

# Comparison between Ethical and Islamic Investment

Ali Abdalsalam

Department of Islamic Economic and Financial, İstanbul Sabahattin Zaim Üniversitesi, Türkiye  
ali.idris@hotmail.com

\*\*\*\*\*

**Abstract**—Ethical investment and Islamic investment are two distinct approaches to investing that prioritize certain values and principles. Ethical investment, often aligned with socially responsible investing, focuses on companies that adhere to moral principles, environmental sustainability, and social responsibility. Islamic investment, on the other hand, is based on the principles of Islamic finance. It adheres to Sharia law, which prohibits investments in businesses involved in activities like alcohol, gambling, and pork production. It also avoids interest (Riba), as earning or paying interest is considered exploitative. Both ethical and Islamic investments share a commitment to moral principles and societal good. However, they differ in their foundational guidelines: ethical investment is broadly based on secular moral principles, while Islamic investment strictly follows religious doctrine.

This paper compares and contrast between these two types of investment reveal how different ethical frameworks can shape investment strategies, and how these strategies can be implemented to align financial goals with personal or religious values.

**Keywords**—Economic Growth, Riba, Credit Risk, Financial Impact, Shariah Compliance.

## I. INTRODUCTION

Ethical investment and Islamic investment are two distinct approaches to investing that incorporate moral and ethical considerations into the investment decision-making process. These approaches go beyond traditional financial analysis and take into account the impact of investments on society, the environment, and adherence to specific values and principles. While both ethical investment and Islamic investment share a common commitment to responsible investing, they differ in terms of their underlying frameworks, principles, and target investor demographics [1, 2].

Ethical investment, also known as socially responsible investing (SRI), focuses on investing in companies and industries that align with certain ethical guidelines. These guidelines may include considerations such as environmental sustainability, social justice, human rights, labor practices, and corporate governance. Ethical investors seek to support companies that demonstrate responsible behavior and avoid those involved in activities deemed harmful or unethical.

Islamic investment, on the other hand, follows the principles of Islamic law, also known as Sharia. Sharia provides guidelines for ethical behavior and economic transactions for Muslims. Islamic investment adheres to these principles, which include avoiding investments in industries related to alcohol, gambling, pork, interest-based financial institutions, and other activities prohibited by Islamic teachings. It also promotes economic justice, social welfare, and adherence to Sharia-compliant financial practices.

While both ethical investment and Islamic investment emphasize the importance of aligning investments with ethical principles, they differ in terms of the specific values and

criteria they consider. Ethical investment has a broader scope, encompassing various ethical frameworks and concerns, while Islamic investment operates within the parameters set by Sharia law. This distinction results in different investment screening methods, prohibited activities, and financial instruments utilized by each approach.

Furthermore, the target investor demographics for ethical investment and Islamic investment differ. Ethical investment is practiced by investors from diverse backgrounds who share common ethical concerns. It is not exclusive to any particular religious group and has a global reach. In contrast, Islamic investment is specifically designed for Muslim investors seeking to align their investments with Islamic principles. It has a stronger presence in regions with significant Muslim populations, such as the Middle East, Southeast Asia, and North Africa [3, 4].

Understanding the similarities and differences between ethical investment and Islamic investment is crucial for investors looking to incorporate moral and ethical considerations into their investment strategies.

By examining their underlying principles, prohibited activities, investment screening methods, financial instruments, and target investor demographics, investors can make informed decisions that align with their values, beliefs, and financial goals.

This paper aims to unravel the intricacies of these two investment approaches. It will explore the practices, principles, and tools that define Islamic Investment, underscoring its adherence to Sharia and its implications on investment choices.

Concurrently, the paper will dissect the various strategies employed in Ethical Investment, highlighting how it intertwines financial analysis with moral and social

considerations across diverse sectors like stock exchanges, real estate, and mutual funds. The ensuing discussion will not only contrast these two forms of investment but also illuminate their common ground, particularly in how they both strive to harmonize financial returns with moral integrity and social welfare.

