**Scientific Journal of October 6 University**
ISSN (Print): 2314-8640
ISSN (Electronic): 2356-8119
Published by October 6 University © All Rights Reserved
Available online at: http:// sjou.journals.ekb.eg

**Citation: Salwa, M.**, (2018). Ethical Mutual Investment Funds and Islamic Investment Funds: A comparative study. Sci.J. of Oct. 6 Univ. 4(2), 75- 81.


**Original Article**

# Ethical Mutual Investment Funds and Islamic Investment Funds: A comparative study

**Salwa . M. Ahmed**

Economics in Commerce Faculty at El Azhar university

**Received: 10-04-2017** **Revised: 18-04-2017** **/ Accepted: 20-7-2017**

## Abstract

Ethical investment funds or socially responsible investment funds (SRIFs) became among the most important financial instruments encouraged corporate social responsibility at the level of financial markets as investors rushed to financial products Which agree between social and environmental responsibility for investment with acceptable performance. Since investors become more aware of the benefits of Ethics and socially responsible investment, the interest in Islamic investing and Ethically Based Investment is also increasing.This paper is concerned with the role of ethical investment funds andIslamic investment funds in economic development and raising growth rates through the promotion of the financial market.This paper addresses four key points, First, the concept of ethical investment and Islamic investment, secondly the concept of Islamic and Islamic investment funds,thirdly study the role and importance of ethical investment funds and Islamic funds in financial market. And finallycomparing ideas, ratios and investment styles underlying SRI and comparing them to Islamic portfolios. with a qualitative assessment of the differences and similarities, SRI and Islamic derived from the application of the investment screens. The paper concluded that the creation of socially responsible investment funds should be considered to meet the wishes of all segments, particularly Ethical Investors.

**Keywords:** Ethical investment , Islamic investment , social responsible investment, corporate social responsibility, Ethical mutual funds, Islamic Investment funds.

## 1. Introduction

Operating While Ethics investment, or Socially Responsible Investing(SRI), seems to be mutually exclusive, ethics have recently become an important issue in the financial and investment fields. Ethics investments,Socially Responsible Investing (SRI),has grown substantially the last two decades, mirroring the public's concern with environmental and social issues.
One of the most important reasons for the emergence of socially responsible investment funds, on the one hand, is the realization of desires and investors' preferences that are not directly realized in the markets, the most important of which are so-called priorities Social, as many investors aspire to make profits, but wants to be restricted to religious purposes, on the other hand, is to achieve a more socially acceptable outcome, without causing Social or political Long-term economic and social imbalances, or disruption of family and social harmony or moral fabric Community.
Islamic investment or Islamic finance or sharia-compliant finance is banking or financing activity that complies with sharia (Islamic law) and its practical application through the development of Islamic economics. Some of the modes of Islamic banking/finance include *Mudarabah* (Profit and loss sharing),*Wadiah*(safekeeping)*Musharaka*(joint venture), *Murabahah* (cost plus), and *Ijar* (leasing).
Among the most important objectives of the Islamic finance in general and particularly the Islamic banks, is

***Corresponding Author Address:** Salwa Mahmoud Abu deif Ahmed , lecture r of Economics in Commerce Faculty at El Azhar university.Email-:salwadeif@yahoo.com

the establishment of justice and elimination of exploitation in business transaction. This can be done by the prohibition in of all sources of illegal "unjustified" enrichment and the prohibition of dealing in transactions that contain excessive risk or speculation

Islamic investment funds are difference from other traditional funds in terms of the nature of relationship between funds managers and investment unit (Sukuk) holders, the nature of savings collection instruments, and the financial institutions that they deal with.This paper study the underlying concepts and principles of SRI and Islamic funds as investment classes, and try to determine whether Islamic mutual funds, as faith-based investments, can be included into the category of socially responsible mutual funds, or if they exhibit distinguishing characteristics that indicate that they would be more fittingly grouped in a separate investment family.

