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## Role of Framing towards Islamic Business Engagement in Asia: A Case of Pakistan

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### Abstract

*The aim of this study is to examine the phenomenon of framing as a cause of making wrong decisions while investing in Islamic stocks. Framing refers to the bias of people that describes the way they respond to a specific option as per its offer. After collecting primary data through interviews, including open-ended questions from the Pakistani stock market under the subjective or constructivist research paradigm, NVivo it is applied to get word cloud for appropriate analysis. The study finds that there are so many complexities and impurities that blindfold brokers and investors to differentiate between Shariah-compliant versus conventional stocks. This research can be further extended by differentiating between long-term and short-term investment horizons.*

**Key Words:** Behavioral Finance, Islamic Business, Framing, Islamic Finance

### Introduction

Framing refers basically to the bias of people that depicts the way they respond to a particular option depending on its presentation. Cognitive bias regulates the decision maker's tendency to a number of options which are framed to influence their choice. It is primarily a study of how an individual or a group of individuals respond in view of their perception of reality. One of the major characteristics of the framing bias is to channelize and shape the choice of an individual in a certain direction. Framing bias has the power to immediately change the decision as well as the perception of the individual about a specific aspect of reality, as it is an effective tactic used to condition the individual's mind and during the processing of this bias usually an average person does not have enough time to thoroughly consider the arguments from all the sides. This occurs when an individual continuously frames the decisions by using a large number of different scenarios. According to this bias, the decisions of an investor, manager or any other person is based on how his perception is shaped. Framing theory assumes that people will always prefer the most rational or logical choice as well as the most preferable or suitable option according to the situation. Frame dependence is the tendency of the people to succumb to framing while making a decision ([Karam, Pappas, & Tamvakis, 2019](#); [Shefrin & Statman, 2000](#)).

### Framing Effect and Risk Behavior

There is a strong relationship between the framing effects and the behavior of each individual in view of the associated risk involved. For instance, if the individual is a risk-taker than a general presentation of a specific thing would affect the individual in a different way as compared to the individual who is risk-averse. Investors generally diversify their portfolio in order to minimize the probability of associated risk while maximizing the probability of return. When all the available choices have the same level of risk, then people tend to choose those options that show the highest probability of return, and when all the items have the same level of return, people normally choose those alternatives that show the lowest probability of risk. Under normal circumstances, an investor opts for the securities with the highest possibility of return and lowest associated risk ([Markowitz, 1952](#); [Saleh, & Sar, 2019](#)).

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[Dorn and Huberman \(2010\)](#) indicated that risk-averse investors choose a less volatile stock. People usually give preference to those choices that are systematically consistent with their perception, attitudes, decisions, and beliefs. There are so many factors that play a crucial role in strengthening the investor's belief about an entity like, availability of the information, strong commitment, favourable movement of the market and many more. For obtaining a return, a rational investor always tries to figure out perfect information about the market. A decision related to a gain is normally based on the perfectly obtained market information than a decision related to the loss ([Fischer, Jonas, Frey, & Kastenmuller, 2008](#); [Schweikert, 2019](#)). Research shows that the decisions of the investors bring about negative results when they concentrate on maximizing return without taking into account factors that may mitigate or hedge risks, or simply when people think optimistically towards the investment without critical analysis.

Sometimes, people perceive the situation wrongly, which makes them make incorrect decisions. In the case of misunderstood context and misperception, rational thinking can be the main cause of illogical decision making. The way a person interprets an idea, the same way his decision takes shape. Learning about the habits and the behavior of a person is a very authentic technique to avoid or eliminate decision bias. Framing characteristics may describe the way a problem is assessed, solutions designed and perceived linkages taking into account all the possibilities. A rational thinker would avoid losses by minimizing the risk factors. Investors generally develop their profile on the basis of financial stability, personal traits, and knowledge of the market, but some other factors which affect their profile building are; consciousness of their status and surroundings. Generally, the investors who are financially strong would be the risk-takers in terms of aggressively managing a portfolio, but at the same time, they apply rational thinking usually in order to avoid bearing a large loss. On the other hand, the investors who are financially weak would be risk-averse and are less confident about their investment choices and are tentative in their portfolio management which implies that generally, both rational and irrational notions come into play depending upon the level of sensitivity of investors according to their situation and historical rate of success.

