Fixed-income Mutual Fund.

	Mean
Conventional Sharpe	-6.564
Sharia Sharpe	3.966
Conventional Treynor	-.216
Sharia Treynor	.597
Conventional Jensen	-3420.736
Sharia Jensen	6556.766
Conventional AUM	-25.336
Sharia AUM	-51.316
Total average conventional fixed-income mutual fund	-863.213
Total average sharia fixed-income mutual fund	1627.503

Table 4. Difference Test ANOVA Fixed-income Mutual Fund.

	F	Sig.
Between Groups	101.66	.000
Within Groups		
Total		

The results in Table 4 indicate that there is a difference in the performance between Sharia-compliant fixed-income mutual funds and conventional fixed-income mutual funds. Mutual fund companies periodically provide information such as Net Asset Value per Unit (NAV/UP) and Assets Under Management (AUM) to external parties to avoid information asymmetry between them and to signal the performance of the mutual fund company.

Research conducted by Ratnawati and Khairani (2012), comparing the performance of Sharia-compliant and conventional fixed-income mutual funds in Indonesia measured using the Sharpe and Treynor methods, showed that there was a difference in performance between Sharia-compliant fixed-income mutual funds and conventional fixed-income mutual funds, with Sharia-compliant ones outperforming conventional fixed-income ones. Another study by Lestari (2015), which sampled fixed-income mutual funds in Indonesia from 2011 to 2013 and measured them using the Sharpe method, produced similar results, indicating a difference in performance between Sharia-compliant and conventional fixed-income mutual funds.

Additionally, research by Li et al (2016) on fixed-income mutual funds, both Sharia-compliant and conventional, listed on Bursa Malaysia, revealed a difference in performance between Sharia-compliant and conventional fixed-income mutual funds in Malaysia, with Sharia-compliant fixed-income mutual funds outperforming conventional ones. This research provides evidence that Sharia-compliant fixed-income mutual funds outperform conventional fixed-income mutual funds (see Table 3).

Table 5. Descriptive Analysis Mixed Mutual Fund.

	Mean
Conventional Sharpe	.152
Sharia Sharpe	-.108
Conventional Treynor	.006
Sharia Treynor	-.026
Conventional Jensen	709.400
Sharia Jensen	1892.443
Conventional AUM	-27.416
Sharia AUM	29.046
Total average conventional mixed mutual fund	170.535
Total average sharia fix mixed mutual fund	480.338

Table 6. Difference Test ANOVA Mixed Mutual Fund.

	F	Sig.
Between Groups	2132.8	.000
Within Groups		
Total		

The results in Table 6 indicate that there is a difference in the performance between Sharia-compliant balanced (mixed) mutual funds and conventional balanced (mixed) mutual funds. External parties, particularly investors, use the information provided by mutual fund companies as signals regarding the fund's performance. The findings from a four-year study conducted by Ratnawati and Khairani (2012) spanning from 2006 to 2009 revealed differences in the performance between Sharia-compliant and conventional balanced (mixed) mutual funds in Indonesia. Another study by Putra and Fauzie (2014) in Indonesia during the period of 2011-2013 showed differences in the performance between Sharia-compliant and conventional balanced (mixed) mutual funds using the Sharpe, Treynor, and Jensen methods. Research conducted by Krishna Reddy, Nawazish Mirza, Busrha Naqvi, and Mingli Fu (2017) in the United Kingdom suggested differences in the performance between Sharia-compliant and conventional balanced (mixed) mutual funds using the Sharpe, Treynor, and Jensen methods. These results indicate that Sharia-compliant balanced (mixed) mutual funds outperform conventional ones (see Table 5).

CONCLUSION

Based on the results of this empirical study, it is evident that there are differences in the performance of equity, fixed-income, and balanced mutual funds as measured by indicators such as return, Sharpe Ratio, Treynor Ratio, Jensen Alpha, and AUM. Overall, Sharia-compliant mutual funds exhibit better average performance compared to conventional mutual funds.

SUGGESTION

The empirical findings of this study have unveiled intriguing insights into the performance of equity, fixed-income, and balanced mutual funds, as evaluated through critical indicators like return, Sharpe Ratio, Treynor Ratio, Jensen Alpha, and Assets Under Management (AUM). Collectively, these results indicate that Sharia-compliant mutual funds, on average, outperform their conventional counterparts.

In a practical context, these findings offer investors a compelling proposition. They suggest that investors seeking potentially better-performing investment avenues might consider allocating a portion of their portfolios to Sharia-compliant mutual funds. However, it is crucial to accompany this decision with a comprehensive risk assessment that aligns the investment with individual financial goals and risk tolerance levels. Financial advisors and portfolio managers could also draw insights from these results. They may explore incorporating Sharia-compliant mutual funds into their recommended investment portfolios, leveraging the potential for enhanced diversification and improved risk-adjusted returns.

For future research endeavors, several promising avenues beckon. Researchers could delve deeper into the specific risk factors that underlie the observed performance disparities between Sharia-compliant and conventional mutual funds. Additionally, a more nuanced examination across various market conditions, such as bull markets, bear markets, and economic cycles, could provide valuable insights into the resilience and consistency of Sharia-compliant funds.

Understanding investor behavior and preferences regarding Sharia-compliant and conventional funds could unveil the key determinants of investment choices and their impact on portfolio performance. Furthermore, as Islamic finance regulations continue to evolve, researchers may investigate how changes in Sharia compliance standards or regulations influence the performance and attractiveness of Sharia-compliant mutual funds.

Expanding the research scope to encompass global markets would yield a more comprehensive perspective on the comparative performance of these funds across diverse regions. Long-term analyses spanning multiple economic cycles and market conditions could provide a more robust assessment of sustained performance differences. Moreover, exploring the potential of Sharia-compliant mutual funds to align with ethical and sustainable investing principles, commonly referred to as impact investing, represents an emerging and socially relevant area of interest.

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