**Objectives of the study.**

There is an increased emphasis on the role of faith and religious beliefs on ethical business practices for some investors who not only seek profits through their investments but they also require the achievement of a moral duty beside the quest of wealth accumulation. Since investors become more aware of the benefits of Ethics and socially responsible investment, the interest in Islamic investing and ethically based banking is also increasing. Ethics investments, Socially Responsible Investing (SRI),has grown substantially the last two decades, mirroring the public's concern with environmental and social issues. There is an increased emphasis on the role of faith and religious beliefs on ethical business practices for some investors who not only seek profits through their investments but they also require the achievement of a moral duty beside the quest of wealth accumulation.Since investors become more aware of the benefits of Ethics and socially responsible investment, the interest in Islamic investing and ethically based investment is also increasing.

The study aims to trace this phenomenon and highlighting the importance of this industry at the level of financial markets. The fundamental questions for this paper is:

1. What is the concepts of Ethical-Socially responsible Investment and Islamic investment?
2. What is the importance of Ethical-Socially responsible Investment funds and Islamic funds in the financial markets? or Can Ethical Investment funds help stimulate financial markets?
3. What are the leading international experiences in utilizing socially responsible investment funds as a mechanism to stimulate the Financial market?

**Methodology**

**To answer these questions, this paper essentially states that:**

1. Investors tend to open up to the environment and moral culture caused by the emergence of socially responsible investment funds.
2. Ethical Investment funds are a shortcut to stimulate the financial market by stimulating targeted investors
3. Developing markets can benefit from some of the leading international experiences in exploiting ethical investment funds as a mechanism to stimulate the financial market.
4. Developing a conceptual framework for the concept of Ethical investment funds - Socially Responsible - and Islamic funds, in addition to its importance.
5. Identify the role of Ethical and Islamic investment funds in the financial markets.

By qualitative and analytical methodology we concentrate on the analysis of the main investment strategies applied in the screened portfolios (Ethically and Islamic), and discuss fund management issues. Concentrating on similarities and differences between Ethical and Islamic Funds.

**the literature Review**

Socially responsible investing (SRI) has grown substantially the last two decades, mirroring the public's concern with environmental and social issues. The development of ethically screened investments emerged in the 1970s as a demand-driven response. Initially, just a few investors, concerned with screening out armaments and "sinful" stocks, invested in the Pax World Fund and the Friends Provident Stewardship(Elmelki & Ben Arab ,2009).

Several empirical studies have been conducted to measure the performance of Traditional Investment funds,Socially Responsible Investment funds and Islamic Investment funds such as the studies of Grossman and Sharpe (1986), Luther, Matatko and Corner (1992), Hamilton et al. (1993), Mallin *et al.*(1995) Elfakhani and Hassan (2005), Mansor and Bhatti (2009)and M. KABIR HASSAN & ERIC GIRARD,(2010).

Grossman and Sharpe (1986) analyzed The relation between financial investments and ethical concerns in response to the so-called "South Africa divestment".They examined the impact of U.S. corporate divestitures from South Africa on pension fund portfolios. The methodology employed by these studies generally involves construction of two different investment portfolios: one without a divestment policy, and the other, a South Africa Free(SAF) portfolio. The two universes were completely different in terms of size. The divested SAF universe consisted of companies whose market capitalization was significantly smaller than those of the total universe. While the findings are mixed, they essentially indicate that avoidance of South Africa related stocks does not improve the returns of an investor who has previously made an optimal set of investment decisions.

Luther, Matatko and Corner (1992) focused their analysis on British Ethical Funds,applied to the returns of 15 ethical mutual funds by investigating their performance and the potential size effect associated with performance. In their research they found some weak evidence of over/under performance relative to benchmark indices.Besides, abias towards smaller companies for ethical mutual fund isdocumented.