### Concerning the Islamic Securities

In the stock market, the Islamic investors invest in halal businesses like textile or automobile business, but if these halal businesses invest/deposit their amount of surplus in an account which is based on interest, then this is not acceptable to them. Most of the businesses in Pakistan and also around the world over magnify profits using financial leverage. Empirical studies show that a large number of companies in Pakistan are highly leveraged since companies like to take the benefit of tax-shield than paying dividends to investors even though a marginal interest rate is prohibited in Islam. Generally, in finance, the cost of equity is said to be higher than the cost of debt because the cost of debt is fixed and there are criteria to ascertain it, but in case of stock, you would pay the dividends according to the earning of a business and the percentage of investment by shareholders which is the prerogative of the Board members.

### Non-Islamic Laws and their Elimination in Pakistan

Majority of the organizations in the world have to rely on non-Islamic rules and laws, which are against the principles of Shariah, i.e., the Islamic way of life or conduct. In a stock market, the majority of corporate investments naturally sway towards a leveraged business. A lot of efforts have been made to eliminate Riba (interest) in Pakistan since its inception but with little success. The efforts for the applicability of Shariah-based laws were started in the 1970s, and during the 1980s Pakistan was a promising country in the world in terms of the application of Shariah law in all type of financial activities.

### Selection among Islamic and Non-Islamic Securities

Since the global financial crisis of 2007, there have been renewed efforts towards reintroducing mature Sharia-compliant financial systems. [Sole \(2007\)](#), in light of a survey result, mentions that the Islamic financial system is evolving rapidly all over the world, especially in western countries.

Investors sometimes find it difficult to assess the merit of an Islamic investment compared to conventional non-Islamic investment. At any situation, the decision of the individuals is generally based upon their level of perception. People with highly rigid perceptions, can't distinguish the options in a competent way ([Grima & Thalassinios, 2020](#); [Lau, Post, & Kagan, 1995](#)).

### Islamic Financial Products

Islamic financial products comprise of musharakah, mudarabah, murabahah, sukuk, qard-e-hasana,

salam, istisnaa, ijarah, diminishing musharakah, bai-muajjal and many more. The major characteristics of the Islamic financial products are the prohibition from the non-Islamic practices, like; a collection of interest, involvement in alcoholic businesses, trading of drug and pork products, involvement in speculation, gambling, the derivative contracts and other cardinal considerations.

### **Problem Statement**

The effect of the framing usually occurs, when people have a large amount of investment, limited time, lack of experience and market knowledge, limited or unrealistic assumptions about market abnormalities and fluctuations, lack of decision-making skills, shoddy allocation skills, and poor appraisal of risk and return, which culminate in optimistic thinking leaning towards framing decisions. Sometimes, the framing effects result in introducing fluctuations in the market. [Brugnach and Ingram \(2012\)](#); [Rehmann-Sutter \(2019\)](#) indicate that people with very weak perception may fear at the time of investment due to framing.

The major issue of the framing occurs when people are confused to make a decision about the selection of securities (Islamic & non-Islamic), and at that situation, anyone with good convincing power, i.e., communication skills can easily trap them to form certain decisions. Usually, people with inconsistent beliefs generally set their benchmark on the basis of framing, which can be detrimental for the entire market ([Clune & O'dwyer, 2020](#); [Wu & Cheng, 2011](#)).

### **Significance of the Study**

With the help of this study, we can easily measure and identify the factors which can be the cause of misperceptions regarding Islamic securities. It can be very helpful for the investor to reduce their level of misconception by using a variety of different techniques and can also be very efficient in a way to eliminate their situation of framing in order to make a sound investment decision in Islamic securities with the higher probability of return and a lower probability of risk. This study tells us about the boundaries of framing and how the market gets destabilized due to it. It would also be very helpful in paving the way for further research examining some other factors relating to the framing effect.

Most importantly, the findings of this research will enable to identify the borders of the human mind that destabilizes the market. This study allows us to identify the factors that lead to making a biased decision toward conventional investment.

### **Purpose**

In order to avoid the unfavorable results, there must be some benchmark provided by the government for the purpose of comparing the positive traits as well as the strengths of a certain vista of investment before and after the framing of a decision because the returns of the stock market also affect the economy as a whole. [Nielsen and Holm \(2007\)](#) diagnose that there must be some evaluation framework under the control of the government in order to compare the options as a learning process for an individual.

