Islamic venture capital – issues in practice

Zaheer Anwer
Lahore Centre of Excellence in Islamic Banking and Finance, University of Lahore, Lahore, Pakistan

Alam Asadov
Prince Sultan University, Riyadh, Saudi Arabia

Nazrol K.M. Kamil
Kulliyyah of Economics and Management Sciences, International Islamic University Malaysia, Kuala Lumpur, Malaysia

Mehroj Musaev
Tashkent Islamic University, Tashkent, Uzbekistan, and

Mohd Refede
International Centre for Education in Islamic Finance, Kuala Lumpur, Malaysia

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Abstract

Purpose – This paper aims to explore the structure and underlying contracts of Islamic venture capital (IVC) and to evaluate its prospects. VC can be perceived as an investment vehicle possessing most of the desirable attributes of a Sharīʿah-compliant investment vehicle. There are certain issues involved in the formation, operations and exit strategies of these investments that are discussed in detail in this paper.

Design/methodology/approach – A detailed review of relevant literature is performed to identify how IVC investments can be made and how related issues may be resolved.

Findings – IVC investment has potential of incorporating Sharīʿah-compliant investment modes. Additionally, it may offer higher than average returns. These attributes can be desirable for Islamic finance industry that is currently in need of equity-based financing products. The major causes of lesser growth of IVC investments are lack of awareness among the investors and the absence of viable investment opportunities for small- and medium-scale investors. IVC may attract general public if established after extensive research aimed at introducing innovative products.

Originality/value – This paper provides an overview of a truly Sharīʿah-compliant investment vehicle, furnishes a synthesis of various suggestions made by industry and academia and suggests viable solutions for valuation, risk management and exit strategies.

Keywords Islamic finance, Islamic venture capital, Sharīʿah-compliant investment

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Introduction

The volume of global investment in Sharīʿah-compliant assets is increasing, and Islamic finance assets have surpassed the figure of US$2tn (IFSB, 2018a). Although Islamic finance is gaining ground at a quick pace, it has mostly relied upon the replication of interest-based financing instruments, and questions are now being raised whether Islamic finance is different in any respect from its conventional counterpart (Chong and Liu, 2009). Instead of replicating conventional finance products, the promotion of equity contracts based upon risk-sharing principles is the ideal way forward for Islamic finance (Smolo and Mirakhor, 2010). In this respect, the venture capital (VC) investment mode has the potential of becoming an ideal Sharīʿah-compliant arrangement if certain modifications are incorporated in its structure, underlying contracts and line of business. This is because VC involves investment in real economic activities. Returns are earned through the active involvement of investors and participation in the business risk, which is the essence of Islamic finance (Elsiefy, 2014).

VC is a form of private equity (PE) that is commonly defined as primary funding provided to young but typically innovative and potentially high-growth companies that are usually not listed on the stock market (Schröder, 2011). These companies have unique ideas for projects or ventures but have trouble getting financing from banks or other financial sources because their ideas are technically difficult for non-experts to evaluate. Venture capitalists provide these entrepreneurs with the required funding to execute the projects. They raise funds from institutional investors and wealthy individuals and provide the entrepreneurs not only with capital but also with advice and management expertise in locating, evaluating and selecting high-risk but potentially high-return projects. VC investments follow different time horizons, ranging mostly from 3 to 7 years (and in exceptional cases, up to 10 years). These investment styles are gaining importance owing to their significant role in developing trade and human capital and contributing to economic and social development.

There are four common stages of business for VCs. In the *seed stage*, financing is made to develop an initial concept through research and assessment of raw ideas. In the *start-up stage*, financing is extended to develop products and perform initial marketing. In this stage, companies are usually in the process of being set up or have been in business for a short period. However, they have not yet sold their products commercially and have been incurring losses. In the *expansion stage*, financing is made for the growth and expansion of a company that has reached the breakeven point or has started generating profits. The capital can be used to perform market or product development, increase production capacity and/or meet additional working capital requirements. The *replacement capital stage* involves purchasing shares from other investors or reducing leverage in capital structure through refinancing of debt.

