

Waqf as a Socially Responsible Investment Instrument: A case for Western countries

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Abstract — In light of the progression of Islamic finance in non-Muslim countries and the design of innovative financial products, the next frontier for Islamic finance is to attract customers and investors from beliefs other than Islam. This paper examines and discusses the case of a specific Islamic contract, Waqf and highlights its possible use as a (Socially Responsible Investment) SRI offering which is not only attractive to the non-Muslim investor, but also in-line with the actual spirit of Islamic teachings. The methodology is an examination of the Waqf contract through different sources of Islamic law as well as an evaluation of mainstream secondary literature on the link of corporate social responsibility and investor prospectation in Non-Muslim countries.

The ultimate result is a proposed viable Waqf product which is in-line with the spirit of Islamic teachings and can be an attractive proposition to the socially conscious investor.

Keywords- *Waqf, Socially Responsible Investing, Islamic Finance Evolution, Islamic Finance and Non-Muslim Countries*

INTRODUCTION

The Social development of poor countries has become a foremost issue in major economies of the world. The past fifteen years or so have seen a shift among the psyche of consumers, especially in Western countries, that prefer products and services which are “environmentally friendly” or “socially responsible”. Firms which are genuinely committed to the welfare of society be it environmental issues like reducing its carbon foot-print (the amount of greenhouse gases released in the atmosphere directly or indirectly by a firm) or working for the social uplift of rural communities in under-developed countries are favored. Such firms promote themselves as having a

unique selling point and in certain cases charge premiums on their products and services which consumers are willing to pay. A growing section of the financial sector is also beginning to reward businesses which identify the link between doing business and being environmentally friendly. This is evident from the increase in what is known as Socially Responsible Investing (SRI).

Islam as a religion emphasizes the betterment of society and goodwill among humans; therefore all activities of Muslims are to be centered on upholding the highest ethics and social responsibility.

Shari’ah are the set of rules derived from the primary and secondary sources of Islamic jurisprudence and cover areas relating to all aspects of a Muslim’s religious, political, social, domestic and private life. On many occasions Islamic teachings emphasize the duties of Muslims towards humanitarian and social welfare.

Many examples such as the Quranic verse below can be found in the teachings of Islam;

Indeed, Allah orders justice and good conduct and giving to relatives and forbids immorality and bad conduct and oppression. He admonishes you that perhaps you will be reminded.

Surat An-Naḥl (16:90)

It is interesting to note from the Verse above that Muslims are not only forbidden from bad conduct and immorality but are ordered to actively do good.

Problem Statement

Although Islamic financial assets worldwide have shown phenomenal growth, there has been considerable resentment from certain quarters that these products lack the actual spirit of Islamic teachings. Moreover, as the Islamic finance industry starts to expand, especially in non-Muslim countries, there should be a strategy shift to make Islamic financial products more appealing to the non-Muslim demographic.

Objectives

In light of the above, the Islamic finance industry can address both these issues by structuring an alternate product which is in line with the spirit of Islamic teachings and therefore shall lead to societal benefit.

This would be a win-win for the industry as the next section shows that being socially beneficial leads to a positive impact on a firm's earnings.

This paper will look to:

1. Assess conventional secondary Western literature linking social responsibility and firm profitability
2. Analyze the implications of the Waqf contract for Non-Muslims
3. Propose a workable Waqf investment structure that can be marketed to both Muslims and Non-Muslims.

LITERATURE REVIEW

Social Responsibility and Investor Perception

Investigating different studies and papers it was discovered that even though there is a wealth of papers that look in to corporate social responsibility or socially responsible investing on one hand and Waqf on the other, but there were no studies that actually made a connection between the two. The literature review will therefore be in two parts, first looking at socially responsible investments followed by studies looking into the Waqf structure and its implications for Non-Muslims.