On the basis of this study, we can minimize the probability of loss in the stock market by making rational, unbiased, and efficient decisions. This way, we can also eliminate the chances of fraud in the market.

### **Objectives of the Study**

The main objectives of the study are: to explore the investors' biased perceptions and decisions regarding securities and instruments, to determine the nature of the problem, i.e., the selection of conventional investment instead of Islamic, and to scrutinize investor psychology.

### **Literature Review**

One of the major questions for a researcher is how an investor perceives the gain and loss in a market, and what does it mean by the term framing effect? This question is typically based on the prospect theory of [Kahneman and Tversky \(1979\)](#), which shows that people are usually risk-averse when they are winners and risk-seekers when they are losers. There are two main dimensions of a prospect theory, i.e., people seem to be risk-averse when the expected results are favorable in a situation, and they seem to take a risk when the expected results are not favorable, and secondly, people are more conscious of losses than gains based on the experiment of Tversky and Kahneman (1979).

Usually, framing affects the human decisions in long-run, and people are generally more conscious about their losses as compared to gains ([Emami, Welsh, Ramadan, & Davari, 2020](#); [Ganzach & Karsahi, 1995](#)). It is important to identify which types of cognitive biases exist in an individual's mind in order to avoid biased decisions. Framing can act as a major asset in a situation when the communicators at both sides try to satisfy one another and want to change one's attitude, belief, perception, and behavior regarding some specific issue. Framing can be a most powerful tool in a situation when the audiences have a low or no knowledge about the subject. Sometimes, the situation is not favorable, i.e., the feelings, perceptions, ideas, belief, and behavior of the individual regarding a certain object have not been changed over time.

Research illustrates that framing affects the assessment of choices in so many different situations, these involve; financial responsibility ([Baily & Harris, 2019](#); [Bay, 2011](#)), investment in the strategic assets ([Coff & Laverty, 2001](#); [Pan, Li, Chen, & Chen, 2020](#)), economic experimentation ([Elliott & Hayward, 1998](#); [Roelvink, 2020](#)), rational choice ([Tversky & Kahneman, 1986](#); [van Aaken & Kurtz, 2019](#)), complex financial decisions ([Endres, Chowdhury, & Alam, 2008](#); [Stein, Wiedemann, & Bouten, 2019](#)), price negotiation ([Alavi, Habel, Schwenke, & Schmitz, 2020](#); [Ghosh & Boldt, 2006](#)), marketing and sales ([Jäger & Weber, 2020](#); [Tuk, Verlegh, Smidts, & Wigboldus, 2009](#)), and conflicting environment ([Kobayashi, 2019](#); [Pellow, 1999](#)).

Most of the companies that are trading their stocks in the market normally focus on ethical practices for the sake of their reputation as well as to satisfy customers and improve perceptions in the mind of investors. In the market, most of the companies take advantage over the others by performing their Corporate Social Responsibilities (CSR). The CSR may help the company to develop a win-win situation for all stakeholders. [Akbaş, Bozkurt, Oktay, and Yilmazer, 2019](#); [Kreps and Monin \(2011\)](#) highlight that CSR can play a very important role in raising positive perception and eliminating various biases of investors toward the company.

In Pakistan, the banking sector made the transition from the state-owned banks to the specialized banks within 2 decades of their operations. In the 1990s, banks mostly revised their policies in line with the injunctions introduced by the regulatory bodies, and on the basis of such initiatives, most of the private banks and financial institutions made an improvement and enhanced their market worth by satisfying their customers in a well-organized manner. During the period of the 1990s and 2010s, the banks streamlined their decision-making powers in critical areas in order to make a better relationship with the customers for better results. The private banks executed their operational strategies in a very professional manner as compared to the state-owned banks, and the private banks emerged as cost-efficient compared to public sector banks ([Burki & Ahmad, 2010](#)).

The investor makes appraisals in line with their perceptions. Sometimes, from the equally valued alternatives, an investor will choose the one with most striking features. [Colman and Stirk \(1999\)](#) revealed on the basis of their empirical results that people usually make biased decisions when all the alternatives have the same attributes and identical features as well. Motivation can also play a very important role in order to influence the decisions of investors. [Blount and Larrick \(2000\)](#) conclude that the responses of the individuals towards the investments in terms of motivation or de-motivation may influence the future investment decision of the investors.

