The Islamic Social Finance & Investment Imperative

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The rapid growth of global Islamic wealth and asset management has contributed to the establishment of a niche market based on the Islamic finance paradigm of interest-free, transparent, profit and loss sharing and mutually beneficial contracts. However, Islamic wealth and finance has been criticized for converging into conventional practices rather than its core principles of socio-economic empowerment and justice. The capitalist attributes of profit maximization without the ethical and moral boundaries has pervaded this industry that was supposed to espouse the ethical and socio-economic tenets as its value propositions for its future growth and survival. There is an emerging trend of Islamic social finance and investments imperative in the industry to meet the growing global demand for ethical investments.

We are in a new era in Islamic finance, driven by a global appetite for socially responsible and ethical investment created by the hype from the UNPRI and the more recent UNSDG 17. Reports by the World Economic Forum in 2011 and ‘SRIs & the case for Islamic Investment Funds’ in 2015, indicate that a paradigm shift in investment mindset is observable through divestments from fossil fuels to the funding of ethical, sustainable and good governance corporations. Between 2012 and 2014 alone, responsible investment grew by 76% in the United States, to approximately USD6.57 trillion or ~20% of all assets under management. Doing ‘good for the society’ seems to be the new investment mantra, where community investment is also on the increase (54% growth observed between 2010 and 2014 in the US). Rising income inequality and mass migrations due to natural disasters, war and political crises have increased substantially over the last decade and the need to do good for the society. Therefore there is a need for sustainable measures (i.e. investing responsibly in real economic activities that are sustainable and socially responsible) to provide a more balanced socio-economic balance to mitigate this growing socio-economic crisis.

Arguably, the two most significant trends of increasing application of advanced technology and the interest in sustainable investments have significantly contributed to the global growth of Islamic social finance and investments. Regulations that defines the parameters of application are now in place to enable the success of these initiatives by capable participants. Their impact on the Islamic finance sector has been primarily positive as the social impact and real economy-linked transactions provide clear evidence of socio-economic empowerment and justice.

Islamic Wealth Management going ‘Green’
The global move towards SRI (socially responsible investment) and ESG (ethical, social and governance) investment has supported the triple bottom line measurement for responsible companies.

The Islamic finance philosophy of a sharing economy envisages a financial system that supports a real economy rather than creating an unsustainable, superficial wealth cloud from a financial system that is created in and of itself. In this quest for socio-economic balance and reduced income inequality, the most recent trend is marked by the rise of sustainable banking that places people and planet before profits. As humanity is becoming more aware of the impact of its use of resources and short-term wealth goals, ethical finance and investment is increasing exponentially (more than 30% of global assets are in SRI at the beginning of 2017). Islamic finance and banking is based on an ethical premise and therefore expected to significantly support the emergence of value-based banking and intermediation over the next 5 to 10 years.

Earlier efforts in ethical investment raised the ire of return-seeking investors as ‘ethical’ was synonymous with welfare handouts, translating into the sacrificing of returns for the benefit of ‘doing good’. In fact, research indicates that performance of ethical investment post-2007 has been either on par or better than traditional investment. A Sharpe-adjusted return comparison attests to this:

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1. The Six United Nations Principles for Responsible Investing
2. The Seventeen United Nations Sustainable Development Goals
3. Published by the Centre for Islamic Asset and Wealth Management at INCEIF
It seems that investing responsibly is actually profitable, even in the short-term. The spin-off over the longer term is significantly profitable as the economy grows and more participants populate various strata of the financial power index, ultimately generating more wealth and prosperity for all.

**Value-Based Intermediation**

Markets are beginning to respond to calls for financial services that are responsible and provide positive socio-economic impact. For example, the environmental organization Greenpeace, documents theiryoutube campaign exposing Banco Santander’s loans of GBP400 million to a logging company expanding its operations in Indonesia. After 3 million views in just 2 days and subsequent public protest, the bank announced within 48 hours that it would no longer lend to the company and that future lending would be based on new sustainability objectives.

Malaysia’s value-based intermediation strategy, driven by Bank Negara Malaysia [regarded as a global exemplar in the dual-banking system] is expected to move the Islamic finance industry into the next phase of sustainable, long-term economic development. The industry is expected to intensify its distinction and personify its existence through value-based intermediation or VBI. Built upon the pillars of entrepreneurship, community empowerment and self-governance, VBI promotes innovation, efficiency and transparency in a substantive ecosystem. Since Islamic finance already echoes these principles, it is a natural vehicle for the sustainable and socially responsible finance paradigm.

**Islamic Social Finance**

The more traditional methods of Islamic social finance have a long history of contributing to the development of Islamic nations. Zakat (alms-giving), waqf (endowment) and sadaqah (voluntary charity) have been used to provide for the basic means of livelihood for the poor and destitute albeit in a mostly informal structure. However, it is envisaged that the future application of these instruments will be exceedingly sophisticated, addressing the existing challenges in calculation, poor collection mechanisms and inefficient distribution channels. The skepticism that zakat payers and waqf donors justifiably emphasize can be dealt with using advances in technology such as the blockchain approach. It is now not difficult to imagine that zakat payment for example, can be calculated and made using smart apps that would present options to payers based on their personal preferences. For example, a zakat payer that would like to see his/her funds being utilized for specific projects, emergency relief or water and sanitation may be presented with several initiatives from various reputable NGOs, together with an independently assessed benefit or efficiency rating. Then using token technology, payees would be linked via unique id’s to the system, with potential to verify that ownership has been transferred (a requirement in zakat) and that the funds have been disbursed correctly. This has the potential of reducing bottle-necks in zakat distribution and ensures that the deserving recipients benefit from these contributions. It also encourages NGOs to enhance the efficiency and the socio-economic impact of their projects. International organizations such as the IFRC (International Federation of Red Cross and Red Crescent Societies) and UNDP (United Nations Development Program) are actively considering Islamic finance solutions to mitigate the funding gap for social development and emergency relief. With regards to research and thought leadership in Islamic finance, the International Centre for Education in Islamic Finance based in Malaysia (INCEIF), has actively embarked on initiatives to encourage policy change to directly impact the social well-being of the society by utilizing Islamic finance percepts.

Islamic wealth management is at an opportune time to actively pursue sustainable investments and social finance in consonance with the global resurgence towards a more equitable socio-economic existence, the core principle of Islamic social finance. We hope that Islamic social finance will significantly contribute towards a more holistic approach in mitigating the global income inequality gap and gradually migrate into a paradigm of human excellence rather than just human survival.