We start off by looking at studies that underlie social responsibility being rewarded by investors. For example King and Lenox (2001) [1] show that an increase in the value of US firms is directly related to a firm adopting environmental standards. Dowell, Hart and Yeung (2000) [2] share a similar view that

firms following a single stringent environmental policy tend to have higher market value. Feldman, Soyka, and Ameer (1996) [3] from their analysis find that improvements in a firm's environmental performance results in the stock price being less susceptible to market movements, which in turn leads to an increase in a public company's stock price thus making it a better investment. Russo and Fouts (1999) [4], establish that firms that follow an environmentally friendly policy benefit from having intangible assets such as goodwill which increases a firm's profitability. In Abramson, Lorne, Chung and Dan (2000) [5], the authors' findings state that socially responsibly screened portfolios offer competitive returns both in the short and long run, compared to the benchmark return.

There are also studies that shed light on the type of consumer that opts for socially responsible investing and how ethical investing affects consumer decision making. Rosen, Sandler, and Shani, (1991) [6] finds that socially responsible investors belong to a demographic that is younger and better educated than to their conventional counterparts. Owen and Qian (2008) [7] find evidence that demographic characteristics as well as non-financial motives influence investors to opt for SRI products.

Williams (2005) [8] implies that the portfolio strategies of consumers are linked with their behavior and attitudes toward social aims. Webley, Lewis and Mackenzie (2001) [9] provides evidence that ideology rather than financial return is the main motive for socially responsible investors as they were found to keep or even increase their ethical holdings when such investments underperformed the market.

Waqf

Even though there is no direct reference in the Quran about Waqf but the contract is derived from the traditions of Prophet Mohammad (PBUH). For example:

Umar bin Khattab got some land in Khaibar and he went to the Prophet to consult him about it saying, "O Allah' Apostle got some land in Khaibar better than which I have never had, what do you suggest that I do with it?" The Prophet said, "If you like you can give the land as endowment and give its fruits in charity." So Umar gave it in charity as an endowment on the condition that would not be sold nor given to anybody as a present and not to be inherited, but its yield would be given in charity to the poor people, to

the Kith and kin, for freeing slaves, for Allah's Cause, to the travelers and guests; and that there would be no harm if the guardian of the endowment ate from it according to his need with good intention, and fed others without storing it for the future."

Narrated by Ibn 'Umar - Sahih Bokhari Volume 3, Book 50, Number 895

The word Waqf in Arabic refers to the "stopping" (one basic meaning of the Arabic root verb, Waqafa) of some piece of property.

According to Sheikh Saleh al-Fawzan [10], a Waqf can be made to benefit the family of the donor or the public for charitable purposes. The charitable purposes could be general or specific (e.g. for the purpose of education only).

Certain conditions apply in order for the Waqf to be valid. These include:

1. That the person who is setting up the Waqf is one who has the authority to dispose of his wealth.
2. That the property given as a Waqf should be something from which ongoing benefit may be derived whilst its original essence remains. Things which can be depleted cannot be given as a Waqf, such as food.
3. That the property given as a Waqf should be something specific. A Waqf consisting of something unspecified is invalid.
4. It is not permissible to set up a Waqf for purposes that are not good, such as helping people to commit sin.
5. In order for the Waqf to be valid it must be executable with immediate effect.

Among the rulings on Waqf, is that it is obligatory to act in accordance with the wishes of the one who set up the Waqf, so long as it does not go against Shari'ah. There is consensus among Shari'ah scholars that it is permissible for Non-Muslims to both start a Waqf and also be considered for receiving benefits of a Waqf endowment. According to B.Ali (2009) [11] even non-Muslims in Muslim countries established Waqf for the benefit of their communities. Waqf can also be in the form of certificates as

implemented by Social Investment Bank Limited (SIBL) Bangladesh. Hasan, Samiul (2007) [12].

Mannan (1998) [13] summarizes the objectives of Cash Waqf Certificate as:

1. To provide liquidity to banks and Waqf institutions by helping to channel social savings through the Cash Waqf Certificate. (Names of family members can be nominated to strengthen integration among rich families)
2. For the development of a social capital market and increase social investment
3. To increase rich communities' awareness on their responsibility for social development
4. To stimulate integration between social security and social welfare.