## II. ETHICAL INVESTMENT

Islamic Ethical investment, also known as socially responsible investing (SRI), is an investment approach that considers both financial returns and the broader impact of investments on society and the environment. It involves investing in companies and industries that adhere to specific ethical guidelines and promote sustainable practices. The primary focus of ethical investment is to generate positive social and environmental outcomes alongside financial returns.

### A. Principles and Values

Ethical investment encompasses a wide range of principles and values, which may vary depending on the investor's specific ethical framework. Some common considerations include:

1. Environmental Sustainability, Ethical investors seek to support companies that prioritize environmental conservation, renewable energy, waste reduction, and sustainable resource management [4].
2. Social Justice, Ethical investment promotes social justice by favouring companies that demonstrate fair labor practices, diversity and inclusion, community development, and support for human rights.
3. Corporate Governance, Ethical investors value companies with strong corporate governance structures, transparency, and accountability. They may seek to avoid companies with questionable business practices, such as corruption or unethical supply chain management.
4. Impact Investing, some ethical investors actively seek investments that have a measurable positive impact on specific social or environmental issues, such as poverty alleviation, healthcare, education, or clean technology.

### B. Investment Screening and Selection

Ethical investment employs various screening methods to identify suitable investments. These methods may include:

1. Positive screening involves actively seeking investments in companies that have a positive impact on society and the environment. This may involve investing in renewable energy companies, fair trade organizations, or companies promoting social justice initiatives [5].
2. Negative screening excludes companies involved in activities that conflict with ethical guidelines. Common exclusions may include industries related to tobacco, weapons manufacturing, fossil fuels, gambling, or companies with poor labor practices.

### C. Financial Instruments

Ethical investment offers a wide range of financial instruments, including:

1. Socially responsible mutual funds, these funds invest in companies that meet specific ethical criteria, allowing investors to diversify their portfolio while aligning with their values.
2. Green bonds, raise capital for projects with environmental benefits, such as renewable energy infrastructure or energy-efficient buildings [6].
3. Community development finance, investments in community development financial institutions or microfinance institutions that support underserved communities and promote economic empowerment.

### D. Target Investor Demographics and Global Reach

Ethical investment attracts a diverse group of investors who prioritize ethical considerations in their investment decisions. It is not limited to any specific religious or cultural group and has a global reach. Ethical investment has gained popularity among individuals, institutions, and even pension funds seeking to align their investments with their values [7].

## III. ISLAMIC INVESTMENT

Islamic investment, also known as Sharia-compliant investment, follows the principles of Islamic law (Sharia) in investment decision-making. It seeks to align investments with Islamic teachings, which include ethical guidelines and financial practices outlined in the Quran and Hadith. Islamic investment aims to generate financial returns while adhering to Sharia principles [1, 8].

### A. Principles and Values

Islamic investment is guided by specific principles and values based on Sharia law, which include:

1. Prohibition of interest (Riba), Islamic investment avoids interest-based transactions and investments in financial institutions that engage in interest-based lending, such as conventional banks.
2. Prohibition of speculative and uncertain investments (Gharar), Investments involving excessive uncertainty, speculation, or gambling-like elements are avoided.
3. Prohibition of prohibited activities (Haram), Islamic investment excludes investments in industries such as alcohol, gambling, pork, weapons manufacturing, and other activities deemed non-compliant with Islamic teachings.
4. Ethical business practices, Islamic investment promotes ethical business practices, transparency, and accountability. Companies with strong corporate governance and adherence to Islamic ethical guidelines are favoured.

### B. Investment Screening and Selection

Islamic investment employs negative screening methods to ensure investments comply with Sharia principles. The screening process typically involves:

1. Sharia supervisory board, investment decisions are overseen by a Sharia supervisory board or committee consisting of Islamic scholars who review and approve investment products and ensure compliance with Sharia principles.
2. Prohibited activities screening, investments are screened to exclude industries involved in prohibited activities, such as alcohol, gambling, tobacco, and interest-based financial institutions [9].
3. Debt-to-Asset ratio screening, companies with excessive debt levels are avoided, as high leverage is considered risky and non-compliant with Islamic finance principles.

