

## ***Impact Investment in Islam: A Review of Social, Environmental and Financial Motives***

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### **Abstract**

*The objective of this study is to discuss the Islamic perspective of Impact Investment, and to analyze its characteristics and requirements in the light of the guidelines given by the Islam. There are very limited studies that focus on the investment with the intention to achieve measurable social and /or environmental impact along with financial return in accordance with Islamic principles. Islamic principles provide a complete guideline for investment to generate wealth. The guidelines according to Sharia rules include: income from legitimate sources, business activities must be performed under the scope of social and environmental benefits, and equivalent sharing of risk and return. Impact Investment recently identified as a possible solution by academic researchers that propose various methods to solve the economic, social and environmental issues with the intention of measurable impact alongside financial return. However, to motivate Muslim entrepreneurs in this particular field, it is necessary to align the objective of impact investment with Islamic principles (Maqasid-al-Shariah). The objective of this effort is to present a workable model to Muslim entrepreneurs to transform simple investment into Islamic impact investment. The paper is divided in different parts; in the next section we briefly introduce the basic notion of impact investment, its purpose and different motives. In the following section, the detailed literature on the notion of Impact investment is discussed. After the literature review, the Islamic point of view is presented in the light of Quran and Hadiths. Conclusion of the paper is presented at the end of the paper.*

**Keywords:** Islamic Impact investment, Society, Environment, Financial return.

### **Introduction**

The paper is based on a review of relevant literature on impact investment which has further been explained from the Islamic perspective

with the help of relevant principles from Islamic Fiqah and shariah. The paper is based on the premise that traditional concept of investment where its sole motive was either to maximize profits or to maximize social and environment impact is no more sustainable. Therefore, such a holistic structure is required which may combine the social, environmental and financial motives under the umbrella of a single organization. The debate on this holistic structure is very limited in the existing body of knowledge. Moreover, the Islamic point of view is completely ignored by the researchers in defining and discussing such a framework. The paper further highlights that the investment principles provided by Islamic Shariah serve as guideline for the type of investment that is both having social, environment as well as financial impact. Thus, as explained in hadith 'Adopting Halal source of earning is a pure form of worship'. The Prophet Muhammad ﷺ also focused on the importance of adapting halal methods of business which is beneficial for all stakeholders including investor, society and environment. Moreover, Muhammad ﷺ also direct Muslims to stay away from any illegal/haram activities which is harmful for society, environment or any other human being. Thus, being a Muslim, it is our responsibility to ensure that investment activities are according with the principles of Shariah to protect the welfare of the society and intends to promote values in the trading place.

Following subsections of this paper individually explain impact investment and its components; the concept of impact investment in Islam; and the relationship between Islamic and contemporary concepts of impact investment. Based on the review of literature, the paper concludes that the Islamic and contemporary concepts of impact investment are not contradictory but reinforce each other.

### **Impact Investment**

Profit oriented organizations have broadened their purpose to pursue social and environmental objectives, while many non-profit firms and governmental organizations have adopted market-based approaches to advance their aims. Impact investment provides a path to blend social, economic and environmental values for sustainable development and has come-up with a unique type of investment that will benefit all three bottom lines: investor, society and environment.<sup>1</sup> Impact investment can be defined as a form of investment that equally focuses on social and environmental issues while generating the monetary profit. Moreover, Global Impact Investment Network (GIIN) defined impact investment as an investment with the intention to generate measurable social and environmental impact alongside a financial return".<sup>2</sup> Therefore, the notion of impact investment focuses on the achievement of economic, social and environmental benefits. The main characteristics of impact investment include:

- Intentionality
- measurable impact

In the following sub-section, we will discuss these two components in

detail:

### **Intentionality**

Intentionality is a characteristic of impact investment which means that the business in which the investment is made should be designed with the intention to make positive impact which should also generate at least return on capital which can range from below market rate also called concessionary (impact first investor) or even above the market rate (financial first investor). Gaining a financial return along with unintentionally created social value does not come under the scope of impact investment. For example, if an investor wants to invest in new clean energy opportunities because he believes there is a high market profit opportunity, he will not be marked as an impact investor.<sup>3</sup> If he invests in the same opportunity because he believes the world needs clean energy instead of polluting sources like coal, he is marked as an impact investor.

