Available online at www.jeeir.com

JEEIR

e-ISSN: 2289-2559

Journal of Emerging Economies & Islamic Research 7(1) 2019, 1 – 13

Journal of Emerging Economies and Islamic Research

Understanding Socially Responsible Investing and Its Implications for Islamic Investment Industry

Mohd Nizam Barom*

Department of Economics and Centre for Islamic Economics,
Kulliyyah of Economics and Management Sciences, International Islamic University Malaysia

ARTICLE INFO

Article history:
Received 15 November 2018
Received in revised form
29 December 2018
Accepted 3 January 2019
Published 31 January 2019

Keywords:
Socially responsible investing;
Islamic investment;
Islamic finance;
Ethic;
Social responsibility

ABSTRACT

Social, ethical and environmental concerns have been used as important consideration for investment decision by an increasing number of investors. This can be seen by the size and growth of the socially responsible investment (SRI) industry in the developed economies. At the same time, scholars and commentators of Islamic finance have also called for Islamic investment industry to learn from the experience of SRI in incorporating social responsibility issues in the investment process, in line with the ethical principles of Islam and the overall objective of the *Shari'ah* (*Maqasid al-Shari'ah*). This would require Islamic investment sector to have a clear understanding of the SRI industry in order to effectively benefit from its experience. This is particularly critical due to the significant diversity of investors and complexity in the issues and strategies adopted in the SRI industry. Hence, this paper adds to the Islamic investment literature by providing an extensive and systematic survey of SRI industry in terms of its (i) underlying motivations and values; (ii) issues of concerns; (iii) types of investors; and (iv) screening strategies. It then synthesizes these components within the context of the 'value-based' investors. This synthesized framework offers a useful tool for Islamic investment practitioners to understand the theoretical and practical aspects of SRI. Subsequently, the paper highlights important implications of the findings for Islamic investment industry in terms of the issues that it needs to consider in emulating SRI practices and a number of lessons that it can learn from the SRI experience.

1. Introduction

Socially responsible investing (SRI) has increasingly becoming a mainstream investment philosophy not only in the Western markets such as in Europe, United States and Canada, but also has flourished in Asia, Japan, Australasia and Africa. Based on the recent global review of the industry, SRI assets has increased from US$13.3 trillion at the outset of 2012 to US$22.89 trillion in 2016 (GSIA, 2017). There

* Corresponding author. Tel.: +603 61964623; Fax: +603 61964850
E-mail address: mohdnizam@iium.edu.my

are a number of important factors that have contributed to the tremendous growth of the industry since 1980s. Apart from the growing investor concerns of social responsibility records of corporations, the increased evidence that ethical funds produce attractive returns (or at least generate similar returns) have pushed SRI into the mainstream investment practice. This growth is enhanced by the growth in advertising and media exposure, the introduction of sustainability indices and the infrastructural support provided by an increasing number of national and regional social investment forum and organisations (Schwartz, 2003). More recently, the launch of the United Nations Sustainable Development Goals (SDGs), with the agenda of addressing global social and environmental challenges, has further increased the appeal and role of the SRI industry worldwide (EuroSIF, 2017).

The growth of SRI and its increasing role of influencing better social, ethical and environmental performance among businesses have made many scholars of Islamic finance to call for Islamic investment industry to build bridges with the SRI movement and emulate its approaches. This is more acute in the face of various criticisms levelled against the industry. For instance, it is said that Islamic finance is a 'prohibition-driven' industry focussing on the legal injunctions of the *Shari'ah* at the expense of its holistic ethical orientation (El-Gamal, 2006; Cattelan, 2010). This is also true in the context of Islamic investment industry as the screening approach is purely exclusionary and the criteria use for screening are absence of ethical concerns beyond the major injunctions of the *Shari'ah* (El-Gamal, 2006; Wilson, 2004; Sairally, 2007; Lewis, 2010; Mohamad *et al.*, 2017). While there are recommendations for Islamic investment to consider banning investment in companies with poor treatment of labour or detrimental environmental policy (Yaquby, 2000; Norman, 2004), these have not been incorporated in the screening process. The incorporation of social responsibility concerns in the Islamic investment industry would be consistent with the objective of the *Shari'ah* (Laldin and Furqani, 2013), and potentially plays an instrumental role in promoting positive impact to the overall wellbeing of the society (Barom, 2013).

In the light of the above, the objectives of this paper are two fold. First, it seeks to provide an extensive and systematic survey on both theoretical foundation and practical aspect of the SRI industry, in order for the Islamic investment sector to effectively benefit from its experience. Secondly, based on the synthesis of the SRI literature, the paper aims to highlight important implications of the findings for Islamic investment industry in terms of the issues that it needs to consider in emulating SRI practices and a number of lessons that it can learn from the SRI experience. For this purpose, the paper proceeds as follows. Section 2 surveys the SRI literature in terms of the underlying values and motivation; issues of concerns; types of investors; and screening strategies. Section 3 synthesizes these different components which resulted in a framework that links the theoretical and practical aspects of SRI, particularly in the context of the value-based SRI investors. Subsequently, Section 4 highlights a number of important implications of the findings on Islamic investment sector, while Section 5 concludes the paper.

