Socially Responsible Investing Interconnect with the Supply Chain Management in Islamic Finance Model

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Abstract - The concept of Islamic finance is related to Socially Responsible Investment (SRI) by many researchers in different time frames based on the similarities between Islamic finance and the concept of SRI and Supply Chain Management (SCM). SRI has been described by many authors as an investment philosophy that includes non-financial, ethical (e.g., social and environmental) objectives. This paper will shed the light on the interconnection between concepts the Socially Responsible Investment (SRI) and the Islamic Finance Model (IFM). To explain and explore the concept of SRI within Islamic Finance qualitative research technique will be used. The findings show that central values in IFM and SRI could be matched to optimize prospects for Islamic finance to tap the large pool of global SRI funds. Moving forward, greater interplay between these two markets should be explored. Key stakeholders on both ends, including financial experts, research centers, rating agencies, non-governmental organizations and even regulators should pursue ways to consolidate the connectivity of these markets. The Islamic finance focuses mainly on risk sharing, individuals’ rights and responsibilities, property rights and the purity of contracts. Receipt and payment of interest in contracts differentiate Islamic Finance from conventional finance. The other factors such as banned on contracts involving investments in alcohol, tobacco, drugs, pornography, prostitution, gambling, armaments, animal experimentation, genetic engineering, financial exploitation makes it similar to social responsible investment SRI.

Keywords: Socially Responsible Investing (SRI), Islamic Finance Model (IFM), Supply Chain Management, Ethical Investing, Environmental, Social and Governance (ESG).

1. Introduction

Islamic finance is rooted on the values of fairness, equality and ethics that lead to social well-being and happiness. It seeks social justice and economic prosperity of the society and encourages sustainable economic activity. Socially Responsible Investing (SRI) has a similar rationale. SRI is sometimes referred to as “sustainable”, “socially conscious”, “mission,” “green” or “ethical” investing [1]. Islamic finance and SRI have been two of the most rapidly growing areas of finance over the last two decades. During this period, they have each grown at rates that far exceed that of the financial markets as a whole. By some estimates, the total volume of Islamic financial assets has grown by 15-20% a year. Islamic Finance (IF) has grown by 10-15 percent per year over past decade. Currently there are more than 300 Islamic financial institutions (IFI) that spread over 51 countries, and also over 250 mutual funds that comply with Islamic principles. IF is based on the Shariah law which gives guidance and solutions in all sort of financial problems. In Shariah law interest is totally prohibited because it has a lot of bad effects on society as a whole. Responsible investment is an investment strategy which seeks to generate both financial and sustainable value. It consists of a set of investment approaches that integrate environmental, social and governance (ESG) and ethical issues into financial analysis and decision-making. Responsible investment goes by many names - it is variously referred to as socially responsible investing (SRI), ethical investing, sustainable investing, triple-bottom-line investing, green investing - but underlying these differing names is a common theme focused on long-term value creation. Value in this context refers not only to economic value, but to the broader values of fairness, justice, and environmental sustainability. By this definition it is clear that SRI is a type of investment that doesn’t look at the financial side of the investment i.e profit motive but focuses on the ethical side and the benefits of the society as a whole. Since the beginning of the financial crisis, a small number of investment strategies have emerged, boasting growth between the current financial storm and resilience to the near collapse of other investment categories [2]. Two of these strategies include SRI and Islamic finance. These two investment approaches remain relatively unexplored but have at
least two similarities: they both apply extra financial criteria and have sparked interest as development opportunities on the London and Paris financial markets. Although SRI as it is applied in France today has grown into a strategy in its own right, it stems from a desire to transcribe the religious beliefs of both individual and institutional investors into financial practices, like Islamic finance. Islamic finance is expanding rapidly in the world. It is expanding not only in nations with majority Muslim populations, but also in other countries where Muslims are a minority, such as the United Kingdom and Japan. Similarly, countries such as India, the Kyrgyz Republic, and Syria have recently granted, or are considering granting, licenses for Islamic banking activities [3]. In [4] explains the significance of Islamic banking as it is not just considered as a business entity which only fulfill the religious obligations of the Muslim community but more significantly it is viewed as a business which focuses on attracting more and more customers whilst retaining the old ones. Further explaining the scope and limitation of Islamic Banking [5] states in their article that Islamic finance is not just limited to banking instead covers financial instruments, financial markets and all types of financial intermediation. [6] suggest that Islamic Banks are required to understand the perceptions of their customers in terms of quality of their service and other factors of investment to achieve the loyalty of their customers. In order to fulfill the Shariah objective of promoting the welfare of society, Islamic financial institutions are expected to consciously align their decisions and actions so that these are ‘socially responsible’ (Sairally). An integral policy approach towards corporate social responsibility (CSR) would constitute assigning explicit social objectives to IFIs over and above their economic, legal, Shariah, and ethical responsibilities. Alternatively, the task of undertaking socially oriented projects could be argued as being a discretionary responsibility of IFIs, with the objective of CSR being sought merely as a peripheral practice. Recent debates on the evolution of the practice of Islamic finance highlighted the profit and economic efficiency motives of IFIs rather than a concern for socio-economic equity and welfare. Islamic finance is often related to social responsible investment or ethical investment by many authors and researchers in different time frame [7]. The similarity between the two is mainly because of the few principles that the investment involved is not just for the profit motive instead involve an investment which is considered best for the whole community in terms of social, religious and ethical perspectives and also investment which involve the production of unethical goods for example alcohol, tobacco, armaments is considered immoral. [8, 9] Socially Responsible Investing (SRI) is a well-designed economic discipline which offers investors with strict moral standards to invest their money without having to compromise their core beliefs and principles. [10] Further he concluded that Socially Responsible Investing enables individual to invest without compromising his/her moral standards, and provides an effective management of corporate behavior and free-market forces thus becoming an important sector of capital markets today.