Islamic venture capital (IVC) investments do not differ from their conventional counterparts, except that they must comply with the principles of the Sharīʿah (Islamic law). Conventional VC funds can exploit any profitable business opportunity, but IVC funds cannot invest in sectors prohibited by Sharīʿah, such as liquor, pork, adult entertainment or other proscribed activities. Also, they can only enter in the contracts permissible by Sharīʿah. Therefore, they appoint Sharīʿah advisors to provide continuous guidance on permissible lines of business and acceptable structures of instruments (Hamzah, 2011). Injazat Capital Limited (UAE), Venture Capital Bank (Bahrain), Malaysian Venture Investment (Malaysia), Kuwait Finance House (Kuwait) and Navis Capital Group (South and Southeast Asia) are examples of famous IVC investment companies (Hassan *et al.*, 2011).

The present work explores the conceptual framework of IVC, its viability in this diverse market place and necessary steps for smooth processing of IVC transactions. The second section explains the process of formulation of an IVC and the possible issues involved. The third section gives details of the investment process. The fourth and fifth sections elaborate the exit strategies and discuss issues in the applications of IVC, respectively. The sixth section concludes the study and provides recommendations on the form and practice of successful IVC investments.

Establishment of an Islamic venture capital fund and profit-sharing arrangements

The process of establishing an IVC fund begins with the creation of a special-purpose vehicle to raise initial capital. Usually, PE and VC funds are structured as limited partnerships comprising general and limited partners. The responsibilities of the general partner (usually an investment company) include fundraising, choice of investments, monitoring of transactions and deciding on optimal exit investments at an appropriate time to maximize the returns on investments. They are entitled to a management fee plus a share of the profits for performing these services. The limited partners share the profits as per the agreed terms and conditions. The legal and regulatory framework of IVC is similar to that of the conventional VC in terms of licensing requirements and regulatory supervision. Malaysia has developed the most advanced form of IVC framework to date (Hamzah, 2011). These provisions allow VC corporations and VC management corporations to deal in securities.

To build a strong and competitive IVC model, Muslim countries need to meet some basic requirements, both in line with international investment standards and Sharīʿah rulings. Elsiefy (2014) suggests six such fundamental requirements to set up an IVC investment vehicle:

(1) IVC is bound to appoint a Sharīʿah advisor to ensure compliance with Sharīʿah investment principles. Although the basic structure of a VC fund does not pose any Sharīʿah issue, the Sharīʿah advisor is required to perform an in-depth analysis of individual contracts/transactions to certify that they satisfy the Sharīʿah requirements. A number of scholars emphasize consideration of *maqāṣid al-Sharīʿah* as a tool to sort out dubious contractual terms (Ahmed, 2011).

(2) IVC will issue only Sharīʿah-compliant financial instruments and avoid impermissible activities such as the sale of debt at a discounted rate. Although the most common forms of VC investment are equity (shares), convertible debt and preferred shares entail Sharīʿah issues.

    Table I reports the Sharīʿah screening requirements for the choice of line of business and capital structure of IVC.

(3) The respective jurisdictions should develop an effective legal structure to meet international standards.

(4) Classic *fiqh* contracts such as *muḍārabah*/*mushārakah* should be drafted in clearly defined terms and in a manner acceptable at both local and international levels to protect the rights of stakeholders involved in these contracts.

(5) The exit strategy should be clearly defined, and there should be an easy exit from the investment.

Sectoral screening	Financial screening criteria	Financial instrument
IVC cannot invest in the following sectors: Alcohol Pork related Gambling Leisure Arms Tobacco Pornography Financial services Any other sectors deemed to be Sharīʿah non-compliant by the Sharīʿah Committee	*Balance sheet-based screening* The sum of cash and interest-bearing account should be less than 33% Receivables and cash should be less than 33% Total debt to total asset ratio should be less than 33% *Income statement-based screening* Total interest and non-compliant activities income should not exceed 5% of revenues However, there are minor variations in definitions of financial metrics suggested by practitioners/Sharīʿah scholars	IVC investments are barred from Investing in interest-bearing instruments Issuance of interest-based instruments Using financial derivatives Short selling Conducting any other Sharīʿah non-compliant activity

Source: Authors' contribution based on El-Gamal (2006) and Screening Methodology of Dow Jones Shariah Index