2. Understanding SRI

The SRI movement aspires to bring social, ethical and environmental dimensions in investment decisions alongside financial returns. Numerous terms have been used to describe this investment philosophy, for instance 'social investment', 'mission-based investing', 'green investment' and perhaps many more, but the two most used terms are 'ethical investment' and 'socially responsible investment' or SRI, where the latter has become more popular and accurate to represent the mature and developed approach of the field. It has now become widely perceived that ethical investment constitutes a reactive measure with a narrow focus that typically entails negative screening, while SRI includes a proactive measure that searches for companies who uphold good practices, and seeks to change corporate behaviour through positive engagement with management (Scanlan, 2005). In other words, SRI is seen as a broader umbrella term that includes ethical investment, and other socially and environmentally oriented investing such as green and mission-based investment, where various approaches are used from simple exclusionary screens to complex corporate engagement. The following sub-sections survey the SRI literature in four important areas, namely investors' motivation and ethical values of SRI; SRI criteria; SRI investors; and SRI strategies, in order to provide a comprehensive and insightful understanding of the industry.

2.1 Motivation and Ethical Values Underlying SRI

The goals of social investors are the key in understanding the values and motivation underlying SRI, and many researchers have approached the SRI practice from the perspective of social investors. For instance, SRI literature has identified two important aspects to the motivations for investing responsibly; the desire to align or integrate personal or institutional ideals with economic interest, and to advocate social change among corporations as to promote positive impact on communities, employees, customers, shareholders, and the environment (Domini, 2001). Due to their importance in shaping the practice of SRI, some have also defined SRI from the investors' viewpoint. For instance, Kinder (2005: 4) defines SRI as "the incorporation of the investor's social or ethical criteria in the investment decision-making process", and the European Social Investment Forum (EuroSIF, 2006: 1) states that "SRI combines investors' financial objectives with their concerns about social, environmental and ethical (SEE) issues".

One of the most important values influencing SRI is the ethical norms founded in religion. Wilson (1997) believes that religious teachings have strong influence in shaping people's conception of ethics, even in the context of increasingly secularised societies. "An understanding of religious teaching helps put ethical issues, including those involving economic relations, in a fuller perspective. Religion has a profound influence on personal and social values, which affects even those without beliefs." (Wilson, 1997: 1). Such claims can be easily validated in the present SRI practice as the religiously-oriented screening strategy of excluding "sin" activities such as gambling, alcohol, and weaponry remain as the leading criteria of SRI funds. In fact, Statman (2005: 14) suggests that "the origins of socially responsible investing lie in religion." Therefore, religious norms constitute an important component to the ethical justifications of SRI.

Rhodes and Soobaroyen (2010) add that the source of ethics for SRI investors can also be located from the concern of one's action towards others. Hence, exclusion of so-called "vicious" companies from the investment portfolio is one of the implications of this ethical value (Dubinski et al., 2003). Prevention of harm towards others or the natural environment entails that investing in arms industry, businesses having links with oppressive regimes, or polluting companies to be inconsistent with this principle. Other related sources of ethics such as universal principles of equality, justice and sustainability have also been championed by the various SRI groups, including feminists, humanity activists and environmentalists, with issues such as equal opportunity, human rights and climate change being strongly advocated.

However, some have questioned the "ethics" underlying the practice of SRI. For instance, the approach to crudely reject certain industry such as liquor, gaming, tobacco or nuclear as totally objectionable is considered to be simplistic, unacceptable and short of careful ethical judgement required by such a movement claiming to be based on 'ethical' values (Johnson, 2003). To go even further, Schwartz (2003) challenges the notion of "ethical screens" and questions whether or not the screening criteria pre-dominantly used by ethical funds can be identified as "ethical". Based on a set of moral assessments largely influenced by consequentialist ethics, he argues that apart from tobacco and possibly alcohol, other 'ethical screens' are lacking support of clear ethical principles which may render them to be 'unethical'. Such screens "are simply screens developed with the intention of reflecting intended investor's social, religious, or political attitudes or beliefs, and nothing more" (Schwartz, 2003: 211). On the other hand, Hawken (2004) criticises the flexibility in which SEE criteria are used and suggests that the SRI practice is too broad and to certain extent, 'meaningless'. Subsequently, he proposes a process of standardization of the SRI terms and strategies so as to bring them closer to a more puritist approach to ethics (Hawken, 2004).

While there are certainly disagreement on the issues considered as ethical or socially responsible, this does not suggest that SRI is absence of any moral grounding. Rather, this reflects the state of development it has reached, where various groups within the broad SRI industry pursue their own issues of concerns consistent with their respective moral, social or political convictions. In other words, religious values, humanist norms, or consequentialist ethics provide the underlying principles in which the SRI criteria are based, and subsequently, influence the strategies they adopt. However, as it will be shown later in this paper, not all SRI investors are subjected to such ethical grounding, as some, despite using SRI criteria in their investment, may not necessarily be motivated by any ethical reasons.