### **Measurability**

Measurability is a characteristic of impact investment which means that social and/or environmental performance should be monitored, measured and reported as such. It is relatively easy to measure financial impact as there are various available parameters that are helpful in this regard like IFRS, However, the major challenge is to measure the social and environmental impact as the outcome of any investment in society and environment is invisible in the short-run.<sup>4</sup> The most acceptable tool till now is developed by GIIN to measure the social and environmental impact which is known as Impact Reporting and Investment Standards (IRIS). IRIS helps to measure social performance of impact investment and addresses a major barrier to the growth of impact investment sector, it also provides a guideline to track, report and define social performance of impact investments with lower transaction cost and also helps the impact investors to understand the impact of the investment they make.<sup>5</sup>

### **Social Motive and Social Impact**

Impact investment is made with a motive to change various segments of the society by trying to address the social problems such as agriculture, clean water, health, housing, education, energy, financial services, microfinance, job creation, provide access to basic needs, provide cost-effective product or services to the community and increase the level of satisfaction in the society at large.<sup>6</sup> Traditionally, government and philanthropic organizations usually invest with a motive to seek a social return, while for-profit investor invest with a motive of financial return.

Impact investors distinguished with a motive to gain both social and financial return.<sup>7</sup> For impact investor it is important to link the targeted social motives in organizational mission statement to accomplish the characteristic of intentionality. The themes of settled social motives can be global in nature or more specifically tied to a region or even local community.

Social motives of impact investment not only help in solving social

issues but also humanitarian and economic problems inherent in a society. Once the social motive is identified which align with mission statements, the outcomes should be measured in order to evaluate the impact investment (World Economic Forum, 2013). Impact Reporting and Investment Standards (IRIS) may be used to measure the impact of impact investment to the society.<sup>8</sup> However the use of IRIS to measure the social impact is very limited. Therefore, in this regard, without standard procedure to measure non-financial performance, investors must rely on their own judgment and proprietary systems to assess whether an impact investment is making progress toward social goals.

#### **Environmental Motive and Environmental Impact**

Considering environmental issues while making an investment help to manage natural environment for the benefits of present and future generations. Natural resources must carefully be planned and managed to safeguard the energy efficiency, climate change, minerals, ecosystems, biodiversity, water and waste management.<sup>9</sup> Environmental performance and socially responsible behavior is major pillar behind the environmental motive of impact investment. An important characteristic of impact investment is that it safeguards natural resources and environment while maximizing financial returns and social impact. Therefore, it can ensure environmental sustainability for present and future generations.

#### **Financial motives and financial Return**

The business in which investment is made should be designed to generate at least a return of capital and strives to generate a return on capital. The financial return can range from below market rate, closer to market rate or even above market rates.<sup>10</sup>

Private profit-oriented organizations invest in social and/or environmental sector to become more sustainable by enhancing corporate image, improving case for further funding; and making tenders more persuasive.<sup>11</sup> The primary motive of these organizations is to increase the profit by focusing on extension in positive financial return with a floor for social and/or environmental impact. These investors are termed as “financial first investors” and consist of commercial investors. On the other hand, government and philanthropic impact investors willing to compromise on the financial return in order to optimize the social and/or environmental return. These investors are termed as “impact first investors”.<sup>12</sup>

O'Donohoe et al. (2010) argued that the capital is traditionally been apportioned by considering two motives; first, to take financial return by minimizing the risks associated with the investment; second, for charitable purposes to maximize the social impact. In contrast to these two motives, impact investment is made to improve the social uplift and to increase the social sustainability by involving in income generating activities. <sup>13</sup>It is relatively easy to measure financial impact as there are various available parameters that are helpful in this regard like IFRS. Earning profit is not

prohibited, “financial first investor” may distribute the profit among their stakeholders, however “impact first investor” require to re-invest to further their social and/or environmental mission.