### C. Financial Instruments

Islamic investment offers a range of Sharia-compliant financial instruments, including:

1. Islamic bonds (Sukuk), which are Sharia-compliant bonds that generate returns through profit-sharing rather than interest payments. Sukuk represent ownership in an underlying asset or project.
2. Sharia-compliant stocks, investments are made in stocks of companies that operate in compliance with Sharia principles.
3. Islamic mutual funds, these funds invest in Sharia-compliant financial instruments, providing diversification and professional management for investors.

### D. Target Investor Demographics and Global Reach

Islamic investment primarily caters to Muslim investors who wish to align their investments with Islamic principles. It has a strong presence in regions with significant Muslim populations, such as Middle East, Southeast Asia, and North Africa.

However, Islamic investment products and services are increasingly being offered globally, allowing Muslim investors around the world to participate in Sharia-compliant investment opportunities [3, 10].

Both ethical investment and Islamic investment incorporate ethical considerations into investment decisions. Ethical investment focuses on broader social and environmental issues, while Islamic investment adheres to specific principles outlined in Sharia law. Understanding the principles, values, investment screening methods, financial instruments, and target investor demographics of each approach can help investors make informed decisions that align with their values and financial goals.

## IV. DEMAND FOR ISLAMIC INVESTMENTS

The demand for Islamic investments has been growing globally, driven by various factors:

1. Religious observance, Muslim investors seek investment options that align with their religious beliefs and comply with Sharia principles. Islamic investments provide a way for them to invest in accordance with their faith.
2. Ethical considerations, Islamic investments appeal to investors who prioritize ethical and socially responsible investing. The prohibition of investments in industries such as alcohol, gambling, and tobacco resonates with those seeking investments that align with their ethical values [11, 14].
3. Market potential, the global Muslim population represents a significant market segment. The demand for Islamic investments stems from the desire to tap into this market potential and cater to the financial needs of Muslim investors.
4. Financial inclusion, Islamic investments provide an avenue for individuals and institutions that prefer Sharia-compliant financial products to participate in the global financial system. It promotes financial inclusion and access to investment opportunities for Muslim investors.
5. Performance and stability, Islamic investments have demonstrated resilience during financial crises, which has increased their appeal to investors seeking stability and long-term sustainability.
6. Government support, some governments, particularly in Muslim-majority countries, have introduced regulations and frameworks to promote Islamic finance and create an enabling environment for Islamic investments. This support has contributed to the growth and development of the Islamic finance industry [2, 10].
7. Global reach, the demand for Islamic investments extends beyond Muslim-majority countries. Non-Muslim investors, including socially conscious investors, are also showing interest in Sharia-compliant investments as part of their diversified portfolios.

## V. ISLAMIC AND ETHICAL INVESTMENT PRACTICES IN STOCK EXCHANGE

Islamic and ethical investment practices can be applied in the context of stock exchanges to guide investment decisions and promote adherence to specific principles and values. While the specific implementation may vary depending on the regulatory framework and investor preferences.

### A. Islamic Investment Practices in Stock Exchange

Islamic investors focus on investing in stocks of companies that operate in compliance with Sharia principles. This involves screening stocks to ensure they meet specific criteria, such as avoiding companies involved in prohibited activities (e.g., alcohol, gambling) and adhering to financial ratios and debt-to-asset ratios compliant with Sharia guidelines [8, 11].

Stock exchanges may develop Sharia-compliant indices that include companies meeting the criteria outlined by Sharia scholars. These indices serve as benchmarks for Islamic

investors and facilitate the creation of financial products aligned with Islamic principles.

Stock exchanges may establish Sharia Advisory Boards or committees composed of Islamic scholars who provide guidance and oversight to ensure compliance with Sharia principles. These boards review and approve listed companies, financial products, and transactions to ensure they adhere to Islamic guidelines.

Stock exchanges can facilitate the listing and trading of Sukuk (Islamic bonds) and other Sharia-compliant debt instruments. These instruments generate returns through profit-sharing rather than interest payments, making them suitable for Islamic investors [9, 11].