2.2 SRI Issues of Concern

SRI has evolved from an investment activity focusing on limited moral injunction into an investment industry addressing broad and diverse issues pertaining to SEE concerns. The roots of SRI in the western world can be traced back to its faith heritage. The founder of the Methodist church, John Wesley (1703-1791), presented some important ethical principles in his sermon, “The Use of Money” which included the call to avoid profiting from gambling, unfair lending and business practices, exploitation of labour, pollution, and corruption (Domini, 2001: 29). In the mid-18th century, the Society of Friends (Quakers) urged its members not to profit from any activity which enslaved fellow human beings (Domini, 2001: 30). The first known mutual fund to use moral injunctions, the Pioneer Fund which was established in 1928 in the U.S., avoided investing in alcohol and tobacco related businesses. This exclusion of ‘sin’ activities, which also include industries such as gambling, weapon manufacturing and pornography, has remained as one of the important SRI strategies today, particularly among faith-based investors.

The modern form of SRI industry emerged in the midst of the turbulent social and political climate in the 1960s in the U.S. as a result of the civil-rights, consumer, and environmentalist movements, coupled with the escalating protests against the Vietnam War, which had raised public sensitivity towards SEE issues. Such movements were further strengthened in the 1970s, and came to include management and labour issues and anti-nuclear sentiment. This new broad perspective of SRI was manifested by the launching of the Pax World Fund in 1971, and the Dreyfus Third Century Fund a year later, to be among the first social funds to avoid ‘sin stocks’, nuclear power and military defence contractors and to consider labour and employment issues (SIF, 2006).

Perhaps the most momentous period in SRI history is the anti-Apartheid movement in the 1980s and continued to the 1990s, as individual and institutional investors including charities, churches, universities, states and pension funds focused SRI strategies onto the corporations having interests in South Africa in the effort to dismantle the Apartheid regime. Subsequently, the disasters of Bhopal, Chernobyl, and Valdez, and the increasing threats of climate change have placed the environmental and sustainability concerns to the forefront of SRI issues. In recent decades, issues involving diversity records, ‘sweatshop’ practices (global supply chain issues), and oppressive regimes have also emerged as important criteria used in the screening, engagement and proxy resolutions among SRI advocates (SIF, 2006). Most recently, with the launch of the United Nations’ Sustainable Development Goals (SDGs), SRI industry has been instrumental, through its integration, sustainability-themed and impact investing strategies, in joining the global agenda of addressing, among others, the issue of poverty, climate change, economic inequality, sustainable energy and consumption (EuroSIF, 2017).

Despite the broad issues addressed by the diverse groups of SRI investors, the criteria of concerns can be summarised into two main aspects of the business; the first being the nature of its activities or sector (products/services), and the second being the policies and operational aspects of the business. As alluded earlier, some popular criteria related to the main business activity of companies include the avoidance of the 'sin' sector (gambling, alcohol, adult entertainment, tobacco and weapons), environmentally damaging sector (deforestation, pesticides/chemicals and mining), and sustainability sector (environmentally friendly technology and renewable energy). While the identification of SRI criteria based on the sector screen is quite a straight forward process, the SRI criteria related to the policies of the companies are more subjective in nature and cover a wide area of concerns such as business practices, labour standards, human rights, environmental policies, community involvement and corporate governance.

2.3 SRI Investors

In understanding SRI, it is very important to recognise the diversity of actors involved who may have significant differences in terms of their nature, motives, approach and objectives. One way of identifying such differences is by comparing between retail and institutional investors. Retail investment reflects individual's values and principles, and therefore, it is expected that investment should be made in a consistent manner or promote these values. However, such straight forward relationship may not be necessarily true in the case of institutional investors. EuroSIF (2003: 7) identifies three groups of institutional SRI investors; institutions like churches, foundations, and charities; companies investing with their own funds such as insurance companies, banks, and corporations; and investors investing money on behalf of others such as pension funds and other retirement financing systems. While the first two groups may be considered to represent "individualised" vision of ethics, investment decision of the latter have to reflect the interests of multiple stakeholders they represent.

From another perspective, Kinder (2005: 11-12) provides a very insightful observation on the present players of the sector. Recognising the "uncomfortable co-existence" between the "old" and the "new", he identifies three distinct categories of investors, beginning with "value-based", and followed by "value-seeking" and "value-enhancing" investors, each with different perspective and approach to SRI. Value-based investors aspire to align their investment with their personal or institutional belief and priorities. As such, exclusionary strategy has been widely used to avoid various types of investments that are inconsistent with their values. For instance, religiously conscious investors may avoid sinful industries such as gambling and pornography, or humanity activists would ban investing in arms manufacture or nuclear related industry. Similarly, these values will also form the basis for the implementation of other SRI strategies such as positive screening, engagement or shareholder activism.

