

The Islamic Finance Ecosystem and Impact Investment

Author:

Mohd Umair Khan

The author has been Consultant (Economic Development
and Strategy) with Impetus Strategy



ImpetusStrategy
<https://impetus.sa/>

The Islamic Finance Ecosystem and Impact Investment

approximately
valued at

2

trillion USD

Islamic finance is an ever-expanding sector, approximately valued at more than \$2 trillion USD. It, however, remains among the concepts people know of but don't know much about. Many know of it as a way of resourcing and managing monies in accordance with sharī'a (Islamic law), but don't know about its features and components. Here, in this article, we aim to briefly contextualize for you the Islamic finance ecosystem, and how it can facilitate impact investment in Saudi Arabia.



So, what constitutes the Islamic finance ecosystem?

Islamic finance is a complex system with broad and specific terms derived from The Holy Qur'an and Prophet Muhammad's (PBUH) life. Though the term did not exist during the time of the Prophet (PBUH), the practice did. The term 'Islamic finance' emerged between the year 1960-70, after a series of discussions and much deliberation. Muslim scholars and economists from the around the world had, at that time, a 'rare opportunity', to deliberate upon issues facing Islamic world with reference to contemporary financial dynamics. In 1976, a conference was held in Makkah, Saudi Arabia, and was attended by 180 participants. Despite the diversity and background differences within the group, there was consensus that the conference was vital for Islamic Economics and Finance as an 'independent academic discipline'. In 1975, shortly before the conference was held, the first commercial Islamic bank, Dubai Islamic Bank (DIB), was established and paved the way for other such financial institutions to emerge.

Unlike the general impression, Islamic finance does not propose a drastically new/distinct financial order, however, it prescribes certain do's and don'ts in line with sharī'a. Some financial concepts central to Islamic finance are:



Not Paying or Charging Interest:



Interest payments are considered prohibited in Islam. Therefore, financial instruments for saving and investment should not include interest component. Islamic banks around the world use different approaches including profit-loss sharing to serve their clients for deposits and loans.



Not investing in businesses involved in prohibited activities:

Islamic financial practice prohibits investing in activities deemed down as impermissible in The Holy Qur'an such as gambling, alcohol, and pork.



Avoiding speculations:

Gambling and activities involving chance are prohibited in Islam and therefore shouldn't be reflected in the investment practices.



Avoiding excessive risk: Excessive risk and uncertainty is also not permitted in the Islamic financial landscape; the consensus is to avoid it. A material underlying asset to collateralize the transaction is important.



Profit and loss sharing: Islamic banking systems employ profit and loss sharing. Islamic banks provide money to an entity whose entire responsibility is to manage it. The practice is known as Mudarabah.



In order to ensure that the abovementioned conditions are abided by, there are screening criteria in the Islamic Finance ecosystem. There are two such criteria:

■ **qualitative**

■ **quantitative**

Qualitative screening includes not investing in enterprises producing harmful products such as alcohol, arms, tobacco among others. On the other hand, quantitative criteria investors avoid enterprises with excessive debt. Under Islamic finance statute, impermissible levels of exposure to Riba is not allowed. These screenings are what people recognize often as harmonizing characteristics between Islamic finance, social finance and impact investment ecosystems.



How can it facilitate impact investment in Saudi Arabia?

The Islamic finance ecosystem is already facilitating the impact investment in Saudi Arabia. We have to understand some organizational dynamics to recognise that relationship. Organizations and/or institutions within Saudi Arabia such as the General Authority for Awqaf (GAA), which manages charitable endowments in the Kingdom, receive funds as part of, among others, Sadaqah Jariyah, a practice derived from Prophet Muhammad's commandments. The GAA, in its mission statement, emphasize their adherence to Islamic law, regulations, and Saudi Vision 2030.

Apart from that, all banks based in Saudi Arabia are either fully Islamic or have an Islamic finance window to provide finance such as loans for enterprises. Vision 2030, given its focus on social and environmental returns apart from economic, has further enhanced and smoothened the process of getting credit for social entrepreneurs. The Small and Medium Enterprises General Authority, Monsha'at, has launched several entrepreneurial complexes, business accelerators and incubators (Al-Kharj and Hail) resulting in 37% increase of small and medium enterprise (SME) sector relative to 2016. Another important aspect that affects enterprises working for social/environmental impact (as well as other businesses and the economy) is the engagement of women through "setting an equal age for both genders, preventing gender discrimination in terms of wages, occupation, work field and hours, and enabling women to incorporate and practice commercial business without obtaining prior consent."

Both domestically in Saudi Arabia, and globally, the Islamic finance ecosystem is facilitating the social and environmental impact. Organizations like Red Cross and Red Crescent Societies are using sharī a-compliant bonds called Sukuk in the domain of water, sanitation and hygiene (WASH) for targeting cholera and other communicable diseases.



Conclusion

This article is aimed at providing a basic understanding of Islamic finance and its relationship with impact sector. We discussed the various characteristics of Islamic financial ecosystem and how it can and already is facilitating social and environmental change in the Kingdom and beyond. At Impetus Strategy, we are hopeful of creating awareness about impact investment in the Kingdom and are well equipped to provide our advisory services to all stakeholders including, donors, investors, entrepreneurs, regulators, governmental entities.

<https://www.ifsb.org/index.php>

<https://core.ac.uk/download/pdf/39283104.pdf>

<https://core.ac.uk/download/pdf/39283104.pdf>

Shariah investment screening criteria: a critical review. .(٢٠١٤) .Bin Mahfouz, S. S., & Ahmed, H .Journal of King Abdulaziz University: Islamic Economics, **27(1)**

<https://www.awqaf.gov.sa/en>

Monshaat Portal - <https://www.monshaat.gov.sa/en/about>

Saudi National Unified Portal for Govt Services -

<https://www.my.gov.sa/wps/portal/snp/aboutksa/investinginksa>

</crucial-components-islamic-finance-system-7/https://ethis.co/blog>

٤-International Federation of Red Cross and Red Crescent Societies, "One WASH Sukuk

<http://media.ifrc.org/> .(٢٠١٩ May) "Concept Note

pdf.One-Wash-Concept-note-May٢٠١٩٠٧٢٠١٩٩/innovation/wp-content/uploads/sites