Stock exchanges play a vital role in promoting transparency and disclosure practices. Ensuring that companies listed on the exchange provide accurate and comprehensive information helps investors make informed decisions, including Islamic investors who prioritize transparency and ethical business practices.

#### *B. Ethical Investment Practices in Stock Exchange*

Ethical investors may apply positive and negative screening methods to identify stocks that align with their ethical guidelines. Negative screening involves excluding companies involved in activities deemed unethical, such as tobacco, weapons, or environmental pollution. Positive screening involves seeking out companies with positive social and environmental impact, such as those focused on renewable energy or fair labor practices.

Some stock exchanges have introduced sustainability indices or benchmarks that track the performance of companies based on environmental, social, and governance (ESG) factors. These indices help ethical investors identify companies with strong sustainability practices and can guide investment decisions.

Ethical investors may actively engage with companies in their investment portfolio to influence corporate behaviour and encourage responsible business practices. This can involve shareholder activism, proxy voting, and dialogue with company management to address ESG issues.

Reporting and disclosures, stock exchanges can require listed companies to disclose ESG-related information, enabling investors to assess the sustainability and ethical performance of companies. Enhanced reporting standards promote transparency and accountability in ethical investment practices.

Stock exchanges may facilitate the listing and trading of ethical investment funds, such as socially responsible mutual funds or exchange-traded funds (ETFs). These funds pool investments from ethical investors and invest in companies that meet specific ethical criteria.

The implementation of Islamic and ethical investment practices in stock exchanges may vary across different jurisdictions and exchanges. Investors interested in Islamic or ethical investing should consult with financial advisors, review the specific guidelines and offerings of their local

stock exchange, and consider their own values and investment objectives when making investment decisions.

## VI. ISLAMIC AND ETHICAL INVESTMENT PRACTICES IN MUTUAL FUNDS

Islamic and ethical investment practices can be applied to mutual funds to align investment decisions with specific principles and values. Both Islamic mutual funds and ethical mutual funds cater to investors seeking investment options that adhere to their religious or ethical beliefs.

#### *A. Islamic Investment Practices in Mutual Funds*

Islamic mutual funds follow the principles and guidelines of Sharia law. These funds avoid investments in companies involved in prohibited activities such as alcohol, gambling, tobacco, and pork products. They also adhere to the principles of interest-free transactions, profit-sharing, and risk-sharing.

Islamic mutual funds employ a screening process to ensure the investments are compliant with Sharia principles. This screening involves the exclusion of companies that derive a significant portion of their revenue from prohibited activities or have excessive debt levels. The screening process may be guided by the advice of a Sharia advisory board or committee.

Islamic mutual funds engage in a purification process known as (zakat) to ensure compliance with Sharia requirements. Zakat involves calculating and donating a portion of the fund's income to charitable causes, with the aim of purifying any impermissible or non-compliant earnings [12].

Islamic mutual funds typically have a Sharia Supervisory Board comprising Islamic scholars who provide guidance and oversight to ensure compliance with Sharia principles. The board reviews the investment holdings and activities of the fund to ensure they align with Islamic guidelines.

#### *B. Ethical Investment Practices in Mutual Funds*

Ethical mutual funds apply positive and negative screening methods to select investments that align with specific ethical guidelines. Negative screening involves excluding companies involved in activities deemed unethical, such as environmental pollution, human rights violations, or weapons manufacturing. Positive screening focuses on identifying companies with strong environmental, social, and governance (ESG) performance and positive societal impact.

Ethical mutual funds may integrate environmental, social, and governance factors into their investment analysis and decision-making process. They consider a company's sustainability practices, employee relations, community impact, and corporate governance standards when selecting investments.

Ethical mutual funds may engage in shareholder advocacy by actively participating in shareholder meetings, voting on corporate resolutions, and engaging with company management. This allows them to influence corporate behaviour and drive positive changes in environmental and social practices [12].

Some ethical mutual funds focus on impact investing, which aims to generate positive social and environmental outcomes alongside financial returns. These funds invest in companies or projects that address specific social or environmental challenges, such as renewable energy, affordable housing, or healthcare access.