The given figure explains the conceptual framework of study.

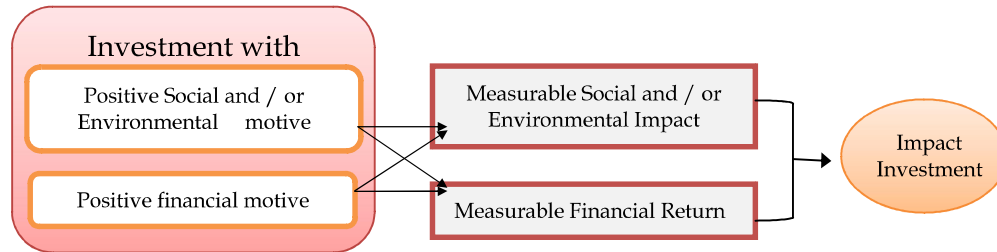


Figure 1: Conceptual Framework of Impact Investment

### Impact Investment in Islam

The term Impact Investment was first coined in 2009, which emphasises on investment with the purpose of social uplift and environmental protection along with financial benefits. The term “Impact Investment” is new, however the concept of Impact Investment is already existed in Islam. Islam is not just a religion, but it represents an entire sense of community and a way of life. The Holy Quran and Hadith gives a complete code of conduct which teaches all facts of social life in accordance with Shariah. Shariah covers all aspect of economic, social and environmental area.<sup>14</sup>

Maqasid al-shariah requires Islamic Investment which consider the justice and welfare of the society and protect environment in addition to earning profit. Islamic Impact Investor can evaluate whether Islamic Investment contribute to social and environmental impact and be closer to fulfilling the principles of maqasid al-Shariah, promoting the maslahah (public interest) and contributing towards social and environmental sustainability. The objective of Maqasid al-shariah is to protect the Religion, Life, Lineage, Intellect and Wealth.<sup>15</sup>

Theoretical background of impact investment in light of Islamic principles highlights in three dimension economic, social and environmental area. Islamic principles also provide a guideline to establish balance between economic, social and environmental dimensions for sustainable development.

The given figure explains the conceptual framework of study.

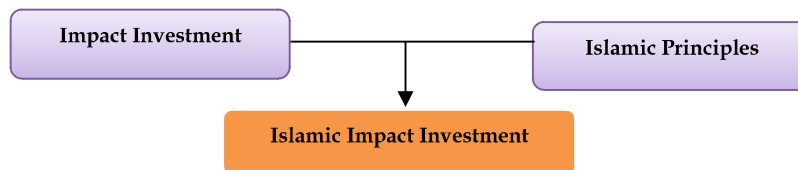


Figure 2: Conceptual Framework of Islamic Impact Investment

### Intentionality in Islamic

The Shariah provide a complete guideline to understand the word "Intention". Imam Mohammed Al-Bukhari (RA) explains in his book Saheeh Al-Bukhari:

(من أحدث في أمرنا هذا ما ليس فيه فهو رد)

*"That every action that is done without seeking Allah's pleasure is invalid and devoid of reward." (Saheeh Al-Bukhari).*

Gaining a financial return (reward) along with unintentionally created social value is not an impact investment. A person who loves to obtain prize and dedications from Almighty Allah should on worthy actions with noble intention. The Prophet Muhammad said about the intention of good deeds that:

(إنما الأعمال بالنيات وإنما لكل امرئ ما نوى)

*"The reward of deeds depends upon the intentions and every person will get the reward according to what he / she has intended."*

According to the lights of above mentioned Hadith, If an investor wants to invest in new clean energy opportunities because he believes there is a high market profit opportunity, he will not be marked as an impact investor.<sup>16</sup> According to another Hadith, if a person is interested in a noble actions, however, remained failed to operationalize his good intention, Almighty Allah will still reward him and acknowledge his good intention. If he successfully operationalize his good intention, Almighty Allah will reward him/her ten times. Moreover, the Prophet Muhammad ﷺ said:

(إنما الأعمال بالنيات)