Early evidence found by Hamilton et al. (1993) found evidence that the market did not price social responsibility characteristics, and that these markets gain nothing in terms of their expected stock returns and financial cost of capital.So Socially Responsible mutual funds did not earn statistically significant excess return and the performance of such mutual funds was not statistically different from the performance of conventional mutual funds. The study of Mallin *et al.* (1995) overcame the benchmark problem of the early studies by using a matched pairs analysis in their UK investigation. They compared the performance of a group of ethical funds with a sample of non-ethical funds, matched on the basis of age and size. They studied the returns earned by 29 UK ethical funds and 29 UK non-ethical funds between 1986-1993.The results of Mallin show that the ethical funds tended to outperform the non-ethical funds.

According to Elfakhani and Hassan (2005) and Hussein (2005), the behavior of Islamic mutual funds does not differ from that of conventional funds. The simple explanation for these similar performances stems from the number of stocks that belong to the portfolios: the minimum threshold needed to eliminate specific and diversifiable risks is guaranteed for both the Ethical and Islamic investment context.Islamic mutual funds are still in their infancy stage of growth and development, most having been around for less than a decade.

Mansor and Bhatti (2009) use yearly data of Malaysian mutual funds industry from 1999 to March 2009, and daily return data of Malaysian mutual funds from July 1, 2008 to May 10, 2009 to analyze the performance and growth rates of Islamic mutual funds and conventional mutual funds in Malaysia. They use non-risk adjusted average returns, standard deviation, and correlation analysis.There is strong correlation between Islamic mutual funds and conventional mutual funds

M. KABIR HASSAN & ERIC GIRARD, (2010), examine the performance of seven indexes chosen from the Dow Jones Islamic Market Index (DJIM) and their non-Islamic counterparts using a variety of measures.Theyanalyze the persistence of performance using four factor pricing models. They use co-integration to examine how the Islamic indexes compare to their non-Islamic counterparts .The sample period is from January 1996 to December 2005 (120 data points) which is further broken down into two sub-periods ,from January 1996 to December 2000 (60 observations) and from January 2001 to December 2006 (60 observations).The main result of the studyis that no difference between Islamic and non-Islamic indexes. The Dow Jones Islamic indexes outperform their conventional counterparts from 1996 to 2000 and underperform them from 2001 to 2005. Overall, similar reward to risk and diversification benefits exist for both the Islamic and conventional indexes.

Recently, Hoepner et al. (2010) studies the investment style of 265 Islamic equity funds and find that Islamic funds are often ‘growth’ portfolios and show a preference for small cap stocks.

The applied studies have shown that there is a good performance of Islamic investment funds and Ethical Investment funds compared to Traditional Investment funds despite the lack of diversification resulting from the rejection of several types of investments contrary to the purpose of these funds, in addition to good performance. During crisis reversing Traditional Investment funds. From a portfolio theory point of view, there are likely to endanger the performance of the portfolio due to a lack of diversification. For this reason, most researchers have tried to determine whether Islamic Investment funds and Ethical Investment funds perform worse than common funds because of less diversification and/or sector exclusion

**Ethical Investment funds Versus Islamic Investment funds (similarities and differences)**.

To introduce morals, religion and conscience into investments is a challenging task and a difficult problem to overcome. Business ethics scholars are unable to precisely define social investing, and attempts to identify what falls within the ambit of social investing. Since the religious beginning of ethical investments, many overlapping investment styles have been grouped into the bucket of socially responsible investments , or SRI. This includes, for instance, faith-based investment **(**Katherina, 2009***)***

The concept of Ethical Investment is based on the philosophical, religious or moral convictions of individual or collective investors, who exclude from their investment universe all stocks in fields which they consider contrary to their convictions. Ethical Investing is growing phenomenon; it deals with the questions of what is considered to be right and what is wrong. In an economic context, Ethical Investments are meant not only to achieve monetary gains and outcomes, but also it relies much more on some other objectives different from those guided only by maximizing the expected utility from pecuniary wealth or income. Ethical investors are firstly concerned about the characteristics of the companies in which the funds are placed and then about the financial returns on their portfolios and the risks involved. This is essentially due to the "feel good" factor for those investors, which can make them having a good conscience about the returns on their assets(Elmelki & Ben Arab ,2009).