With the rapid growth of SRI and the popular believe that investing based on SEE criteria may not necessarily result in lower returns, and in some cases, may even over-perform its conventional counterpart (Derwall *et al.*, 2011), another distinct type of SRI approach has emerged in the late 90s and is identified by Kinder (2005) as Value-Seeking SRI. Unlike value-based investors, value-seeking investors search for the social and environmental aspects of businesses which may affect financial performance and apply them as financial selection criteria to achieve higher returns. This observations is consistent with the description of Dubinski et al (2003) where they identify four types in which ethical concerns can be expressed in SRI practices: value-based ethics resulting in the exclusion of so-called "vicious" companies from the investment portfolio; fructification-oriented ethics with a view to long-term investment; consequence-based ethics aimed at initiating a behavioural change in the investment target; and ethics envisaged as a discriminating criterion in the search of the best financial performance. While the first three foundations of responsible investment are intrinsically reflective of value-based investors, the fourth can be seen as an attempt by investors to advance financial returns using ethical criteria without ascribing ethical values to the act of investing itself, rendering the plausibility of segmenting SRI investors into ‘value-based’ and ‘profit-seeking’ investors (Derwall *et al.*, 2011). This approach also resembles the instrumental premise of CSR, where social responsibility initiatives and stakeholder management are considered strategic tools to advance economic interest.

As SRI move deeper into the mainstream investment industry and is embraced by more institutional players, there emerged the third generation of SRI investors known as value-enhancing investors, where the techniques of “shareholder activism” and “engagement” are pre-dominantly used to maintain or increase the financial value of their investments (Kinder, 2005: 11). While the role of union and investor representatives is acknowledged as the catalyst in bringing institutional investors to the SRI front (EuroSIF, 2003), the concern towards the fiduciary responsibility is seen as one of the important impediments for many institutional investors, particularly pension funds to commit to broader social, ethical or environmental issues (Juravle and Lewis, 2008). This is consistent with the emphasis given by the value-enhancing investors to corporate governance characteristic of the companies they invest in, and less of its environmental or the social aspects, as the latter issues are less material to the financial aspect of the investment. This tendency was empirically observed on 101 U.S. and European institutional investors who are signatories of the United Nations Principles of Responsible Investment (UNPRI), where corporate governance issues were found to be given the most attention in investment policy statement and company reports by almost all of the investors (Sandberg et al., 2009).

2.4 SRI Strategies

The dynamic nature of SRI industry has stimulated the development of several new strategies to accommodate the changing environment and needs of investors. From its origin of a mere avoidance approach of ethically unacceptable sectors, the current SRI movement has adopted various other strategies such as positive screening and engagement or shareholders activism (Domini, 2001). In addition, EUROSIF (2006) identifies ‘integration’ as a new strategy used by SRI investors. Though each strategy can be implemented independently, investors often use more than one strategy in pursuing SRI.

Screening involves the traditional exclusionary strategy which uses negative criteria to filter out unethical businesses. Based on the practice in Europe, the EuroSIF (2006) identifies two other variations of negative screening strategies; simple screen and norms-based screen. Unlike the commonly practiced strategy where a large number of criteria are used in the filtering process, simple screen only focuses on the exclusion of single sector or issue of concern for its investment such as excluding arms industry, pornography or tobacco, or banning investment in certain countries for human rights reasons. Norms-based screening, on the other hand, based its negative screening process by examining the companies’ compliance with international standards and norms such as those issued by the International Labour Organisation (ILO) and the United Nations (UN).

If a negative screening tries to avoid ethically undesirable business practices, a positive screening, in contrast, adopts a more proactive approach and seeks to invest in businesses with good corporate social performance or with products or services that have positive impacts on both the community and environment. Examples of this approach are pioneer screening and sustainability-themed investing, where investment is focused on ‘industries of the future’, such as the transition to a sustainable development and a low carbon economy. Some SRI investors perceive exclusionary screening as restrictive and limits the potential sectors in the investment portfolio. This has led to the emergence of the ‘best-in-class’ strategy, where SRI investors invest in companies identified as leaders in the SEE front within each sector, including the traditionally problematic ones. For instance, in Canada, if the natural resource sector (oil and gas, mineral deposits, paper and forest products) is screened out, the remaining large cap companies are too small for an efficient investment portfolio (Schwartz, 2003). Using this strategy, companies which are otherwise excluded based on the exclusionary screening of unacceptable sectors can still be included in the portfolio, provided that these companies demonstrate good social responsibility records and stand out from others in the industry.

Engagement or shareholder activism is another approach in which SRI investors can exercise their influence as shareholders to promote responsible business behaviour onto the companies or to protect and enhance returns from investment. SRI investors will engage in a dialogue with the management on their issues of interest related to social, ethical, environmental or corporate governance. In cases where agreement cannot be achieved, SRI investors may use their power to sponsor resolutions and vote on them during the companies' Annual General Meeting. Finally, a recent development of the SRI industry identifies integration as the new trend in which investors incorporate ESG issues into investment. This strategy entails an explicit inclusion of social, ethical, environmental and corporate governance risks by asset managers into the traditional financial analysis for investment purpose. For instance, a recent EuroSIF survey found that about 80 percent of SRI respondents indicated that they adopt some degree of ESG integration in their investment analysis. This is very encouraging as EuroSIF considers ESG integration as one of the key strategies in advancing Sustainable Development Goals (EuroSIF, 2016). The other essential approach is 'impact investing', where strategies such as 'best-in-class', sustainability-themed investing, and shareholder engagement and activism are used to foster favourable social and environmental impact in the community (EuroSIF, 2017).

