

## Islamic finance as an alternative investment

Posted By [Alpha Male](#) On February 23, 2010 @ 10:00 pm In [Hedge Fund Industry Trends](#), [Today's Post](#) | [2 Comments](#)

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<sup>[2]</sup>Islamic finance is an industry which has steadily gained attention since its establishment in the late 1970s. It is distinct from conventional finance in its outward adherence to Islamic law (shahria'h). One such distinction, [as provided here](#) <sup>[3]</sup>, is that it prevents the use of interest, given the notion in Islamic texts that making money from money constitutes usury. Islamic finance is based on the belief that wealth should be created only through [legitimate trade and investment in assets](#) <sup>[4]</sup>. Since the 2008 financial crisis, it has understandably gained in popularity given that it generally forbids both debt trading and excessive risk taking.

The ubiquity of interest-based lending is such that it may seem inconceivable for functioning financial system to forbid it. However, the payment of interest has been condemned by various communities for hundreds, even thousands, of years. The Greek philosopher Aristotle said, "Very much disliked also is the practice of charging interest: and the dislike is fully justified for interest is a yield arising out of money itself, not a product of that for which money was provided. Money was intended to be a means of exchange; interest represents an increase in the money itself. Hence of all ways of getting wealth, this is the most contrary to nature."

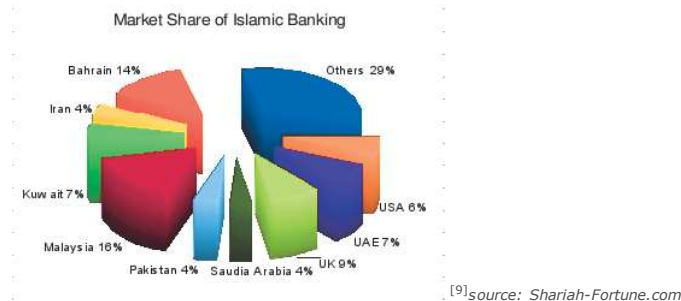
With much the same viewpoint of Aristotle, Islamic finance holds that money itself does not have the quality of growing or lessening; it is an inert thing that acquires value through the merit, talent or labor of someone else. Thus, money is an instrument that can be decreased or increased only by the person who is using it. Interest-based lending is further criticized on the basis that it creates inequity by favoring the rich and running against the interest of the whole society by allowing a small group to attain vast profits.

Islamic finance adopts an alternative to interest-based lending in the form of partnership-based focus: [Profit and Loss Sharing](#) <sup>[5]</sup> (PLS), which allows for the investor and entrepreneur to bring together their capital so that risk and reward can all be shared. PLS is intended to benefit society as a whole, and is executed in Musharakah and Mudarabah. Musharakah involves partners providing funds for a venture, with profits shared according to their invested capital. Consequently, the loss is also taken the same way. Banks partake in this as well, and the bank's part of the profit is linked to their financial risk. Mudarabah is when one partner gives money and the other party provides his knowledge/talent to invest and manage the project. Then the profit is shared according to a predetermined ratio.

On an international level, Islamic banking units have been launched by some of the largest international banks, including HSBC, Lloyd TSB, and Citibank. The United Kingdom has experienced great growth in the field, with over 20 institutions offering Islamic banking facilities, and more than 2 million people taking advantage of them. Harvard University has also started an Islamic Finance Project to conduct research and analysis aimed at promoting better understanding of the field. It seeks to further dialogue on the subject by conducting Islamic Finance Forums, with prominent players from all over the world participating.

After taking the throne from Malaysia, the U.A.E is currently the Islamic banking hub, but that could soon change, according to [an article in Forbes](#) <sup>[6]</sup> by Lionel Laurent. Cities like Singapore, London, Hong Kong, Bahrain, and Sydney are all eying the sector, hoping to become the center of the Islamic banking world.

London is already regarded as the West's hub for Islamic banking. It began offering mortgages that were compliant with Islamic law as early as 2003, and it continues to grow as it is now offering [Sukuk bonds](#) <sup>[7]</sup> or Islamic bonds. The Australian Government is also keen on Islamic finance as Trade Minister Simon Crean recently introduced the Government's [first publication](#) <sup>[8]</sup> on the subject. Crean stated that: "Islamic financing is a crucial plank in the Government's strategy to make Australia a financial hub in the Asia Pacific region."



While Islamic finance has become increasingly popular worldwide, there remain issues that impede its growth. Corruption and bad investments exist—whether real or perceived—in countries which are among the largest practitioners of Islamic finance, tainting its reputation with risk in the West. Further, varying interpretations of Shahria'h in terms of what is lawful and what is not can cause confusion, regulatory challenges, and difficulties in acceptance.

Nevertheless, Islamic finance is vastly expanding. The current holdings are estimated at around \$1 Trillion worldwide. Once Islamic finance finds some uniformity, a better regulation system, and easier ways for universal adoption, it could become a driving force in the world of finance. As a result, [The World Bank announced](#) <sup>[10]</sup> at the end of 2009 that it plans to try and help uniform Islamic finance by working with Islamic finance industry standard-setting bodies.

Article printed from AllAboutAlpha: Hedge Fund Trends & Alternative Investment Analysis: <http://allaboutalpha.com/blog>

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[1] AllAboutAlpha.com Editorial Board: <http://allaboutalpha.com/blog/about-us/editorial-board/>

[2] Image: <http://allaboutalpha.com/blog/wp-content/uploads/2010/02/islamic-finance.jpg>

[3] as provided here: [http://en.wikipedia.org/wiki/Islamic\\_banking](http://en.wikipedia.org/wiki/Islamic_banking)

[4] legitimate trade and investment in assets: <http://islamonline.com/news/articles/73/What-are-Islamic-funds-.html>

[5] Profit and Loss Sharing: [http://74.125.95.132/search?](http://74.125.95.132/search?q=cache:aH7PxM11flkJ:www.globalwebpost.com/farooqm/writings/islamic/i_econ_fin/if_partnership.doc+islamic+profit+and+loss+sharing&cd=2&hl=en&ct=clnk&gl)

[q=cache:aH7PxM11flkJ:www.globalwebpost.com/farooqm/writings/islamic/i\\_econ\\_fin/if\\_partnership.doc+islamic+profit+and+loss+sharing&cd=2&hl=en&ct=clnk&gl](http://www.forbes.com/2008/04/21/islamic-investment-dubai-cx_1l_islamicfinance08_0421cities.html)

[6] an article in Forbes: [http://www.forbes.com/2008/04/21/islamic-investment-dubai-cx\\_1l\\_islamicfinance08\\_0421cities.html](http://www.forbes.com/2008/04/21/islamic-investment-dubai-cx_1l_islamicfinance08_0421cities.html)

[7] Sukuk bonds: <http://en.wikipedia.org/wiki/Sukuk>

[8] first publication: <http://www.austrade.gov.au/Landmark-Islamic-finance-publication-Ministerial/default.aspx>

[9] Image: [http://allaboutalpha.com/blog/wp-content/uploads/2010/02/pie\\_chart1.jpg](http://allaboutalpha.com/blog/wp-content/uploads/2010/02/pie_chart1.jpg)

[10] The World Bank announced: <http://english.alrroya.com/content/world-bank-help-islamic-finance-standardise>