Socially responsible investing, as defined by the Social Investment Forum (2006), includes social screening (i.e., the consideration of social criteria to either avoid or seek out specific investments for a portfolio), community investing, and shareholder advocacy. Since over two-thirds of SRI assets are in screened mutual funds or separate accounts(Social Investment Forum, 2006),many financial institutions in the marketplace have started to offer products that consider different social issues in the selection of portfolio assets.(Elmelki & Ben Arab ,2009)

Cowton (1994) defines ethical investments as those that make use of ethical and social criteria in the selection and management of investment portfolios.Using this as a basis, many authors have tried to establish a comprehensive definition; however, this is not a simple task and business ethicists have not reached a general consensus. The world of ethical investments and definitions associated with it can be greatly influenced by the cultures of various countries. While religious criteria were originally used, they have been supplanted at times by environmental strategies, anti-war projects and human rights activism (Sparkes, 2002).

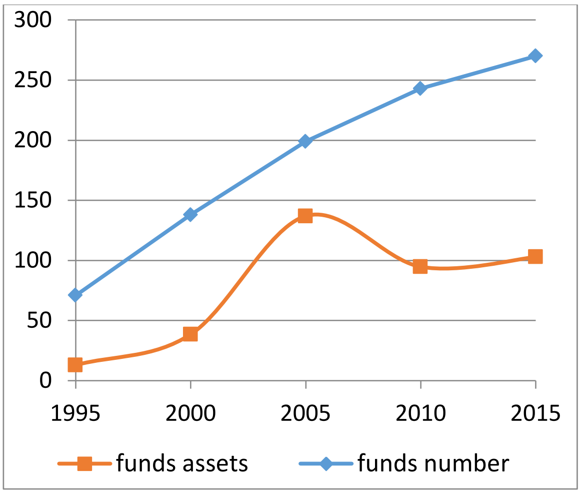
Eurosef defined Social Responsible Investment (Eurosef, 2016) "Sustainable and Responsible Investment (SRI) is a long-term oriented investment approach which integrates environmental, social and governance (ESG)ESG factors in the research, analysis and selection process of securities within an investment portfolio. It combines fundamental analysis and engagement with an evaluation of ESG factors in order to better capture long term returns for investors, and to benefit society by influencing the behavior of companies"(Eurosef,2016).

The definition provided by the North American Social Investment Forum is only slightly different, stating that "socially responsible investing (SRI) is an investment process that considers the social and environmental consequences of investments, both positive and negative, within the context of rigorous financial analysis" (Social Investment Forum, 2005).

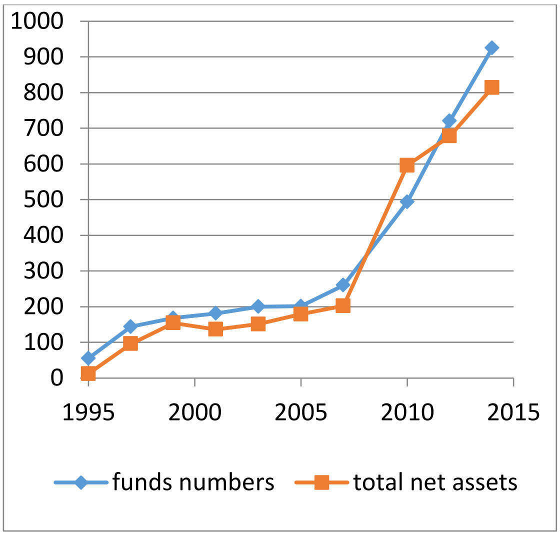
In all of the above definitions, the emphasis on financial performances is obvious – there is not social investment without financial soundness.Even if, in theory, an investor is willing to sacrifice some part of performance to reach social goals that he considers very important, the performance of ethical funds is very much of concern as in the case of any other financial investment (Wilson, 1997).