3. Synthesis of SRI Literature

Based on the preceding discussions, this section seeks to provide an overall understanding of SRI by synthesising the available literature on the theoretical underpinnings and practical aspects of SRI. It has become apparent that the SRI industry consists of diverse investors who can substantially differ on their values and motivation, issues of concerns and the strategies adopted. Nevertheless, as the aim of this paper is to examine and learn from the experience of SRI in incorporating social responsibility concern in Islamic investment, where Islamic norms and ethics are indispensable elements in shaping the investment process, it is natural to focus the subsequent discussions on the theoretical framework of SRI from the perspective of the value-based investors.

Many SRI studies have highlighted the importance of 'consistency' between conviction and action as the ethical grounding for 'value-based' SRI (Sparks, 2002; Kinder, 2005; Sandberg, 2007). Values have also been shown to have significant effect on investment decision (Pasewark and Riley, 2010). The principle of consistency focuses on the ethical convictions subscribed by individuals, or even a group of investors or institutions, where such values will influence their SRI issues of concerns. This reflects the 'expressive' nature of the investment decision, where investors extend their ethical beliefs and social identity into their investment choices (Glac, 2009). While such a characterisation seems to be a straight forward relationship, its complexity lies on the possible multitude of issues supported by different investors and the intensity of conviction on such issues (Hummels and Timmer, 2004; Pasewark and Riley, 2010). In this respect, the set of ethical issues of concerns may differ between faith-based investors and environment or human rights-based investors, and in the case where the concerns are commonly shared, the 'intensity' of importance of different issues among different group of SRI investors may well varied. For instance, religiously motivated investors will put issues such as the avoidance of 'sin' activities as of paramount importance, while investors with strong human rights commitment may have issues such as gender and racial discrimination as their key priority.

Another component to the theoretical framework of SRI is the commitment to carry forward the ethical convictions and the corresponding issues of concerns of the investors onto the actual investment choice. As noted by various SRI studies, the motivation of investors to invest ethically are driven by both financial and non-financial motive (Lewis and Mackenzie, 2000). The presence of pecuniary and non-pecuniary components in the investment decision will raise the issue of the level of commitment to SRI concerns when the two motives are in conflict. While value-based investors may be willing to sacrifice some financial returns for the sake of SRI- which reflects their strong commitment (Webley et al., 2001; Pasewark and Riley, 2010), many studies have also repeatedly reported that SRI investors hold different proportion of SRI and non-SRI investments (Lewis and Mackenzie, 2000; Webley et al., 2001; Nielsson, 2008). Findings have also shown that financial motive has a significant influence on the level of such commitment; e.g. the percentage of total investment invested in SRI is influenced by its expected financial returns (Nielsson, 2008) and the willingness to sacrifice financial return among SRI investors depends on the level of returns they received from the regular (non-SRI) investment (Glac, 2009). Therefore, it can be said that the level of commitment among investors in pursuing SRI issues will be largely influenced by their level of ethical conviction and the intensity of importance they attach to such issues.

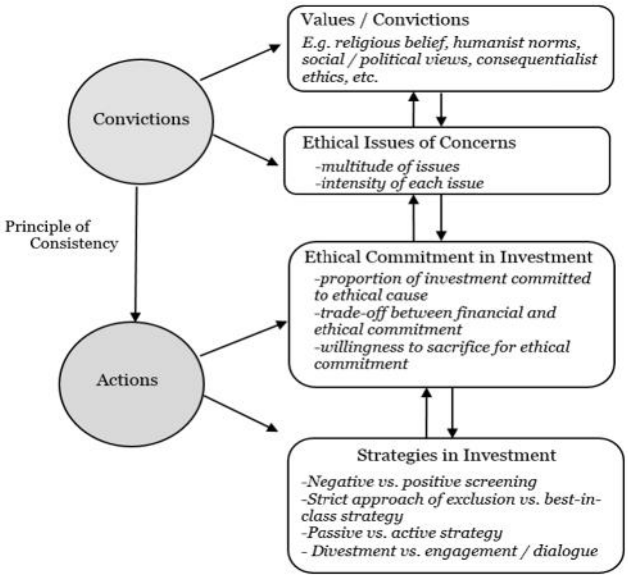

Fig. 1: A General Framework for Value-Based SRI

Subsequently, the three elements described above will influence the strategies adopted by the respective SRI investors; namely, what specific area of SEE will be addressed; whether broad areas of social responsibility be pursued or only confined to certain issues; and to what extent such issues will be addressed, namely strict treatment (totally screen out) or a more tolerant approach (best-in-class approach).

The relationship between the ethical values and convictions, the issues of concerns, the level of commitment in investment, and the investment strategies is summarised in Figure 1 above. As previously discussed, the ethical convictions subscribed by SRI investors will influence the SRI issues of concern. The level of conviction and the intensity of importance of SRI issues will also determine the level of commitment in the investment process and the appropriate strategies in addressing these issues. The arrows indicate that the four components are interdependent and the interactions between them will shape the whole framework of SRI practiced by the investors. As the world changes and different issues take president over others, the subscribed values or convictions as well as SRI issues of concerns can change overtime, and therefore, potentially change the manner in which SRI issues and strategies are adopted. Similarly, changes in the attitude towards the trade-off between pecuniary and non-pecuniary returns may alter the level of commitment of SRI investors, and subsequently the SRI issues and the strategies adopted in addressing such concerns may also be reshaped.