## Relationship between Islamic & Non-Islamic Securities

Because of the financial globalization in the world, investors in the market can easily diversify their portfolio in order to minimize their risk. Majority of the investors in the market did not want a business with profit and loss sharing, because they usually think such investments entail higher risk. So, they generally prefer the fixed amount of profit, where a very low percentage of risk is involved. The mutual funds that comply with the principles of Shariah, carefully examine all the aspects of a business before investing in it. The managers in the conventional system can make profits through so many ways like speculation, but the managers of the Islamic system make profit only as per the laws of Shariah as closely as possible. [Abdel-Khaleq and Richardson \(2007\)](#) identify that we can expand the share of Islamic securities and make a chain on the basis of self-awareness. According to them, Islamic securities are more beneficial than the conventional securities. Islamic finance usually focuses on wealthy and profitable vistas for investment in order to provide increased benefit to their customers. In Islamic finance, the chances of business growth are higher than conventional finance. Islamic finance gives emphasis to startups compared to the conservative financial system ([Brown, 2003](#); [Ismail, 2019](#)). Giving a chance to a small business, not only the entrepreneur benefits, but it is also in favour of the investor, the market, and the economy as a whole.

## Methodology

This research paper used the qualitative method, which is usually used to discern the perception of a specific individual or a group regarding a specific issue. This research is unique in the sense that no past research details the reasoning towards the framing of investors aiming for conventional investment instead of Islamic investment, i.e., as per Shariah Screening Criteria – SSC - for Investment, as in vogue at Pakistan Stock Exchange (PSX). This study investigates the various factors behind the lack of SSC based investment in PSX. This study offers a wide-ranging clarification of broker's point of view regarding a type (conventional or Islamic) of investment in the stock market of Pakistan.

As far as the philosophical context is concerned, this research is based on the subjective or constructionist paradigm. In this perspective, the data are collected via interviews from experts, as the idea of constructionism is based on the real understanding of a person reflected from his real-life experiences. Throughout the interviews, the fact-finding method enabled respondents to exercise a certain degree of freedom in contrast to having a set of closed-ended questions. To be a constructivist in nature, the research accounts inspects and attempts to depict the cavernous meaning and importance of social conduct and knowledge, through different opinions, conducts and mental states.

Generally, inductive reasoning works from specific explanations to broader outlines. Sometimes, this is called a 'bottom-up' technique. Inductive reasoning commonly introduces specific explanations, and finally facilitate in developing insights.

In this tenacity, present research collected data through primary sources, for which the research principally arranged for *Widespread Interviews* ([Polkinghorne, 2005](#)) concerning conventional and SSC based investment from stock market experts and professionals.

Interviews were semi-structured or very amorphous from time to time according to the condition to facilitate the providers to give a diverse range of responses. Comprehensive interviews were largely used to snatch the widespread information and market experience of individuals with meanings connected with the situations at hand.

Subsequent to the interviews of experts and specialists in the PSX, the research also verified the outcomes of those interviews on *Nvivo* for clear breakdown ([Bazeley & Richards, 2000](#); [Gibbs, 2002](#); [Richards, 1999](#); [Welsh, 2002](#)) and got 'word clouds' for word frequency ([Bringer, Joy, Johnston, & Brackenridge, 2004](#); [Miles, Smith & Firth, 2011](#)) and for the assortment of *Optimum Reasons* ([Bazeley & Jackson, 2013](#); [Henderson & Segal, 2013](#)).

Afterwards, with captivating interviews from the professionals of Pakistan Stock Exchange, this research grabbed the interviews of numerous shareholders too – on the basis of experts' responses, so as to take into account the emotional responses of individuals towards conventional investment instead of Islamic. As no one may usually admit that he is a predisposed personality, however, this is not the case, and *Eleanor MacLean* wrote in her famous book titled 'Between the Lines' that not even a single person is totally cognitive in this world.

As per the requirements of the study, experts and investors from PSX were the populations for this research, and the sample size for this research was 13 experts of the market and multiple investors (informally) of PSX.

## Results and Discussion

Mainly, this research arranged the interviews of 13 experts, but, only 10 responses were sufficient as per the theme of this research. And after that, this research confirmed the responses of experts by taking many informal interviews of investors in PSX.