Many financial markets have succeeded in meeting the demands of ethical investors to create portfolios of ethical and religious investments through which they can enter the financial markets without compromising their beliefs and principles.

**Figure (1): Islamic investment funds in Saudi Arabia**




**Figure(2): Ethical investment funds in united states**




Ethical investment funds have been able to attract capital seeking ethical investment, from a single ethical fund in 1971 to 493 ethical funds in 2010 with a net asset value of 596 billion US dollars. Of these, 8 are Islamic funds with more than US $ 2.7 billion

Islamic law and precepts constitute a part of every Muslim's cultural and spiritual identity. These laws are based largely on the Qur'an and the Sunnah, which is the practice of the Prophet. The Holy Qur'an does not contain only moral teachings, but offers guidance in all aspects of life, including any socio-economic behavior. This should not be surprising; the Prophet was a successful business man, known for his integrity and honesty. In his teachings he regulates family behavior and inheritance, contracts and property, social and fiscal norms, and the use of public and private goods.

Islamic economy is founded on Shari'ah: it does not deny profit, private ownership and market forces, but they are not given total freedom and must be reached in accordance with the divine prescriptions.The application of Sharia to investment choices and management is not a new phenomenon. Earlier Muslims were able to establish an interest-free financial system for mobilizing resources to finance productive activities and consumer needs, which had worked effectively for centuries. As Muslim societies became more sophisticated, and their financing needs more complex coupled with stagnating Islamic thought evolution, the Islamic-based financial system was gradually replaced by the interest-based system in recent times. The contemporary increasing desire of Muslims to bring their modern economic and financial activity to conform again with their cherished religious values and beliefs, has led to a growing interest in Islamic-approved Investment vehicle(Said Elfakhani& Suliman S. Olayan& M Kabir Hassan , 2005).

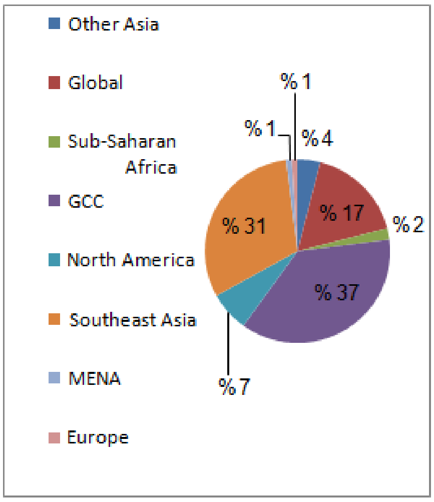
Figure (1) shows that Saudi Arabia was one of the Pioneer countries to understand the specifics of ethical investors, resulting in a large and rapid response by investors to the financial market, investment in Islamic funds and socially responsible

Islam has very clear prescriptions about how business should be done with special focus on the social and ethical dimensions of business. Islam requires Muslims to lead their lives according to the Islamic legal code of 'Shariah' that Muslims worldwide are expected to follow to the extent possible given their circumstances. The Shariah, or divine guiding principles, is the Islamic law of human conduct which regulates all matters of the lives of Muslims. It is based on God's holy word in the *Qur'an,* the deeds and sayings of the prophet Mohammed (*Sunah*), and the consensus of Islamic religious scholars). Islam places the highest emphasis on ethical values in all aspects of human life. In Islam, ethics governs all aspects of life.Islamic teachings strongly stress the observance of ethical values and moral principles in human behaviour which are repeatedly stressed throughout the Holy *Qur'an* and the numerous teachings of the Prophet (PBUH).The most important of the basic Islamic values of life are the believe in the existence of God-the creator, temporary life on earth, accountability of all actions on the Day of Judgment, and reward by the All-Aware according to the real motive of every human action. Among the principle pillars of an Islamic society are love and fear of God, honesty, and justice .Islamic finance flows from the principle that religion cannot be divorced from any aspect of life, including business.