CONSIDERATIONS

As a Waqf is to continue till no more economic benefit can be taken from the asset, we have to structure an investment product for perpetuity; this means that we have to look at an investment strategy that gives preference to capital preservation. We also have to take into consideration the time value of money for the capital fund and have to plough part of the income generated (depending on the inflation factor) back to the capital fund. Another important aspect to be considered is that the actual capital amount cannot be used for either charitable purposes or as investment returns to the person(s) nominated by the Waqif (capital provider or investor). It should be noted here that it is widely accepted by Shari'ah scholars that the Waqif cannot nominate himself as the benefactor of the Waqf income but can nominate his or her family members for example spouse or children. According to Marzuki, Shahimi, Ismail and Zaini (2012) [14] immediate disbursement is not necessary as there is already the charitable instrument of Zakat for that.

The paper also states that the cash Waqf model has advantages over conventional microfinance which can act as a unique selling point in attracting non-Muslim ethical investors; Due to the structure of the cash Waqf model (discussed later on) sustainability is ensured. This is because the capital collected is not to be dispersed and only proceeds of investments are to be used for disbursement. Unlike the Waqf, microfinance institutions have to balance deposits and loans for liquidity management.

Another criticism of microfinance institutions is that due to the higher probability of loan default, they charge high interest rates which require weekly payments. It is also sometimes stated that microfinance institutions sometimes have to turn away the really needy as they may not be able to find guarantors or because the credit risk is very high. This is not the case for cash Waqf as their survivability is not dependent on the repayment of borrowers. Moreover, due to the Islamic nature of Waqf, borrowers can either be given a benevolent loan or a capital investment (Mudarabah contract).

PROPOSED STRUCTURE

To start off, an investment firm will float Waqf certificates in denominations of whatever value suits the specific jurisdiction. These certificates will be of two types both aimed at different type of social investor:

- 1) General Waqf Certificates: These will be aimed for people more inclined towards using the Waqf as a purely charitable instrument i.e. they leave it to the discretion of the Waqf institute to disburse the investment returns to whomever it deems worthy or invest in whatever social project chosen in accordance with the rules set-out by the institute.

Nominee Waqf Certificates: This certificate will give the investor the choice to have a specific nominee(s) receive the returns of the capital invested. As discussed earlier, the Waqif cannot nominate him or herself. It should be made clear to specific Waqf certificate holders that a certain percentage of their investment returns will be used for socially beneficial projects before being disbursed to their specific nominee(s).

The investment strategy should be structured in a way that not only preserves the capital but also leads to capital appreciation and income generation. An advantage to conventional investment funds is that as the Waqf certificates are non-redeemable, almost all of the capital can be invested.

As the Waqf structure has a very long term horizon, investments can be made in illiquid assets such as real estate which can lead to capital appreciation. These properties can also be income generating i.e. through rent. For stable cash flows,

investments can be made into Islamic or Shari'ah compliant fixed income instruments such as Sukuks. Investments can also be made in Shari'ah compliant equities but after considerable due diligence.

A percentage of the income generated can be used to invest in socially responsible, Shariah compliant businesses using a Mudarabah contract. This can act as both income generating and helping entrepreneurs looking for seed capital. The reason why generated income rather than Waqf capital is used for the Mudarabah contract is to minimize risk as much as possible.

A percentage of the generated income can also be used to give out interest free loans to needy people using the Qard Hasana contract. (Figure 1 for graphical representation of structure)