Table I.
Sharīʿah compliance requirements

(6) An important consideration while establishing an IVC is the profit-sharing arrangement. IVC investments can choose to enter into either *muḍārabah*- or *mushārakah*-based contracts depending upon the nature of the investors and their respective needs. In the case of pooled investments and running of affairs through a management team, *muḍārabah* structures are appropriate as the management works as *muḍarīb* in this scenario and shares profits with investors in a pre-agreed ratio. However, in view of the nature of IVC funds and the underlying philosophy, a *mushārakah* design is more appropriate. The investors run the operations jointly and share the risk and profits as per the agreement.

Investment process, operations and risk management

Once the stakeholders finalize the preliminaries, appoint Sharīʿah advisors and decide on the design of the investment, they are required to develop a comprehensive strategy related to the investment process and operational activities. They also need to formulate a comprehensive risk management framework to protect the interests of investors and other stakeholders.

Valuation to measure investment size

Once the agreement is reached between investors, they reach a position where they can start investing in projects. In the case of VCs, investors need to take into consideration both the beginning and end of the investment. More formally, a valuation is made twice, i.e. before making the final investment and at the time of exit. "Pre-money valuation" is most frequently used to determine the size of investment against a certain equity stake in the target company (Leach and Melicher, 2011). "Post-money valuation" is used to calculate the share price to be quoted to the general public before the initial public offering (IPO) or to other investors.

In this regard, the traditional techniques used to value the equity can be used for IVC investments as well. One such approach is the use of price/earnings multiples of a comparable company. This technique provides a realistic estimate of the share prices of the similar entity in the market. Care should be adopted in the selection of comparable factors such as age of the company, its operating structure and financial history. It is important to take into account the liquidity premium before reaching the final share price (Leach and Melicher, 2011).

Another commonly used method is cash flow analysis, which requires estimation of future cash flows and then discounting them using an appropriate discount rate to find out their present values. This technique is widely used and capable of giving accurate results, provided the estimation exercise is done effectively. However, this method is very subjective and requires considerable investment of time and money.

Moving further, net asset value (NAV) – the net difference in market value of a company's assets and liabilities – is used in practice. This method is engrained in economic reality due to the fact that the current prices are a reflection of the actual worth of a company. On the flip side, this method is very subjective and ignores the potential of a company to generate future positive cash flows. Therefore, it is not suitable for a growing company that has many opportunities for growth ahead, which should be accounted for.

To perform an effective evaluation, the sponsors can make necessary adjustments to these techniques in view of their business model, industry conditions, unique advantages and growth opportunities. Additionally, IVC investments can use a hybrid approach to value the equity stake, involving a combination of the price/earnings multiples method and NAV method to reach an acceptable price for all the stakeholders.

Investment models

IVC investment can be made in three different formats. The first strategy is *direct investment to investee by the IVC*. The capital is collected from multiple investors and used to buy the controlling shares of the target company. The management of the acquired company is usually replaced by fund managers to implement the devised business strategy, as per the IVC mandate. For this kind of investment, a huge amount of capital is needed to invest in a particular company and hold the majority position. Although this form of investment has a higher ability to conform to Sharīʿah principles, this transaction involves huge risk, and the company is required to perform comprehensive valuation before making any investment decisions. Qatar Venture Capital and the world's first International Islamic Venture Capital House are some of the companies that have used this approach.

The second form is *investment in the IVC fund*. A professionally managed structure fund is formed by designing a portfolio of selected companies. This approach effectively reduces IVC risks through diversification. However, as most of the companies invest in multiple business segments, it is difficult to perform a comprehensive assessment of each business segment for the purpose of Sharīʿah screening. Therefore, strong governance, a clear statement of policy and involvement of Sharīʿah advisors are required to mitigate Sharīʿah non-compliance risk. Practitioners of this format in the Middle East and North Africa region – particularly countries of the Gulf Cooperation Council – include Bahrain Bank and the First Islamic Investment Bank.