4. Some Implications for Islamic Investment Industry

The preceding sections has surveyed the SRI movement and examined its underlying values and motivation, issues of concern, types of investors and investment strategies. Based on the available information, the discussions further synthesise these components and provide a general framework to understand the ethical underpinning and practical aspects of SRI within the context of a ‘value-based’ SRI. In the light of this, the remaining discussion of this paper highlights a number of important implications for Islamic investment industry in relation to SRI, particularly in terms of the issues that need to be considered in emulating the SRI practice and the lessons that can be learned from the SRI experience.

4.1 Important Issues to Consider

Some of the important issues that need to be considered by the Islamic investment industry in emulating the practice of SRI are identified in the following points:

- **Diverse underlying values and motivation**

As can be seen in the SRI industry, there are significant heterogeneity in terms of the types of investors and their underlying values and motivations. Even in the context of value-based SRI, the ethical foundations can be shaped by religious, humanist, consequentialist or any other moral grounding. Hence, any initiatives to build bridges with the SRI movement need to recognise this important fundamental difference. Islam rejects the conception of ethics based on purely intellectual ground as can be found in the literature of humanist and consequentialist ethics. Even though Islam may share humanist and consequentialist aims of better quality of life and respect of human rights, these must always be linked with the Islamic conception of what is good and what is wrong as divinely decreed in the primary sources of the Shari’ah.

- **Absence of the prohibitions against riba’ and gharar**

Despite similar emphasis given on social responsibility issues, the practice of Islamic investment is grounded in the *Shari’ah*, which is the legal and ethical system of Islam. Hence, there are a number of important *Shari’ah* injunctions and rules that need to be followed, which can be reflected by the various qualitative/sectoral and quantitative/financial screens practiced by Islamic investment industry. While some of the sectoral screens, namely exclusion of gambling, liquor, pornography, weapons, and many others, may be similar to the practice of religious-based SRI investors, important injunctions involving the prohibitions of riba’ and gharar which render the interest-based financial sector and speculative investment products to be excluded from the allowable investible universe are unique to Islamic investment. Similarly, such injunctions also formed the backbone of the financial screens such as interest, liquidity and debt ratios, which are peculiar to Islamic investment industry. These transaction rules are considered as critical minimum element to ensure fairness and equity in exchange from the Islamic perspective.

- **Flexibility in the social responsibility issues of concern**

An important feature of SRI is that it is an ever-changing area as different issues take precedent over others, dependent on societal, cultural and financial factors (EuroSIF, 2006). In fact, SRI practitioners believe that the diversity of SRI criteria and issues are actually the strength of SRI, not its weakness. “Some have criticised SRI for its lack of uniform standards for what is “socially responsible” in investments. They are right that there are no such standards; they are wrong in implying there should be” (Kinder, 2005: 19). The broad dimensions of SRI and its flexibility permit the industry to provide options for investors who may have diverse issues of concern, and more importantly, accommodate the evolution of SRI criteria as new issues may emerge and rise in importance. Hence, Islamic investment industry need to be aware of this fact as the ‘emerging’ social responsibility issues in the SRI industry may not always be entirely in line with Islamic principles. Instead, the social responsibility issues that Islamic investment industry needs to prioritise must be in line with the needs of the society within the framework of *maslahah*.

- **Flexibility in the Screening strategies**

Given the diversity of investors with differing degrees of commitment for ethical concerns, various screening approaches are being used in the SRI industry. These screening strategies are often flexible and deal with a certain issues of concern deemed important for the respective investors. For instance, investors with strong health conscious may ban investing in companies related to tobacco and liquor, and nothing else. Other investors may use the best-in-class strategy and continue to invest in ethically questionable industries. Hence, Islamic investment industry will not be able to emulate some of the simple and flexible screening strategies without first fulfilling the initial screening for permissibility, which involves the mandatory set of sectoral/qualitative and financial/quantitative screens.

4.2 Lessons for Islamic Investment Industry

In addition to the issues that the Islamic investment industry needs to consider in emulating the practice of SRI, there are a number of important lessons that Islamic investment industry can learn from the experience of SRI. These are highlighted in the following points.

- **Diverse types of investors and level of commitment**

The experience of SRI clearly reveals the divergent motives of various groups of investors. This is highly likely true with the investors in Islamic investment industry as well. For instance, some of the investors can have strong commitment to the *Shari’ah* principles, and therefore will only invest if it is clearly deemed as *Shari’ah* compliant. Other investors may not be as committed, and therefore the investment decision can be driven by high returns. Hence, it is important to understand the motivation underlying the investment decision and the profile of the investors for the continuous growth and innovation of new products in the Islamic investment industry.