CONCLUSION

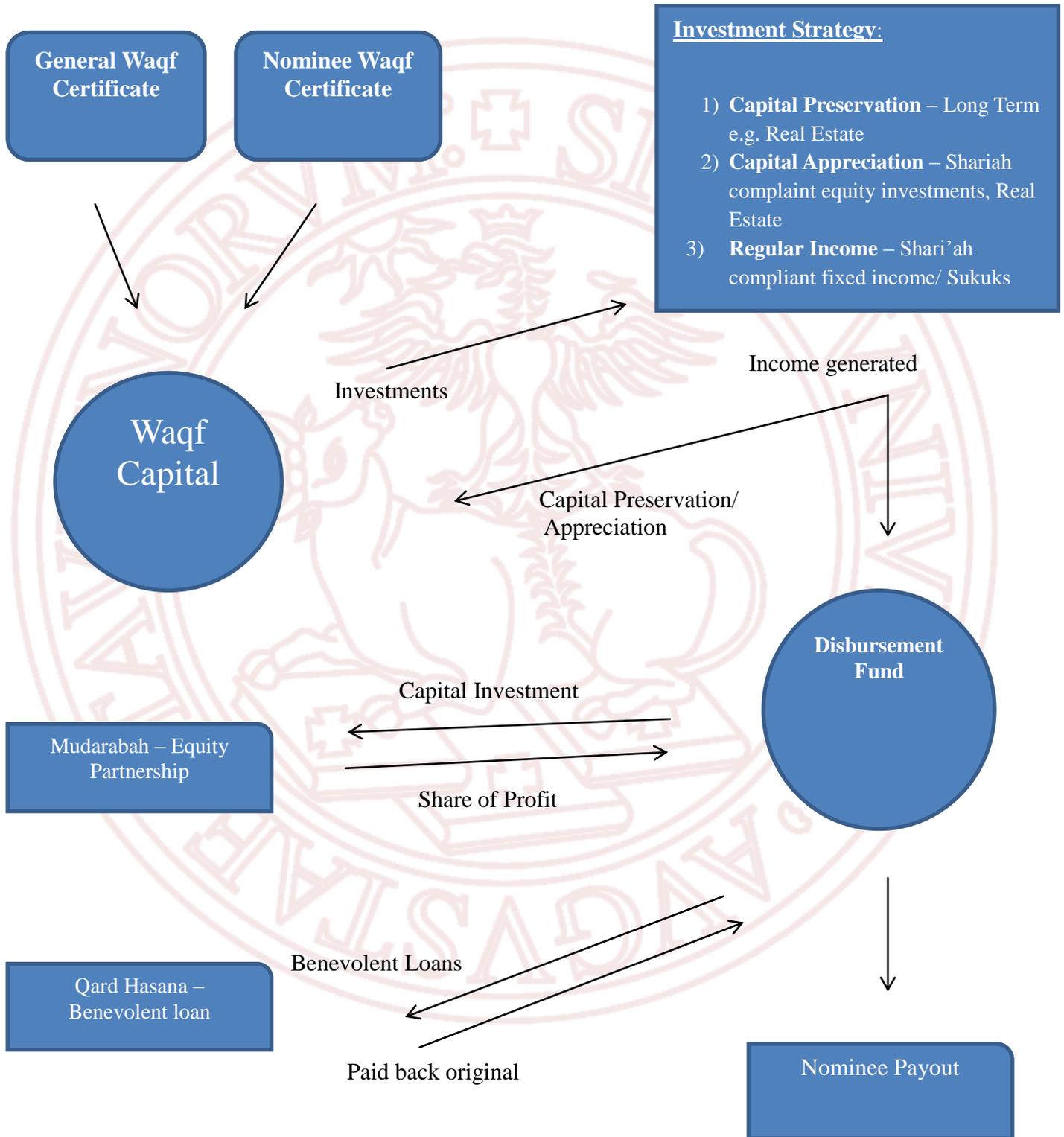
We started off by stating the problem that current Islamic financial products are more inclined towards compliance as a box ticking exercise rather than actually being Islamic in nature and spirit. Another issue was that Islamic finance picks up globally, Islamic financial institutions especially in non-Muslim countries should expand from a Muslim majority consumer base to a more diversified one.

This paper proposed the use of the Islamic social contract of Waqf as a possible solution for both the issues. This study was mainly an investigation of:

- a) The positive relation between social responsibility and increased firm value
- b) The Waqf contract – its implications and different considerations

Using secondary literary sources, the paper proposes a viable Shariah compliant alternative Socially Responsible Investment (SRI) certificate.

Figure 1. Structure of Waqf



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