2. Methodology
To explain and explore the concept of SRI within Islamic Finance qualitative research technique will be used. As the nature of the research being explanatory and exploratory the qualitative research method would be very beneficial. By definition, qualitative research is an unstructured, exploratory research methodology based on small samples which provides insights and understanding of the problem setting. The qualitative research approach is use as this approach allows a more depth and greater richness of the Islamic finance principles and the concept of SRI. In qualitative research method it is very easy to get in-depth and conceptual ideas from different individuals and members of the staff in different banks. In qualitative research it is easy to explore topic in detail and more depth than quantitative research methods which is very helpful in drawing conclusions later in the research [11]. The methodology adopted in this research would be qualitative including

- case study approach
- Direct observation

Because it gives the detailed insight into the theme of the study and explains it in depth. Yin defines case study in the research as the method of case study analysis in the research refers to a group of methods which emphasize on qualitative analysis. Based on several different types of case study the explanatory case study
will be used in order to explain and evaluate the
definition and principles of Islamic banking and
the different ways of Islamic financing. It will
also relate the concept of SRI in Islamic
financing and how they evaluated. In depth
interviews with the members of the staff in
different banks will help in understanding the
Islamic finance principles and how they are
implemented in the banks to perform different
operations. The concept of SRI will be
investigated and discussed side by side in this
research. The principles of Islamic finance and
its characteristics compared with SRI will be
discussed in an explanatory way in this research
for the proper understanding of the Islamic
finance policies and principles in today’s world
and also the concept of SRI in Islamic finance
model will be evaluated.