*"actions are by intentions, and this is taken for every matter."*

The Prophet Muhammad ﷺ has made a special emphasis on the role of honesty in financial dealing. He said:

(أن الأمانة نزلت في جذر قلوب الرجال ثم علموا من القرآن ثم علموا من السنة)

*"Honesty was preserved in the roots of the hearts of men and then they learnt it (honesty) from the Quran, and then they learnt it from the (Prophet's) Sunna (tradition)."*<sup>17</sup>

### Measurability according to Islam

The measurement of impact of the Islamic Investment is relatively a new research approach. Impact can be defined as the positive impact generated from activities taken by an individual or organization, that aims to protect and preserve the five major interests in Islam, which are faith, life, intellect, posterity and wealth.<sup>18</sup> By protecting and preserving these five interests, the activities undertaken may improve and enhance the living condition of every member in the society, particularly the poor and marginalized group by ensuring that they have equal opportunities as the other members of the society. The authors categorized the methodologies of impact assessment or measurement into general or specific groups. General methodologies broadly capture all impacts i.e economic, social and

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environmental, while specific methodology only capture one type of impact.<sup>19</sup>

The purpose of Islamic Impact Investment is to contribute for socio-economic development and to create fair society as manifested in the principles of Shariah. Impact can be measured by achievement of established objectives which fulfils the principles of Shariah and promotes the *maslahah* (public interest) and also contributes toward the social sustainability. Islamic principles explain how good relations can be made humans with other humans and gives a variety of living ethics for whole life in a good manner for all humans, these ethics not only focus on economic values but also emphasise on development of welfare, social and economic equality and contentment among all humans. Islamic rules and regulation also guide in business community.<sup>20</sup>

### **Social Motive and social Impact in Islam**

According to Oxford Institute for Sustainable Development social motives are considered as how individuals, group of people and society as a whole spend their lives and protect the rights of each other as well as protecting the environment and planet as well.<sup>21</sup>

Social activities involved developing such a places and environment where people can live in a peaceful manner and where needs and wants are easily achievable. In an Islamic point of view, there are two types of basic human need; spiritual needs and physical needs. Spiritual needs are fulfilled through a strong belief in God, whereas, physical need are fulfilled by making optimum use of environmental resources.<sup>22</sup>

The strength of social activities depends on sustainable development. Sustainable development means to fulfill the existing demands and requirements without compromising the resources of the future generations.<sup>23</sup> The Qur'an and the Hadith provide a framework for social sustainable development by Shariah, responsibility (*Faradh*), empowerment (*Shura*), equilibrium (*Al'adlwalihsan*), endowment (*Al-Wqaf*) and almsgiving (*Zakat*). Social sustainability is related with economic and environmental sustainability efforts, rather than as one of the important pillars of sustainable development itself.<sup>24</sup> The Islamic principles focuses on equal distribution of wealth and discourage the gathering of wealth and luxury items and focus on the struggle to gain only basic necessities. The role of Ummah, in this regard is to motivate individuals to invest with noble spirit with the motives to earn financial benefits along with benefiting the society and protecting the environment.<sup>25</sup> As al-Ghazali said, "the critical motive of Shariah is to encourage and ensure the welfare of the people."<sup>26</sup>

Vargas et al. 2010, stated that Muslim's investment activities are not

exclusively for earning money, but especially, to achieve the fardukifayah.<sup>27</sup> Islam not only guides to serve for the community but it also guides Ummah to care for God creator even of animals, as stated in Bukhari. Volume 8, Book 73: #38

(يَا رَسُولَ اللَّهِ وَإِنَّا لَنَا فِي الْبَهَائِمِ لِأَجْرًا فَقَالَ: فِي كُلِّ ذَاتِ كَبِدٍ رَطْبَةٌ أَجْرٌ)

*"O Allah's Apostle! Is there a reward for us in serving the animals?" He said, (Yes) There is a reward for serving any animate (living being)."*