Ethical mutual funds prioritize transparency and provide regular reports to investors on the fund's holdings, investment decisions, and impact metrics. They disclose information related to ESG factors, ethical guidelines, and engagement activities, allowing investors to make informed decisions [13].

The specific investment strategies and criteria of Islamic and ethical mutual funds may vary across different fund providers and regions. Investors interested in Islamic or ethical mutual funds should carefully review the fund's prospectus, investment strategy, and adherence to the desired principles. Consulting with a financial advisor with expertise in Islamic or ethical investing can also help investors select mutual funds that align with their values and financial goals.

## VII. ISLAMIC AND ETHICAL INVESTMENT CREDIT, MARKET RISK

Islamic and ethical investment practices take into consideration credit risk and market risk, similar to conventional investment practices. However, there may be some specific considerations and approaches within the context of Islamic and ethical investing.

### A. Credit Risk in Islamic and Ethical Investments

Credit risk refers to the potential for loss arising from the default or non-payment of debt obligations by the issuer of a financial instrument. In the case of Islamic and ethical investments, credit risk assessment focuses on evaluating the creditworthiness of the companies or entities in which the investments are made [10].

Islamic and ethical investment funds conduct thorough creditworthiness assessments of potential investments to ensure that the underlying companies have the financial strength and ability to fulfil their obligations. This assessment involves analysing financial statements, debt levels, cash flow, and other relevant factors.

In addition to creditworthiness, Islamic investments also assess the Sharia compliance of the issuer. This includes evaluating the nature of the business, sources of revenue, and compliance with Sharia principles to ensure that the investment is in line with Islamic guidelines [13].

To manage credit risk, Islamic and ethical investment funds typically diversify their portfolios across different issuers, sectors, and asset classes. Diversification helps reduce the concentration of credit risk by spreading investments across a range of companies or entities.

### B. Market Risk in Islamic and Ethical Investments

Market risk refers to the potential for investment value to fluctuate due to changes in market conditions, such as interest rates, exchange rates, or stock market movements [4].

Islamic and ethical investments are exposed to market volatility, just like any other investment. Market conditions and economic factors can impact the value of investments, including stocks, bonds, and other financial instruments held within the portfolio.

Asset allocation strategies are employed to manage market risk. Islamic and ethical investment funds may allocate investments across different asset classes, such as equities, fixed income, and commodities, based on the investment objectives and risk tolerance of the fund and its investors.

Risk management techniques, such as hedging, diversification, and active portfolio management, are employed to mitigate market risk. These techniques aim to minimize potential losses resulting from adverse market movements [13].

Islamic and ethical investments often emphasize a long-term investment horizon, aiming to ride out short-term market fluctuations. The focus on long-term value and fundamentals helps investors withstand temporary market volatility and capture potential growth over time.

## VIII. ISLAMIC AND ETHICAL INVESTMENT IN REAL STATE

Islamic and ethical investment principles can be applied to real estate investments to align with the values and guidelines of Sharia law and ethical considerations.

### A. Islamic Real Estate Investment

Islamic real estate investment avoids involvement in activities that are considered non-compliant with Sharia principles, such as investments in properties related to alcohol, gambling, or other prohibited industries. Investments in businesses that comply with Islamic finance principles, such as halal food establishments or healthcare facilities, may be preferred [1, 14].

Islamic real estate investment adheres to interest-free financing principles. Instead of conventional interest-based loans, Islamic investors utilize Sharia-compliant financing methods such as partnerships (Musharakah) or profit-sharing arrangements (Mudarabah) to acquire or develop real estate properties.

Islamic investment in real estate emphasizes transparency, fairness, and equity in transactions. Investors strive for clear and equitable agreements, ensuring that all parties involved in the real estate investment are treated fairly and without exploitation.

Islamic principles promote the ethical use of property. Real estate investments should contribute positively to society and avoid activities that harm the environment or the community. Investments in properties that meet environmental sustainability standards or provide social benefits, such as affordable housing or educational facilities, may be favored.