3. Results and discussion
3.1. Islamic finance model
Islamic banking and Finance is a growing
phenomenon, which came into existence to satisfy the
financial needs of 1.6 billion Muslims around the
world and non-Muslims alike. Islamic banking and
Finance refers to a system of banking or banking
activity which is consistent with Islamic law (Sharia)
principles and guided by Islamic economics. In
particular, Islamic law prohibits usury, the collection
and payment of interest, also commonly called riba
(usury). Generally under Sharia Islamic law, making
money from money, such as charging interest, is
usury and therefore not permitted. Wealth should be
generated only through legitimate trade and
investment in assets. But investment in companies
involved with alcohol, gambling, tobacco and
pornography is strictly prohibited. The Islamic
financial model works on the basis of risk sharing [7].
According to current estimates, the Islamic finance
industry is now worth around US $500 billion, with
around $250 billion of that in banks and the other
$250 billion invested in various funds. The Islamic
economic principles of sharing risks and rewards, and
participating in the wealth creation activity via equity
rather than debt has provided a solution that
eliminates debt in its existing interest based form
while continuing to promote entrepreneurship and
creativity in the economic cycle. As due to Islamic
finance’s ethical principles and the recent growth of
ethical investments shows how large the market could
be, Islamic finance will appeal to Muslims and non-
Muslims alike. Islamic Finance now seems to be a
reality and is on its way to be institutionalized, albeit
at different levels in different countries, and the
Western world is also now selectively and cautiously
positioning to invest in this system. There are
promising signs that Islamic Finance trends are
sustainable. It is entrenched in a well conceptualized
Islamic economic system whose mysteries are being
unfolded with renewed academic interest in the
subject. While undeniably faith driven, the Islamic
finance system has great potential to meet the
financial gaps and requirements of development and
society at large and as such its demand would be
robust going beyond religious grounds. Islamic
financial products are available in the UK from a
number of high Street banks which offer current
accounts and mortgages tailored for Muslims. The
UK is home to the first wholly Sharia compliant retail
bank in the West, Islamic Bank of Britain, which was
authorized by the Financial Services Authority (FSA)
in 2004. In addition, London has become an
important financial centre with major international
firms and the Middle East’s biggest traditional banks
offering Islamic products. The rapid development
of the Islamic finance and Islamic banking industry, not
only in the Middle East but across the globe, has
produced new Shariah compliant products and
structures, which have in turn resulted in an estimated
growth in demand for Islamic financial services of
15% - 20% per annum (www.hm-treasury.gov.uk).
This trend has increased the number of Islamic
banking and financial institutions, and a wider variety
of Islamic financial services products and instruments
ranging from basic deposit products, investment
accounts, equity funds, capital-protected funds,
Islamic bonds, Islamic hedge funds and Islamic swap
equivalents. The Islamic financial system is viewed
by Muslims as an alternative to the existing interest-
based financial system and institutions and by non-
Muslims as a healthy development that adds a variety
rendering financial system as highly competitive [12].
Given the UK’s position as one of the leading
international financial centres, it is no surprise that
part of this growth has taken place in London which
is now seen as an emerging global ‘hub’ for Islamic
finance. At the same time, the government has wanted to give the UK’s relatively large Muslim community (around 3% of the population) access to financial services consistent with their religious beliefs. There are thought to be about 1.8 million Muslims in the UK or 3 per cent of the population. 50% of these are estimated to reside in the London area. There are also estimated to be about half a million regular Muslim visitors to the UK and approximately 12 million Muslims living in the EU, principally in France & Germany. A rough estimate suggests that the UK’s Muslims have, in total, savings of approximately £1 billion. And in addition to the permanently resident population there are of course many Muslims who visit the UK. Last year over half a million Muslims visited from the Middle East and Pakistan, spending nearly £600 million in our economy. So the potential market, whether for savings products, borrowing, or simply transaction-related finance is very large. Islamic financial products are available in the UK from a number of High Street banks which offer current accounts and mortgages tailored for Muslims. The UK is home to the first wholly Sharia compliant retail bank in the West, Islamic Bank of Britain, which was authorized by the FSA in 2004. The FSA has also authorized the European Islamic Investment Bank which is the first such investment bank. In addition, London has become an important financial centre with major international firms and the Middle East’s biggest traditional banks offering Islamic products. The main centres for Islamic banking still tend to be concentrated in the Middle East and Gulf region. Assets controlled by Islamic banks at the global level are estimated to be $200-500bn and are growing at a pace of 10-15% per year. Islamic Finance now seems to be a reality and is on its way to be institutionalized, albeit at different levels in different countries, and the Western world is also now selectively and cautiously positioning to invest in this system. There are promising signs that Islamic Finance trends are sustainable. It is entrenched in a well conceptualized Islamic economic system whose mysteries are being unfolded with renewed academic interest in the subject. While undeniably faith driven, the Islamic finance system has great potential to meet the financial gaps and requirements of development and society at large and as such its demand would be robust going beyond religious grounds. Distinct from Islamic countries, is the interest of few global financial centers such as London that now provide policy and tax incentives to promote Islamic finance industry to attract funds from high net worth clients. Same motivation seems to have driven global banks such as HSBC, Standard Chartered, Deutsche Bank, Citibank etc. to set up special hubs to structure Islamic finance products. There are several different methods of Islamic Financing. According to the research of [13] Islamic Scholars have approved certain basic types of contracts as being complied with the principles of Islamic Finance which can be used by Islamic Banks to attract funds and provide financing in an Islamic way (Table 1).