Despite criticisms on Islamic investment having minimal social impact, the organization appears to strive to make a difference towards promoting social justice and welfare. The impacts of the organization extend beyond profitability.<sup>28</sup> However, using conventional performance standards that only measure financial impacts would seriously undermine the positive impacts that the organization has contributed to the social sector.<sup>29</sup>

### **Environmental Motive and Environmental Impact in Islam**

When the goal of impact investment aligns with the Islamic principles by avoiding waste, depletion of resources, environmental corruption, rationalization of natural resources and to protect the environment for public welfare and for the sake of financial return, the investment may be termed as Islamic Impact Investment. Prophet Muhammad ﷺ directed his Sahaba to safeguard the environment and to be kind to all living things. Narrated by Sahlibn al-Hanzaliyyah, The Prophet ﷺ came upon an emaciated camel and said:

(اتقوا الله في هذه البهائم المعجمة فاركبوها سالحة واكلوها سالحة)

*"Fear Allah regarding these dumb animals. Ride them when they are in good condition and feed them when they are in good condition."*<sup>30</sup>

Prophet Muhammad ﷺ educated his supporters not to waste water even while having the ablution from a flowing river. Moreover, Prophet Muhammad ﷺ motivated his followers to plant trees for the sake of future generations.<sup>31</sup> The Prophet ﷺ said:

(قَالَ رَسُولُ اللَّهِ ﷺ " مَا مِنْ مُسْلِمٍ يَغْرِسُ غَرْسًا، أَوْ يَزْرَعُ زَرْعًا، فَمَا أَكَلَ مِنْهُ طَيْرٌ أَوْ إِنْسَانٌ أَوْ بَيْمَةٌ، إِلَّا كَانَ لَهُ بِهِ

صَدَقَةٌ)<sup>32</sup>

*"Allah's Messenger (ﷺ) said, "There is none amongst the Muslims who plants a tree or sows seeds, and then a bird, or a person or an animal eats from it, but is regarded as a charitable gift for him."*

The Holy Quran also focuses on the protection of general environment. In various verses in the Quran, Muslims are directed to do so. Disobeying of this command is considered a sin. God Almighty says:

وَاللَّهُ لَا يُحِبُّ الْمُفْسِدِينَ ٥٤٠٠٦٣

*"And Allah do not love those who do mischief."*

وَلَا تُسْرِفُوا إِنَّهُ لَا يُحِبُّ الْمُسْرِفِينَ ١٤١٠٠٣٤

*"But waste not by excess: for Allah loveth not the wasters."*

وَلَا تُفْسِدُوا فِي الْأَرْضِ بَعْدَ إِصْلَاحِهَا ذَلِكُمْ خَيْرٌ لَكُمْ إِنْ كُنْتُمْ مُؤْمِنِينَ ٨٥٠٠٣٥

*"And do no mischief on the earth after it has been set in order: that will*



*be best for you, if you have Faith."*

Allah commands humans to evade doing harm things and deteriorating, because they cause devastation of the environment.<sup>36</sup>

Human being is entitled to utilize and search for all resources which Allah created in the universe e.g, air, water, animals, sun, moon, day, night, light, plants etc to build their own lives and the universe, in accordance with Islamic principles. Muslim need to utilize these resources for their own benefits and for others honestly and preserve it, use it considerately and moderately, and pass it on to future generations in a good condition, it is also a worship of Allah.<sup>37</sup>

Unfortunately, the Muslim countries used Islam only as a slogan, failing to realize positive contribution it can make towards the betterment of their society and community for their survival. Due to lack of government finances, available natural resources are not fully utilized, ultimately, people remain deprived from their basic needs like energy deficiency due to improper utilization of water (Lack of dams), insufficient plantation of trees, which increase pollution day by day and weak agriculture system etc which directly affect the living of community. Griffin (2013) stated that Impact Investment allocate focuses on building partnerships and allocating resources to promote social change and protect environment.<sup>38</sup>

Verse 34 of Al-Luqman separates the Islamic and conventional investment.<sup>39</sup> Investment that Islam is the sacrifice of the resources at present to obtain definitive results, with the hope to obtain greater results in the future, either directly or indirectly, while still adhere to the principles of Sharia as a whole (Kaffah), besides any form of investment is based on worship of God to reach the outer and inner happiness in this world and in the hereafter.