- **Affecting positive change as part of motivation to invest**

An interesting difference in the practice of SRI is the presence of the aim of affecting change for better social, ethical and environmental performance. The current practice of Islamic investment industry is structured in order to ensure that the investment is in line with the *Shari’ah* acceptable parameters for the investment to be deemed as permissible. While this is an important component to the investment process, the motivation to have positive impact to the society must also be part of the spirit in Islamic investment practices in view of the objectives of the *Shari’ah*, which generally promotes the well-being of the society.

It is also important to highlight the need for the sales or investment consultants of Islamic investment funds to create the awareness of investing not only to earn ‘halal’ return, but also to impact positively to the society through the investment decision. This second component to the motivation can strengthen the loyalty of investors in times of lower returns, because the investors will have in their mind a second form of return which is non-pecuniary in nature.

- **Avoidance of all harm- the need for a policy-based screening criteria**

SRI has evolved to adopt new issues beyond the initial exclusion of 'sinful' activities to cover other potential sources of harm to the society and the environment. As has been shown earlier, these issues can be generally categorised into sector-based criteria (screening out businesses involving in tobacco, liquor, gambling, weapon manufacturing, pornography, and other harmful activities) and policy-based criteria (screening out companies with bad business practices, labour standards, or environmental policies). As the avoidance of harm is the core to the objectives of the *Shari'ah*, it is important to recognise that potential harm can equally come from the policies of the companies. Hence, policy-based criteria must also be considered in the screening process for permissibility in Islamic investment industry.

- **Positive and proactive approaches for social responsibility**

The underlying foundation of Islamic finance is founded on the premise of Islamic values and ethics, where the ultimate goal is to realise the objective of the *Shari'ah* in terms of preventing harm and promoting good in the society. The current screening methodology of Islamic investment industry has so far focussed on the exclusionary strategy of filtering out activities which are impermissible. In this respect, the investment should not be reduced to the issue of *halal* or *haram* alone and efforts to incorporate the positive aspect of the screening process should be encouraged as it is highly in line with the objective of the *Shari'ah*. Similarly, other approaches such as the engagement and advocacy strategies can also be implemented as part of the effort to foster better social, ethical and environmental records among the companies invested.

5. Conclusion

Despite important differences between the practice of socially responsible investing and Islamic investment industry, many scholars have emphasised the parallel aims between the two sectors and the vast potential for convergence and collaboration. In both industries, the overall wellbeing of the society, the realisation of social justice and the sustainability of the environment are among the shared objectives in the investment process. In the face of SRI as a growing movement championing socially responsible practices of businesses, it is timely that the Islamic investment industry learns from the experience of SRI and embraces social responsibility concern in the investment strategy.

This paper has synthesized the SRI literature and developed a general conceptual framework towards understanding the theoretical and practical aspects of SRI. Based on this framework, a number of important implications in terms of the issues that Islamic investment industry needs to consider in emulating the practice of SRI and valuable lessons from its experience are discussed. This offers important insights for industry players in the Islamic investment sector in relation to SRI. As a conclusion, the consideration of various aspects of social responsibility concerns in the screening process will bring the Islamic investment practice closer to the idealised Islamic ethical values and the objectives of the *Shari'ah*.

References

Barom, M. N. (2013). "*Conceptualizing a Strategic Framework of Social Responsibility in Islamic Economics*." International Jurnal of Economics, Management and Accounting, 21(1), 65-95.

Cattelan, V. (2010). "Islamic Finance and Ethical Investments: Some Points of Reconsideration". In M F. Khan & M. Porzio (Eds.), *Islamic Banking and Finance in the European Union: A Challenge* (pp. 76-87): Edward Elgar.

Dembinski, P. H., Bonvin, J. M., Dommen, E., and Monnet, F. M. (2003). "The Ethical Foundations of Responsible Investment". *Journal of Business Ethics, 48*(2), 203-213.

Derwall, J., Koedijk, K., & Ter Horst, J. (2011). "A tale of values-driven and profit-seeking social investors." Journal of Banking & Finance, 35(8), 2137-2147.

Domini, A. (2001). *Socially Responsible Investing: Making a Difference and Making Money*. Chicago: Dearborn Trade.

Dunfee, T. W. (2003). "Social Investing: Mainstream or Backwater?". *Journal of Business Ethics,* 43, 247-252.

El-Gamal, M. A. (2006). *Islamic Finance : Law, Economics, and Practice*. Cambridge: Cambridge University Press.

EuroSIF. (2003). *Socially Responsible Investment among European Institutional Investors.* European Social Investment Forum.

EuroSIF. (2006). *European Sri Study 2006.* European Social Investment Forum.

EuroSIF. (2016). *European Sri Study 2016.* European Social Investment Forum.

EuroSIF. (2017). *SDGs for SRI Investors.* European Social Investment Forum.

Glac, K. (2009). "Understanding Socially Responsible Investing: The Effect of Decision Frames and Trade-Off Options". *Journal of Business Ethics,* 87(1), 41-55.

GSIA. (2017). Global Sustainable Investment Review 2016. Global Sustainable Investment Alliance.

Hawken, P. (2004). *Socially Responsible Investing*. Sausalito, California: Natural Capital Institute.