<table>
<thead>
<tr>
<th>Method name</th>
<th>Description</th>
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<tbody>
<tr>
<td><strong>Mudarabah (Profit Sharing)</strong></td>
<td>Mudarabah is a form of partnership in which the capital required for the project is provided by one partner (rab-ul-maal) while the other party (mudarib) manages the investment by using his expertise. Profits from the investment are distributed according to a fixed pre-determined ratio.</td>
</tr>
<tr>
<td><strong>Musharakah (Partnership Financing)</strong></td>
<td>In Islamic finance basic principles Musharakah is described as it involves a partnership among both parties who provide the capital towards the financing of a new or established project. Management is taken by one or both parties and profit are distributed on a pre agreed ratio allowing managerial skills to be remunerated and losses are shared on the basis of equity participation.</td>
</tr>
<tr>
<td><strong>Murabahah (Cost Plus Financing)</strong></td>
<td>Murabahah is defined by [13] that it involves the bank who agrees to buy an asset or goods from a third party at the request of its client and then resell the goods to its client with a mark-up profit. The client purchases the goods either against immediate payment or for a deferred payment. Murabahah is the most popular method of Islamic Financing.</td>
</tr>
<tr>
<td><strong>Istisnaa (Commissioned manufacture)</strong></td>
<td>It is the new concept in Islamic Finance which involves future structuring possibilities of trading and financing. One party buys the goods and the other party is responsible for manufacturing it according to agreed ratios. This method is often used by Islamic banks to finance construction and manufacturing projects.</td>
</tr>
<tr>
<td><strong>Salam Advance Purchase</strong></td>
<td>Salam is defined as a purchase of specified goods for full forward payment. This contract is regularly used for financing agricultural production.</td>
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3.2. The Islamic economic model

The beliefs of Islam encompass all aspects of a Muslim’s life, determining the articles of their faith and the relationships between man and God, and between human beings. They also determine their moral and behavioral code, as well as giving the framework for their daily activities. Islamic law or Sharia – as revealed in and derived from the Qur’an and Sunnah (the sayings and practices of the Prophet Muhammad) – governs all economic and social activities and undertakings of Muslims.

The Islamic economic model has been developed over time, based on the rulings of Sharia on commercial and financial transactions. The Islamic financial framework, as seen today, stems from the principles developed within this model (Table 2).

<table>
<thead>
<tr>
<th>Islamic economic model includes</th>
<th>Characteristic</th>
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<tr>
<td>Fairness.</td>
<td>This is reflected in the requirement that everyone involved in a transaction makes informed decisions and is not misled or cheated. On a macro-economic level, the Islamic model aims at social justice and the economic prosperity of the whole community; for example, specific Sharia rulings seek to reduce concentration of wealth in a few hands, which may be detrimental to society. (Institute of Islamic Banking and Insurance)</td>
</tr>
<tr>
<td>Promotes the right of individuals to pursue personal economic wellbeing</td>
<td>makes a clear distinction between what commercial activities are allowed and what are forbidden. For example, transactions involving alcohol, pork related products, armaments, gambling and other socially detrimental activities.</td>
</tr>
<tr>
<td>The strict and explicit prohibition of Riba</td>
<td>Sharia scholars consider exchanging interest payments within the conventional banking system as a type of Riba. Modern Islamic banking has developed mechanisms to allow interest income to be replaced with cash flows from productive sources, such as returns from wealth generating investment activities and operations. These include profits from trading in (real) assets and cash flows from the transfer of usufruct (the right to use an asset), for example, rental income. (Islamic Banking &amp; Finance in the Kingdom of Bahrain).</td>
</tr>
<tr>
<td>risk and profit-sharing (and loss-bearing) philosophy</td>
<td>Islamic transactions are similar to, if not the same as, equity-based transactions in rewarding performance. However, Sharia requirements go further to ensure that in distributing profits more emphasis is placed on reward for effort rather than reward for merely owning capital.[12].</td>
</tr>
<tr>
<td>The Islamic Law of Contracts plays a pivotal role within the Islamic financial system</td>
<td>Islamic commercial jurisprudence consists of principles and rules that must be observed for transactions to be acceptable in Islam; and the Islamic Law of Contracts is at the heart of this. One important principle is contractual certainty</td>
</tr>
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</table>

Under this body of law, uncertainties or ambiguities that can lead to disputes may render a contract void under Sharia. While some of these principles and rules are based on clear and explicit rulings of Sharia, others are derived from Sharia scholars’ interpretations and understanding of the law, known as Fiqh, as set out in the Qur’an. These interpretations can and do differ between Sharia scholars. Certain contractual terms deemed to be valid under Sharia by the scholars of one school of Fiqh may not be acceptable to scholars from another school. This has had significant implications for the development of Islamic finance. In summary, Under Islamic principles, Sharia law defines the framework within which Muslims should conduct their lives. The overarching principle of Islamic finance and banking products is that all forms of interest are forbidden. The Islamic financial model works on the basis of risk sharing. The customer and the bank share the risk of any investment on agreed terms, and divide any profits or losses between them. In addition, investments should only support practices that are not forbidden – trades in alcohol, betting and pornography are not allowed. Moreover, an Islamic banking institution is not permitted to lend to other banks at interest. Ever since the demise of the great Muslim empires, and the subsequent dominance of western ideas and policies, Muslims have continually strived to resurrect the tradition of applying Islamic principles to contemporary issues. Of all the effort being exerted, perhaps no attempt has been more controversial than the Islamic Finance experiment. Global Islamic Finance is a market growing at between 10-15% per annum with assets in excess of $1 Trillion. Many mainstream western financial institutions have incorporated departments dedicated to the research and development of Islamic Finance, and many stand-alone ‘Islamic Banks’ have sprung up over the last few years. These changes are occurring both in Muslim and in western countries, and are driven by a global trend amongst Muslims to become more observant of their faith. In the UK the Government is actively trying to establish the City of London as the global centre of Islamic financial activity, and the Bank of England was the first central bank internationally to abolish ‘Double
Stamp Duty’ on Islamic home purchase plans. Notwithstanding these developments, critics have accused the Islamic Finance industry of being little more than a talking-shop which at best is contributing little towards progressing the real aims of Islamic Finance and at worst is engaged in outright deception.