The number of Islamic investment funds around the world has grown significantly, with only 300 Islamic funds in 2004, more than 750 in the first quarter of 2010, with a steady increase. Assets managed by Islamic funds reached $ 52.3 billion at the beginning of 2010, up from $ 29.2 billion at the end of 2004.

The 2007-2008 global financial crisis has negatively impacted traditional investment funds, leading to a decline in their managed assets from $ 26.1 trillion in 2007 to $ 19 trillion at the end of 2008. However, Islamic investment funds continued to rise even during the financial crisis.

**Figure(3):Global Islamic Funds Outstanding by Geographic Area End 2014percentage of assets under management**




The majority of the asset managementproducts are targeted toward people who arewell-off. For example, in the MENA Region,while public pension funds target governmentemployees, private pension funds are targeted toward a small number of privileged professionals. As a result, people with lower income levels are unable to benefit.Achieving the goal of shared prosperity will require coming up with products that serve the needs of the poor and low-income groups. Although still at the idea stage, a recent opportunity in the Islamic finance realm that can contribute to the well-being of a society is the socially responsible investment (SRI)*sukuk*, which provides the investors opportunitiesto invest in assets and projects that are targetedto produce environmentally sustainable and socially responsible outcomes.

The area of socially responsible investment (SRI) has great potential for the Islamic asset management industry to increase its contribution to shared prosperity. The notions underlying the SRI concept have a lot in common with the broad goals of Islamic finance. The strong emphasis on adhering to the values related to social and environmental development inherent in Islamic theology and jurisprudence has important implications for the investment behavior of investors in Islamic finance. Therefore, relating the Islamic finance products such as *sukuk* to the concept of SRI and building a product structure that complies with the fundamentals of the SRI concept will not only increase the number of products in which both Muslim and non-Muslim investors may invest but also increase the contribution of Islamic asset management to shared prosperity.

## Conclusions

Summing up, we have verified through qualitative methodology that Islamic funds show different characteristics when compared to SRI, both in terms of asset allocation and economic profile. Faith based funds are managed in accordance with specific, clearly defined values, and these values can clash with the emphasis of SR fund places on human rights and environmental protection.

This research is located in the topic area of Ethics and social responsibilities in the financial field with a particularemphasize on the Ethical and Islamic investment funds.Islamic finance in general and the Islamic funds in particular can be seen as new ideas and applications to bring investment ethics and social justice into the financial and economic fields. The Islamic financial system has ethical foundations which are based on achieving prosperity and fair distribution of income and wealth among the society. The principles of Islamic financial market were derived from the Shariah law (Islamic law). According to the Islamic finance the ethical investment is based on a moral filter which defines the levels of halal (permissible) and haram (prohibited and undesirable) promoting a positive social climate for society, and providing an expedient legal framework. In prohibiting transactions based on the interest rate, Islam seeks to establish a society based upon fairness and justice. Islamic law besides prohibiting the payment and/or collection of interests also prohibits financing activities which conflicts with the moral value system of Islam such as dealing with liquor, pork, gambling, a casino, a night club or any other activity which is prohibited by Islam or known to be detrimental to society and anything which Islamic law deems Haram (unlawful).

by the qualitative methodology we concentrate on the analysis of the main investment strategies applied in the screened portfolios (Socially Responsible and Islamic), and Concentrating on similarities and differences between SR and Islamic Funds, and basing our considerations on an ideal archetype of SR fund.

Islamic Investment Funds is a unique instrument for expressing social and environmental responsibility and good performance, for a sense a Muslim is responsible for others, for the environment and for future generations as a successor in the land. With the establishment of Islamic banks, the establishment of Islamic investment funds was started. Many of them were established in countries Arab and others, to work on investment in accordance with Islamic law, and helped to create these funds.

The business relations in the Islamic framework are mainly ethics based originating from religious beliefs, trust and faith. Religious norms/values and beliefs are supposed to regulate human behavior in society. The Islamic finance embraces the philosophy of risk sharing, ethical and religious goals, including a quest for justice, and the promotion of social and economic welfare which extends beyond profit maximization. (Elmelki & Ben Arab, 2009).