Hummels, H, & Diederik, T. (2004). "Investors in Need of Social, Ethical, and Environmental Information". *Journal of Business Ethics,* 52(1), 73-84.

Johnsen, D. B. (2003). "Socially Responsible Investing: A Critical Appraisal". *Journal of Business Ethics,* 43(3).

Juravle, C., & Lewis, A. (2008). "Identifying Impediments to Sri in Europe: A Review of the Practitioner and Academic Literature". *Business Ethics: A European Review*, 17(3), 285-310.

Kinder, P. D. (2005). *Socially Responsible Investing: An Evolving Concept in a Changing World.* KLD Research & Analytics.

Laldin, M. A. and Furqani, H. (2013). *"Developing Islamic finance in the framework of maqasid al-Shari'ah: Understanding the ends (maqasid) and the means (wasa'il)."* International Journal of Islamic and Middle Eastern Finance and Management, 6(4), 278-289.

Lewis, A. (2001). "A Focus Group Study of the Motivation to Invest: 'Ethical/Green' and 'Ordinary' Investors Compared". *Journal of Socio-Economics,* 30(4), 331-341.

Lewis, A. & Mackenzie, C. (2000). "Morals, Money, Ethical Investing and Economic Psychology". *Human Relations,* 53(2), 179-191.

Lewis, M. K. (2010). "Accentuating the Positive: Governance of Islamic Investment Funds". *Journal of Islamic Accounting and Business Research, 1*(1), 42-59.

Mohamad, S., Othman, J., Lehner, O., and Muda, R. (2017). "Social Sukuk: A New Mechanism to Fund Social Services." Journal of Emerging Economies and Islamic Research, 5(1), 69-81.

Nilsson, J. (2008). "Investment with a Conscience: Examining the Impact of Pro-Social Attitudes and Perceived Financial Performance on Socially Responsible Investment Behavior". *Journal of business ethics,* 83(2), 307-325.

Nilsson, J. (2009). "Segmenting Socially Responsible Mutual Fund Investors: The Influence of Financial Return and Social Responsibility". *International Journal of Bank Marketing,* 27(1), 5-31.

Norman, T. L. (2004). "Islamic Investment Funds". In Sohail Jaffer (Ed.), *Islamic Asset Management: Forming the Future for Shari'a-Compliant Investment Strategies*. London: Euromoney Books.

Pasewark, W. R., & Riley, M. E. (2010). "It's a Matter of Principle: The Role of Personal Values in Investment Decisions". *Journal of Business Ethics,* 93(2), 237-253.

Rhodes, M. J. and Soobaroyen, T. (2010). "Information Asymmetry and Socially Responsible Investment". *Journal of Business Ethics,* 95(1), 151.

Sandberg, J., Juravle, C., Hedesström, T. M., and Hamilton, I. (2009). "The Heterogeneity of Socially Responsible Investment". *Journal of Business Ethics,* 87(4), 519-533.

Sandberg, J. (2007). "Should I Invest with My Conscience?". *Business Ethics: A European Review*, 16(1), 71-86.

Sairally, S. (2007). "Evaluating the 'Social Responsibility' of Islamic Finance: Learning from the Experiences of Socially Responsible Investment Funds". In Munawar Iqbal, Salman Syed Ali & Dadang Muljawan (Eds.), *Advances in Islamic Economics and Finance: Proceeding of the 6th International Conference on Islamic Economics and Finance* (Vol. 1, pp. 279-320). Jeddah: Islamic Research and Training Institute, IDB.

Scanlan, C. (Ed.). (2005). *Socially Responsible Investment: A Guide for Pension Schemes and Charities*. London: Key Haven Publications.

Schwartz, M. S. (2003). "The "Ethics" Of Ethical Investing". *Journal of Business Ethics*, 43(3), 195-213.

SIF. (2003). *2003 Report on Socially Responsible Investing Trends in the United States.* Washington: Social Investment Forum.

SIF. (2006). *2005 Report on Socially Responsible Investing Trends in the United States*. Washington: Social Investment Forum.

Sparkes, R. (2002). *Socially Responsible Investment: A Global Revolution*. West Sussex: John Wiley & Sons Ltd.

Statman, M. (2005). "The Religions of Social Responsibility". *Journal of Investing*, 14(3), 14-23.

Webley, P., Lewis, A., and Mackenzie, C. (2001). "Commitment among Ethical Investors: An Experimental Approach". *Journal of Economic Psychology*, 22(1), 27-42.

Wilson, R. (1997). *Economics, Ethics and Religion- Jewish, Christian and Muslim Economic Thought*. New York: New York University Press.

Wilson, R. (2004). "Screening Criteria for Islamic Equity Funds". In Sohail Jaffer (Ed.), *Islamic Asset Management: Forming the Future for Sharia Compliant Investment Strategies* (pp. 35–45). London: Euromoney Books.

Yaquby, N. (2000). *Participation and Trading in Equities of Companies Which Main Business Is Primarily Lawful but Fraught with Some Prohibited Transactions.* Paper presented at the Fourth Harvard Islamic Finance Forum- Islamic Finance: The Task Ahead., Harvard University, Cambridge, Mas.