The third form is the *crowdfunding* platform, which bypasses the banking system and connects suppliers of capital (investors) with users of capital (individuals and businesses requiring funds) through the latest tools of information technology. Most of the time, there is no intermediary or regulator, and investors bear the whole risk alone. This model is deemed to be in compliance with Sharīʿah principles and has high potential for growth in the coming years. Some examples include Beehive (UAE), which was the first Islamic online marketplace for peer-to-peer financing in the Middle East.

Operations

After valuation, the company performs investment in the target and starts taking an active part in operations. Choosing an appropriate financial structure and an exit strategy is considered a vital decision for the VC project. The selected financial instruments should be Sharīʿah-compliant and selected in view of the firm's age and level of stock market development. IVC needs to ensure that the strategy and structure are beneficial for both the investor and the invested company by ensuring that the risks and returns are fairly distributed between both parties (Ahmad Farid, 2012).

The application of equity-based contracts such as *mushārakah* and *muḍārabah* requires fairness and honesty, and the related parties can include additional conditions to effectively execute these contracts and run operations smoothly. Any violation of the conditions placed for these contracts may result in corresponding compensation to be paid by the party breaching the agreement. Moreover, proper due diligence has to be conducted to remove any issue of asymmetric information and to correctly estimate future performance.

Risk management

The designing of an effective risk management structure is extremely important for IVC investments as they endorse essentially equity-based contracts and are exposed to business risk and other unique risks such as Sharīʿah non-compliance risk due to their distinct nature.

To begin with, *legal liability risk* is highly important for these entities, which is the probability that a court may block the company's operations or restrict/ban its activities in certain jurisdictions (Hamzah, 2011). To address this risk, it is essential to ensure before entering into the contract and assuming the ownership that the target company is not involved in an activity that violates Sharīʿah principles or local laws. IVC can take different measures to mitigate legal liability risk, and the role of lawyers and legal consultants is highly critical in this regard. They are required to adopt a prudent approach from the initiation of the contract and scrutinize the credentials of the target company very carefully. They need to seek the opinion of Sharīʿah scholars regarding the permissibility of principal business activities of the company. The structure of transactions should not contain any elements of *gharar* (avoidable uncertainty), *jahālah* (lack of information) and *ḍarar* (harm), which are risk components in the context of Sharīʿah. There should also be an assessment of the company's liabilities by conducting a search of government and regulator records. This exercise will reveal whether the company is facing any litigation related to business transactions, breach of intellectual property rights or other disputes related to employee liabilities or product liabilities. The next step is an evaluation of the rights of the signatories involved and a judgement of their competence to execute the transaction. The final appraisal should be of whether the company is abiding by all the prevailing laws and is not involved in any undesirable activity.

In addition to legal liability risk, IVC enterprises may face other forms of risk including credit risk, equity investment risk, market risk and operations risk. Credit risk is the potential threat of failure of the counterparty to meet its obligations as agreed at the time of a contract (Gladstone and Gladstone, 2002). Similarly, the capital providers always face the threat of loss of investment due to inappropriate utilization of funds or lack of professional management skills. These risks are relevant for all *muḍārabah* and *mushārakah*-based contracts between the management and shareholders of the IVC. These risks are less prevalent in IVC funds due to their structure and can be further addressed through enhanced disclosure.

Market risk is a part and parcel of all risk-sharing contracts and is largely dependent upon market conditions. It is extremely important for the investors in an IVC to select for investment a company suitable to their risk appetite. They need to avoid highly volatile and speculative sectors to safeguard their long-term interests and face minimum losses during adverse market movements.

Operations risk emanates from flawed procedures and/or weak controls. IVC funds need to develop an infrastructure of robust internal processes and induct experienced professionals to run the operations to mitigate operational risk. The implementation of sound internal controls and periodic external audits are instrumental in avoiding losses from faulty processes.