## Analysis of Responses

An average broker and their agents associated with PSX do have an understanding of the SSC, but the study reveals that they are reluctant to frame SSC compliant stocks in the minds of their customers (investors) due to some practical reasons. Brokers believe that although SSC compliant stocks are theoretically less risky, the earning per share in the short term is higher in case of conventional stocks. This leads us to a dilemma; where on the one hand we have low turnovers in the market along with minimal risk, and on the other hand, we have higher short-term gains and risks as well as lower turnover.

The lower turnover of most of the SSC compliant stocks is very much apparent in the PSX's historical data.

Our brokers believe that there is a positive trend towards halal preferences in choosing the type of stocks in the market. Here we face another dilemma where we observed that even with the halal preference in mind, an average investor is only concerned about the type of business to be halal, i.e., an investor may decline a commercial bank's stocks but he has almost no preference towards the selected stock's financial dealings which in most cases are based on Riba (interest). In addition, other factors for an SSC compliant stock are also ignored in most cases. Here the role of a broker is also important who can frame the SSC stocks and educate about all the factors responsible for making an investment in SSC compliant securities.

So, a highly leveraged company is most likely to attract more investments, and a commercial venture is most likely to deal with banks for a credit line, i.e., Letter of Credits (LCs) which are interest-based debt instruments. An example of such cases is the textile industry, which in general is a Halal business, but most of the growing textile concerns can be seen dealing with commercial banks when their financial statements were examined.

## **Conclusion**

In the 21<sup>st</sup> century, our average broker is also inclined towards Islamic investments, but he somehow cannot differentiate between different SSC factors and make them meaningful enough to influence the preference of his clients. This can be clearly seen from the answers of our respondents who are stock brokers. There is a long list of SSC compliant stocks in PSX, but there are merely few that fall in the category of blue-chips, this also impacts the short-term investors' preferences.

This study makes an important contribution theoretically and practically. First, based on prospect theory, the literature is extended by studying the emerging market, "Pakistan" which is a key player in the international market. The results indicate that brokers have limited knowledge of Shariah securities and much concerned about the losses on the investment. Second, investors in the emerging economy have risk-averse behavior and prefer short term investment over the long run, which indicates that the main concern of investor is to enjoy the short-term gains. Third, the results of our study are important for investor and policymakers as a study has identified the several factors which creates misconception in the mind of investor regarding Shariah securities and also have identified the factors which create destabilization in the market. Based on identified factors, Investors can eliminate the situation, which affects their return in the long and short run. Lastly, the results are indicative of the analysis and understanding of the investment from the perspective of both investors and brokers, through which they can make their investments more viable.

A long-term investment, on the contrary, is more likely to attract SSC compliant stocks, but a further study is required to investigate the latest comparison between long-term and short-term investments in PSX.

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## APPENDIX

### Questions

1. Do you have any idea about Shariah Screening Criteria (SSC)?
2. Do you think SSC is beneficial for the health of stock market?
3. Do you guide your clients (investors) to tilt towards SSC companies?
4. Are you clients concerned about "Halal" and "Haram"? How do they classify them?
5. Do you personally have religious preferences in business? If yes, then why aren't you guiding your investors as well towards SSC compliant stocks?

### Answers

1. Yes, I have idea about it.
2. In my understanding this gives an opportunity to the investor and they can enjoy halal returns. Simultaneously, an equal size SSC company is less risky.
3. No, in my experience the conventional stocks give better returns in the short term. As a broker my first preference is the maximization of my clients returns in short term. On the other hand, had I got more opportunity with clients that are longer term investors, I would prefer the SSC stocks.
4. Most of the clients with "halal" preferences are comparatively more interested in the "type of business" to be halal, which is only one requirement for an SSC stock. In addition to the "type of business" there are multiple variables and areas of concern for classification for an SSC compliant stock, but unfortunately, they stick to the first step only. This led them to avoid mainly "banks", "tobacco" and "insurance" companies in PSX. An average investor has zero percent interest in checking the business's financial deals i.e. they do not value the facts that these non-banking, non-tobacco and non-insurance companies still have interest-based arrangements in their business e.g. Credit Lines, Usance Letter of Credits etc.
5. Yes, I do have preference towards Islam in business. Interestingly there is a long list of SSC compliant stocks that are available to investors in PSX, but apparently none of them is a blue-chip company. My clients as already mentioned are more concerned in the short-term gains so the preference is more towards blue chips.



Figure 1