3.3. Fundamental Rules of Islamic Investment

There are three fundamental sets of rules which dictate what a believer can or cannot engage in with respect to business. The first rule is to avoid the giving or taking of interest at all costs, whilst the second is to avoid investment in ventures which are involved in unethical concerns eg Breweries, Pornographic outlets, Tobacconists etc. The third concerns the nature of the contract between the parties. I will take a look at all three.

I Ban on Interest – Allah (SWT) has placed a bilateral ban on Interest. Neither can the borrower pay it, nor can the lender receive it. Countless explanations have been offered from various people, Muslims and non-Muslims alike as to why Interest represents an extraordinary evil. Nonetheless, the following is a small list of some of the reasons exhibiting the problems with Interest. Readers are advised to read the relevant guides for further information.

A. Rich just get Richer – A 1998 development report by the United Nations concluded that the richest 225 in the world own more wealth than the poorest 2.5 Billion. Analysts have accused Interest as being the primary driver behind this shocking disparity.

B. Banks are too powerful – The interest economy is distinguished by one institution which has almost unbridled control over the production and control capital. This institution of course is the Bank. Banks these days not only create most of society’s money supply (the Government creates only 7%), but also utilise a concept known as ‘fractional reserve’ which allows the Banks to artificially create and lend to the public up to 49 times what is in the vaults. Former US President Thomas Jefferson stated that ‘Banking Institutions were more dangerous than standing armies’, whilst Lord Josiah Stamp (former director of the Bank of England) warned the British public that ‘If you want to be slaves of the Bankers, and pay the costs of your own slavery, then let the Banks create money’.

C. Indebting the 3rd World – Jesse Jackson, the American preacher come activist once famously said ‘they no longer use bullets and ropes, they use the IMF and the World Bank’. The wealth of the developing world has been plundered resulting in future generations being plagued with debt owed to Western banks and the World Bank/IMF. Susan George, the highly respected economist estimated that the debtor nations stared the 1990’s 61% deeper in debt than the 1980’s.

II Restrictions on Investment in Unethical Areas – Alongside the bilateral ban on interest, the other key parameter around which an investment strategy must be structured is the ethical nature of the investment. Islam totally accepts profitability as the prime business motive, but even this cannot be at society’s expense. Recent statistics compiled by police forces in the UK show that between 60-70% of weekend crime is fuelled by Alcohol. Naturally then, fuelling the growth of the Alcohol Industry by Investing in Pubs or Alcohol Distillers is not in society’s best interests. In addition, with a clear proven link between tobacco and cancer, cigarette manufacturers are also impermissible to invest in. The following is a concise list of the prohibitions. For a full list of all the prohibitions, please consult the chapter on Islamic Investment in Mufti Taqi Usmani’s book, The principles of Islamic Finance’.

- **Alcohol** - Alcohol brewers and Distillers, and any other firm involved exclusively in the production or sale Alcohol.
- **Banks** – Banks and other Banking Institutions involved in Interest. (Insurance firms are usually also included in this)
- **Gambling** – Casinos and all other Gambling outlets.
- **Pornography** – Manufacturers and sellers of pornographic material including any firms involved in pornographic activity.
- **Tobacco** – Manufacturers and sellers of tobacco and tobacco related products.
- **Shariah Reservations** – Any business whose activities the Shariah Board feels are prejudicial to the Interests of Islam or Muslims.
- **Gearing** – Any business which has a debt to equity ratio in excess of 33%.