### **Financial motives and financial Return in Islam**

Earning legitimate income is not prohibited in Islam, however, income generated from unlawful activities are banned in Islam. Islam focuses on the continuous efforts for growth and development rather to trust only on their fate. As narrated by Prophet Muhammad ﷺ:

(أَلَا مَنْ وَّلِيَ يَتِيمًا لَهُ مَالٌ فَلْيَتَّجِرْ فِيهِ وَلَا يَتْرُكْهُ حَتَّى تَأْكُلَهُ الصَّدَقَةُ)<sup>40</sup>

*"The person that is responsible in managing the wealth of an orphan has to invest it, and don't let it finish as caused of sadaqah."*

Beside financial objectives, the emergence of Islamic investment as a viable alternative to conventional investment arose from the Islamic investors' dear need to earn halal profits. Hence, in contrast to conventional investors that consider investment as a way to generate more materialistic profit, Islamic investors perceive Islamic investment as an act of worship.<sup>41</sup> Islam has given a full freedom to its followers to earn as much money as they can through Halal means. Moreover, Muslims are encouraged to indulge in Halal

business activities that will ultimately bring economic prosperity, as is reflected in the following verse of Qur'an, in which Allah says:

فَإِذَا قُضِيَتِ الصَّلَاةُ فَانْتَشِرُوا فِي الْأَرْضِ وَابْتَغُوا مِنْ فَضْلِ اللَّهِ وَادْكُرُوا اللَّهَ كَثِيرًا لَعَلَّكُمْ تُفْلِحُونَ 42.010

*"And when the prayer has been concluded, disperse within the land and seek from the bounty of Allah, and remember Allah often that you may succeed."*

Economics activities in Islam have been completely regulated by the concepts of livelihood (al-Rizq), legal (halal) and illegal (haram) sources of income.<sup>43</sup> People who do not follow Islamic teachings and always concentrate on the benefits and earn their livings illegitimately, they endanger the country and society, Allah will punish them for this.<sup>44</sup>

Islam is not against of the earning profit through the engagement in business activities. Caliph 'Umar focused on the Islamic orders to earn one's own living things by saying. "No one of you should refrain from seeking a livelihood and say;

*"O God! Give me sustenance', for the sky will certainly not rain gold and silver."*<sup>45</sup>,

and that:

(وابتغوا من فضل الله، ولا تكونوا عبالا على الناس)

*"Seek of the bounty of God and be not a burden on others."*<sup>46</sup>

The only pre-conditions that must be met to do business activities are; first, by considering these as a part of a religion and to please the Almighty Allah; secondly, to fulfill the demands of the society, and finally to generate reasonable income. Community development and ethical business are prerequisites of Islamic entrepreneurship. The 'hunt of self-interest' and 'self-centered wealth creation' are not the principal objectives behind Islamic Investment.<sup>47</sup> Although Islam allows working for others for a fixed salary, however, it encourages Muslims to embark on entrepreneurship as the preferred option to earning Halal income. Beg, (1979) noted that Islam does not only motivate Muslims to Earn money for themselves, but to work hard to earn Halal income as much as they can so that they can provide benefits to the community and the Muslim ummah at large.<sup>48</sup>

## **Conclusion**

Islam promotes social and environmental development based on Islamic principles. This study proposed new parameters for Muslim to invest for legitimate profits keeping in view the Islamic principles for welfare of the community and to protect the environment. Islamic Impact Investment is much more than elimination of interest and conforming to the Shariah

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Impact Investment in Islam: A Review of Social, Environmental and Financial Motives requirements. It provides a comprehensive system that contributes towards social and environmental benefits alongside financial return in accordance with Islamic principles. Thus, by having the right parameters and method to measure the degree of impact contributed by Islamic impact investment, various Islamic investors can examine whether business achieved its established objectives in accordance with Islamic principles, promoted the social benefits and protected the environment or otherwise.



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