*B. Ethical Real Estate Investment:*

Ethical real estate investment considers the social and environmental impact of property investments. Investors seek properties that contribute positively to communities, such as sustainable and energy-efficient buildings, mixed-income housing developments, or projects that enhance the local infrastructure or public spaces.

Ethical real estate investors prioritize responsible property management practices. This includes ensuring fair treatment of tenants, maintaining safe and healthy living conditions, and adhering to ethical business practices in rent collection, eviction processes, and property maintenance.

Ethical real estate investors actively engage with the communities in which their properties are located. They consider the needs and concerns of the local community, collaborate with stakeholders, and strive to create positive social and economic impacts through their real estate investments [3, 14].

Ethical real estate investment may involve seeking financing from institutions that align with ethical values, such as those with responsible lending practices, fair interest rates, and a commitment to social and environmental responsibility.

Ethical real estate investors integrate environmental, social, and governance (ESG) factors into their investment decisions. They consider the environmental impact of properties, social aspects such as tenant well-being and community development, and governance practices of property management companies.

Both Islamic and ethical real estate investment practices aim to align financial activities with religious and ethical values. Investors interested in these approaches should consult with real estate professionals or financial advisors experienced in Islamic and ethical investing to understand the specific guidelines and opportunities available within their respective regions.

## IX. CONCLUSION

Ethical and Islamic investment approaches share the aim of aligning investment practices with specific values and principles. Ethical investments consider a broad range of ethical considerations and focus on positive impact, while Islamic investments adhere to Sharia principles and guidelines.

Both approaches involve screening processes, but differ in their specific criteria. Islamic investments have additional requirements related to Sharia-compliant financing structures and often involve the oversight of Sharia supervisory bodies.

They both consider social and environmental impact, credit risk, and financial returns. However, Islamic investments have additional considerations related to Sharia compliance, including the avoidance of interest-based transactions.

The choice between ethical and Islamic investments depends on an individual's or institution's specific values, beliefs, and investment objectives. Investors should carefully evaluate their preferences, consult with professionals, and select investment options that best align with their goals.

## REFERENCES

- [1] ShaharBano "Why Should Muslims Invest in Halal Real Estate", The Halal Times, Islamic Finance, 2022.
- [2] Alowaiyesh, W, Mohame. M. Shahid, M and Noh, M "Development of Şukūk in the State of Kuwait", 2020.
- [3] Andrieş, A. Ongena, S. Sprincean, N. and Tunaru.R "RiskSpillovers and Interconnectedness between Systemically Important Institutions", Journal of Financial Stability, 58, 2022.
- [4] Çınar, F "Regulatory Landscape and Shariah Governance in Turkey", IFN Islamic Finance News, 2020
- [5] INF Omanr "Islamic Finance News", International Monetary Fund, Annual report, 2020.
- [6] Report "Islamic Financial Services Board", Islamic Financial Services Industry Stability, 2021.
- [7] Report "Islamic Financial Services Board", Islamic Financial Services Industry Stability, 2022.
- [8] Kafou, A "Islamic Financial Engineering at the Crossroads: Between the Need for Hedging and the Compliance Requirements", Journal of Islamic Finance, 11, 2022.
- [9] KBB and EY Turkey "Participation Banking Strategy", Update Report 2021-2025.
- [10] Billah, M "Teaching and Research Methods for Islamic Economics and Finance", In Teaching and Research Methods for Islamic Economics and Finance. Routledge, 2022.
- [11] Andrea Foglie and Ida Claudia" Islamic stock market versus conventional: Are islamic investing a 'Safe Haven' for investors? A systematic literature review", Elsevier, Pacific-Basin Finance Journal, 2020.
- [12] Mufti TaqiUsmani "Principles of Shariah Governing Islamic Investment Funds", Meezan Bank, 2022.
- [13] N. Rahableh, I. Bhatti and F. Mismar" Developments in Risk Management in Islamic Finance", Journal of Risk and Financial Management, 2019.
- [14] Adam Fayed "Best Tips for Halal Investing in Real Estate in 2023", Financial Guidance, 2023.