The advantage of Islamic finance is the large investments by financial industry across main hubs in GCC/Middle East/South East and South Asia, within countries and growing foreign ownership and joint ventures across borders, in infrastructure development in this industry through:
(i) issuance of holistic banking licenses or opening of special windows or creation of hubs/dedicated Islamic asset management funds, private equity funds and hedge funds etc. accompanied by Dow Islamic Index to which all such transactions subscribe too are large;
(ii) development of Shariah knowledge and understanding and engagement of Shariah advisors and scholars which together are providing required consensus, guidance and legitimacy to Islamic industry, products and structures; and
(iii) development of Islamic standard setters such as the Islamic Financial Supervisory Board and Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and International Islamic Financial Market (IIFM) etc. by the central banks as well as a range of Multilateral Development Agencies including the Islamic Bank Development. The combined efforts have helped develop and initiate implementation of Islamic prudential regulatory, accounting and auditing frameworks, and inspection and supervision of financial institutions;

All these regional and global efforts are serious long term initiatives which are irreversible though maintaining and building momentum on these fronts would be critical to address the questions of sustainability and challenges facing this industry.

III Uncertainty (Gharar) & Gambling (Maysir) - Just like any transaction requires a legally valid contract in order for it be to acceptable under English Law, the Shariah also requires all transactions to concur with Islamic Contract Law. There are certain aspects within Islamic contract Law which are not to be found in Western Law. Chief amongst is Gharar, which has the ability to effectively render a contract null and void. Gharar represents ‘significant uncertainty’ in the existence, ownership and availability of the subject matter as well as ambiguity pertaining to price and delivery. It’s quite a wideranging definition and hits at the heart of the Shariah’s desire to avoid disputes between contractors. Any current uncertainty which may lead to a dispute in the future automatically falls in the domain of Gharar. In addition to Gharar per se, there also other contractual rules such safaqat-fi-safaqat (rolling 2 contracts into one) which need to be avoided. Elements such as Gambling (Maysir), Betting (Rihan) & Qimar (Games of chance) cannot figure in a legitimate contract in the eyes of the Shariah.

Now that we understand the three main guiding principles, we are in a position to construct a Shariah-compliant portfolio.

1. Creating A Portfolio – Low, Medium & High-Risk.

The above discussion has emphasised the importance of any investment being undertaken in a Shariah-compliant manner. Shariah compliance must be considered alongside other parameters which would govern any investment. Prime amongst these other factors (such as charging structure, amount to be invested, access requirements, timeframe for investment, financial strength of companies being invested in and so on) is the risk profile of the client. Without a careful consideration of a client’s profile, even the most shariah-compliant portfolio will not effectively address a client’s concerns. Risk is inextricably linked to return. The beauty of varying risk-based investment is that they assist in adding valuable diversification to the portfolio. Assets held in low-risk investments will rarely breach the 5% return level. However, they are very unlikely to generate a loss. Conversely assets held in high-risk investments are likely to easily exceed the 10% return mark in any given year, however they could just as easily fall by that amount. Hence, a diversified approach of various assets classes is comparable to putting one’s eggs in different baskets. Most clients will usually obey the above logic and require a portfolio incorporating all elements of the risk spectrum.

2. Low-Risk

Low Risk Shariah-compliant investments can be categorised as follows;

- Islamic Bank Accounts
- Direct property Investment
- Property Shares
- Property Investment Bonds

Islamic Bank Accounts

These can be operated either by a home-grown Islamic Bank or by a non-Muslim Bank with an Islamic window. In the UK, the Islamic Bank of Britain and HSBC Amanah both offer the Islamic Bank Account service. Naturally, no interest is paid on these Bank accounts and instead they accrue returns via profit. Profit is made via the concept of commodity Murabaha, which is explained below. IBB currently pay up to 4% per annum whereas HSBC Amanah only pays a return on large corporate deals. At a retail level no return is paid to clients. It is however fair to point our that HSBC will ensure that funds in their Islamic Bank accounts are segregated from the main operations and will not be used in any interest based activity. There are, perhaps, five main reasons:
3.4. Global expansion of Islamic finance

The first experience of Islamic banking in modern times seems to have been in the Middle East in the 1960s. (Islamic Financial Services Board) It is, therefore, a relatively young industry and nobody really knows the exact size today. But from a small base, the market size is now estimated to be about £250bn globally (www.hm-treasury.gov.uk/newsroom ). There are also around 300 financial institutions around the world offering Islamic products (www.imf.org/external/pubs/ft/fandd/2005) Not surprisingly, the growth of the industry in the Middle East and South East Asia has influenced the UK market [13]. Initially, products created in the traditional markets were brought into the UK by some of the key industry players, but now products developed in London are being marketed in other countries, for example in the Middle East.