## References

**-Annual Banking and Finance Conference**, Melbourne University. 2009: 15-17

- Elmelki Anas& Ben Arab Mounira(2009) *Ethical Investment and the Social Responsibilities of the Islamic Banks*, ***International business research***, 2:1.

-Elizabeth F. Goldreyer, J. David Diltz. (1999)"*The performance of socially responsible mutual funds: incorporating sociopolitical information in portfolio selection*", ***Managerial Finance***, 25; 1: 23-36.

-Ernst & Young, 2010,*Islamic Funds & Investments Report*,**6th *Annual World Islamic Funds & Capital Markets Conference***, ( www.EY.com)

-Fadillah Mansor & M. Ishaq Bhatti,2009,*The performance of Islamic mutual funds: The Malaysian Case*, **The *14th Annual Banking and Finance Conference***, Melbourne University, 2009

-Grossman, B. and W. Sharpe (1986), "*Financial Implication of South African Divestment*," ***Financial Analysts Journal***. 42; 4: 15-29.

-Hamilton, S., Jo, H., and Statman, M. (1993): "*Doing Well While Doing Good? The Investment Performance of Socially Responsible Mutual Funds*" ***Financial Analyst Journal***, 49(6): 62-66.

-Hung-Gay Fung, Sheryl A. Law and Jot Yau,2010,*Socially Responsible Investment in a Global Environment*, ***Edward Elgar Publishing*, Inc**., USA.

-John B. Guerard, Jr& Bernell K. Stone "*Socially Responsible Investment Screening: Strong Empirical Evidence of no Significant Costfor Actively Managed Value-Focused PORTFOLIOS*"

-Katherina Glac,2009, Understanding *"Socially Responsible Investing: The Effect of Decision Frames and Trade-off Options"*, ***Journal of Business Ethics***. 87; 1: 41–55

-Luther, R. G. and J. Matatko (1994), "*The Performance of Ethical Unit Trusts: Choosing an Appropriate Benchmark*", ***British Accounting Review***, 5; 4:57-70.

-Luther, R. G., John Matako and Desmond C. Corner (1992), "*The Investment Performance of UK 'Ethical' Unit Trusts*", ***Accounting Auditing& Accountability Journal***, 5; 4: 57-70.

-Milton Friedman , 1970, *"The Social Responsibility of Business is to Increase its Profits"*, ***The New York Times Magazine***, September.

-Mark St Giles, et al, *"Managing Collective Investment Funds*", Second Edition, **John Wiley Edition**,-7 England, 2003.

-Mallin, C., Saadouni, B. and Briston R. (1995) "*The Financial Performance of Ethical Investment Trusts*" ,***Journal of Business Finance and Accounting***, **22** (4), 483-496.

-Mansor, F., & Bhatti, M. I. (2009*)."The Performance of Islamic mutual funds: The Malaysian Case*".Paper presented in the *14th* ***Annual Banking and Finance Conference***, Melbourne University, September 29.

-M. KABIR HASSAN & ERIC GIRARD 2010, "*FAITH-BASED ETHICAL INVESTING : THE CASE OF DOW JONES ISLAMIC INDEXES*", ***Islamic Economic Studies***. 17:2.

-Salina H. Kassimand Saqinah Kamil, 2012," *PERFORMANCE OF ISLAMIC UNIT TRUSTS DURING THE 2007 GLOBAL FINANCIAL CRISIS:EVIDENCE FROM MALAYSIA* "***Asian Academy of Management Journal***, 17; 2: 59 –78.

-Said Elfakhani& Suliman S. Olayan & M Kabir Hassan , 2005 *,"comparative Performance of Islamic Versus Secular Mutual Funds "****School of Business American University of Beirut***, Beirut, Lebanon.

-**Social Investment Forum Foundation,** ***Report On Socially Responsible Investing Trends In The United States*** **2010** :8.

- (Www.Socialinvest.Org)