3.5. Markets and skills base

London is well placed to take advantage of these trends. It has a tradition going back to the seventeenth century, if not before, of being willing to innovate and respond flexibly to new ideas. London has deep and liquid markets and the exchanges are among the most frequently used venues for listing and trading financial instruments globally. The London Metal Exchange has already been mentioned. The UK financial services industry has a proven record of developing and delivering new products and a large pool of legal, accounting and financial engineering skills on which to draw. Several of these firms have now established or expanded offices in other Islamic centres. English law is already the preferred legal jurisdiction for many Islamic finance transactions.

3.6. Islamic windows:

Several major international institutions such as Citi, Deutsche, and HSBC have had a presence in the Middle East and South East Asia for several years. As a result, they have developed considerable knowledge and experience of local markets, including Islamic ones. To accommodate the new and growing demand for Islamic products, they have established business lines known as ‘Islamic windows’, some of which are based in the UK and others in the Middle East and South East Asia. These windows have contributed significantly to the development of Islamic finance because of the institutions’ global experience in product development and their access to far greater resources than those available to local institutions in the Middle East and South East Asia.

3.7. Excess liquidity in the Middle East

The sharp rise in oil prices since 2003 has resulted in huge liquidity surpluses and a surge in demand for Islamic as well as conventional assets in the countries of the Gulf region. The capacity of the local financial markets has not, however, been able to develop at the same speed. As a result, demand for assets has considerably outpaced supply and Middle Eastern investors have been looking, in large numbers, for suitable alternatives. This demand was quickly identified by Islamic and conventional institutions that now provide a channel through which assets within other markets are sold to these investors, often by way of Sharia-compliant transactions. Financial Times,[14] This has been particularly notable in the UK. A recent example is the acquisition of Aston Martin by two Kuwaiti financial institutions, using Sharia-compliant financing.

3.8. Public policy and taxation

Since the early 2000s the government, for reasons of wider public policy, has introduced a series of tax and legislative changes specifically designed to remove obstacles to the development of Islamic finance. The first significant change came in the Finance Act 2003 which introduced relief to prevent multiple payment of Stamp Duty Land Tax on Islamic mortgages (see below). (The Finance Acts) The Finance Acts 2005 and 2006 contained further measures aimed at putting other Islamic products on the same tax footing as their conventional counterparts. Most recently, the Finance Act 2007 clarified the tax framework further, in the case of Sukuk (plural of Sak, are trust certificates representing individual ownership of the underlying assets). Sukuk are comparable to bonds. This is very much work in progress.

4. Socially responsible investment

4.1. Background history of Socially Responsible Investing (SRI):

According to [in 2] report, it is widely accepted that the current SRI movement derives from investment approaches based on Christian beliefs, by they Catholic or Protestant. Religious groups naturally wanted to make investments that were consistent with their principles. Sector based exclusions and active ownership predominated early on in SRI strategy. Christian groups also founded other SRI approaches, even if other larger institutional investors, in terms of assets under
management, have since taken over. Sector-based exclusions in 1760, John Wesley, founder of the Methodist Church, was a firm believer in the ties between ethics and the use of money. He argued that investors should not act as owners but as stewards or custodians of property and should not create wealth while harming one’s neighbor. He was therefore one of the first opponents to slavery, following the example of the Quakers, the members of the Religious Society of Friends. As early as the late 19th century, the Quakers aligned extra-financial considerations with their investment choices by applying a sector-based exclusion strategy in line with their religious convictions.

4.1.1. In the United States

The Pioneer Fund, the first socially responsible fund, was launched in 1928 by the U.S. Federal Council of Churches. Its investment policy excluded businesses involved in alcohol, tobacco and pornography, sectors still on the blacklist of so-called ethical SRI funds. Investment in the fund was, however, restricted. It was not until 1971 that the first ethical mutual fund, the Pax World Fund, was publicly available to individual investors. In addition to the exclusion of traditional sin stocks such as tobacco and gambling, the basis for this fund was to protest investments in companies that could profit from the Vietnam War, hence the name, pax, meaning peace in Latin.

4.1.2. In Europe

The first ethical investment vehicle in Europe was launched by the Swedish Temperance Society, as a fund called Ansvar. Like the Pioneer Fund, investment in the fund was restricted to advocates of the movement. In the United Kingdom, the Anglican Church began practicing ethical exclusions as part of its investment rules in 1948, when the Church Commissioners were formed. A similar body was initiated by the Methodist Church in 1960. In France, the first two ethical funds were aimed at Christian investors. In 1983, the investment firm Meeschaert and the not-for-profit organisation Ethique et Investissement (Ethics and Investment), founded by a group of nuns who were the general treasurers of their congregation, launched the fund Nouvelle Stratégie 50, which excluded the tobacco, weapons, alcohol, pornography and gambling sectors. Geared towards a Christian client base, the investment firm applies these exclusion criteria to its other SRI funds. The second historic fund is Hymnos, launched by Crédit Lyonnais in 1989 to meet the specific requirements of religious congregations. An ethical committee comprising of twenty religious and non-religious figures meet on a quarterly basis to review the ethical criteria to be applied in the sector-based assessment of companies and to ensure that securities are screened against these criteria. Selected companies must be involved in businesses that comply with Christian and humanist ethics. Socially Responsible Investing (SRI) has been described by many authors as an investment philosophy that includes non-financial, ethical (e.g., social and environmental) objectives [15]. In the conference of Islamic Economics and Finance Alam states that the performance of SRI in particular in Islamic Finance has been a subject of interest among many scholars and has resulted in many academic scholars analyzing it in different aspects and time settings. In 2008 the European study by EUSIF (The European Social Investment Forum) states that “SRI, a generic term covering ethical investments, responsible investments, sustainable investments, and any other investment process that combines investors financial objectives with their concerns about environmental, social and governance (ESG) issues.” The North American Social Investment Forum states “SRI considers both the investor's financial needs and an investment’s impact on society. SRI investors encourage corporations to improve their practices on environmental, social, and governance issues.” According to [17] the main idea of these definitions is that SRI is a type of investment that does not look at only financial performance but takes into consideration the impact of underlying business activities of the investment on society. Sairally [18] in his research states that Socially Responsible investment (SRI) has been compared with the concept of Islamic finance. Based on similar core values – such as individual responsibility, commitment to the social interest, promotion of human welfare, care for the environment, concern for economic and social justice, and responsibility to avoid harmful and unproductive activities – Islamic finance has been promoted as a socially responsible paradigm rooted on religious doctrine. In the Islamic Finance Expert [16] many industry analysts viewed SRI as the key to sustainability, which is attractive to investors. Commenting on the product and business opportunities than arise from the packaging of SRI with Sharia principles, Barkawi said in the 9th International Islamic finance Forum [14], that companies that are both sustainability leaders and compliant with Sharia principles over the last couple of years actually perform better. Introducing the special session on ‘Islamic Finance and Socially Responsible Investing’, conference chairman Kavilah Chawla, principal with Nur Advisors
of the USA, told delegates that Islamic finance has a moral obligation to include into economic development and globalisation those at the lower end of the income scale. Alex Barkawi, managing director of Switzerland-based SAM Indexes, told delegates that the three key criteria of SRI are economic, environmental and social. The funds available in SRI are involved in the development of communities. This type of investment usually takes the form of community banks, community credit unions or microenterprise lenders [19]. Addressing delegates Guler Manisali Darman, principal of GMD Advisors, Turkey, said: ‘We all know that Islamic finance is an ethical and equitable enterprise, we all know that it’s young and growing vigorously, we all know that it is Sharia compliant, but in terms of social responsibility we have to admit that more is expected, in addition to the rules, [16].

5. Conclusion

Central values in Islamic finance and SRI could be matched to optimize prospects for Islamic finance to tap the large pool of global SRI funds. Moving forward, greater interplay between these two markets should be explored. Key stakeholders on both ends, including financial experts, research centres, rating agencies, non-governmental organizations and even regulators should pursue ways to consolidate the connectivity of these markets. Islamic finance being a new concept need a lot of attention and explanation in today’s world. Different authors and researchers have explain this concept in different aspects and timings. This research is about the Islamic financing and social responsible investment and how these two can be interrelated. Based on the literature review Islamic finance is the method of financing in which interest is totally prohibited because of negative impacts on human beings and society as a whole. Islamic finance focuses mainly on risk sharing, individuals’ rights and responsibilities, property rights and the purity of contracts. Receipt and payment of interest in contracts differentiate Islamic Finance from conventional finance. The other factors such as banned on contracts involving investments in alcohol, tobacco, drugs, pornography, prostitution, gambling, armaments, animal experimentation, genetic engineering, financial exploitation makes it similar to social responsible investment SRI. Investments in Islamic finance and social responsible investment are based on the principle that investment involved is not just for the sake of profit but it involve an investment which is considered best for the whole community in terms of social, religious and ethical side. This paper explains the concept of Islamic finance and social responsible investment. Further to understand the method of Islamic finance the different methods and their explanation is given in the literature review. However the different research questions and the research method adopted to find the answers provide the deep insight into this topic and provide critical evaluation among the two in the research.

References