Equity investment risk arises from entering into partnership in a particular financing or general business activity in which the provider of finance shares the business risk. This kind of risk is associated with equity-based transactions such as *muḍārabah* or *mushārakah*. IFSB (2018b) suggests various measures to address this risk for profit-sharing instruments:

- The risk profiles of partners (*muḍārib* or *mushārakah* partners) need to be carefully assessed. In this regard, the past track record of the management team should be assessed to evaluate their experience and their past dealings in similar projects. Moreover, the quality of the business plan, as well as the competence of human resources related to the proposed business activity, should be analyzed.
- The legal and regulatory environment affects equity investment risk, and therefore, IVC management should carefully review the tariffs, quotas, taxation and subsidies that may affect their business activity. Moreover, they need to keep track of any sudden policy change affecting the quality and viability of investments.
- IVC management should make every possible effort to minimize information asymmetry through continuous monitoring of operations. They can introduce a periodical reporting system that can transmit timely information.
- IVC management should ensure that their valuation methodologies are appropriate and consistent, and they should perform valuation at frequent intervals. These methods need to be discussed with partners, and their consent should be obtained before the start of the activity.

Exit strategies

After investors value the company and make investment, there needs to be a carefully crafted exit strategy (financially viable and Sharīʿah-compliant). When partnership terms are being negotiated, serious consideration should be given to the timing and strategy to harvest the investment for IVC investors. There should be a formal agreement in place regarding the exit strategy so that there is no uncertainty in the minds of either of the two parties involved (Leach and Melicher, 2011). From a Sharīʿah perspective, this is an important consideration for the avoidance of *gharar* (ambiguity).

There are several options available to IVC investors and management of the invested company to execute “exit” transactions. These alternatives include IPO, leveraged buyouts (LBOs), management buyouts (MBO), mergers and acquisitions (M&As), systematic liquidation and a newly innovated Sharīʿah-compliant method known as *mushārakah mutanāqiṣah* (MM; diminishing partnership).

IPO in many cases is the most preferred option for both investors and the invested company. Although it may be both time-consuming and costly owing to disclosure requirements and IPO-related expenses including fees paid to auditors, lawyers, consultants and regulatory authorities, investors prefer this method owing to a better valuation of the company made by consultants. Nevertheless, the IPO strategy is viable mostly for longer-term investments, especially in the cases where companies are closer to the stage of maturity or at least in rapid-growth stages to have successful IPOs of their shares. IPOs, however, are not suitable for investments with shorter horizons. Another challenge to the suitability of IPOs for IVC is the level of development in financial markets. As most Muslim countries have stock markets that are either inactive or in early development stages, price discovery through an IPO may not be an optimal alternative.

Outright sale occurs when owners sell the venture to family members of entrepreneurs, managers, employees or outside buyers. The latter could include other venture capitalists. MBOs and LBOs are also part of this option. However, this concept is broader than both of them as it includes other potential buyers either from inside or outside of the company. In some cases, the earnings obtained through such sales are higher as compared to IPOs, especially when potential buyers see some niche in the company that regular shareholders may fail to realize (Ahmad Farid, 2012).

LBO takes place when independent investors buy the company from the original owners by using capital raised from debt financing (Gladstone and Gladstone, 2002). An LBO decision is taken after conducting valuation of the company, assessment of current market conditions, level of industry growth, marketability of products, infrastructure and exit strategy of the LBO fund and other factors. The new management may retain the existing management or hire a new team. Islamic versions of LBOs could be done using Sharīʿah-compliant modes of sales-based financing (such as *tawarruq* or *murābaḥah)*. Among the first Islamic LBOs was the buyout of Aston Martin from Ford by two Middle East investment companies (Hassan *et al.*, 2011).

MBO occurs when the company's management buys a controlling interest from the other investors, mainly through the use of leverage. However, it requires a willing seller of those interests. MBOs are attractive options for an exit mechanism as they save costs, time and effort, and the company does not need to expose confidential business secrets to outsiders or competitors. MBOs also restrict the scope of takeover of the company by competitors. As management is familiar with the working environment, the daily operations of the company do not suffer and the pursuit of long-term plans remains intact. The transaction can also be smoother than other modes as there is a lower probability of underpricing or overpricing. That is because the management is well aware of the current position and future prospects of the company and industry and, hence, is in a better position to calculate the fair value.

M&As can also be considered as suitable exit mechanisms. A merger of two companies gives rise to a new company from the combination of the two, whereas an acquisition is the result of the purchase of one company by another, and eventually only the acquiring company remains in existence (Gaughan, 2010). Depending on the level of bureaucracy and the speed of structuring the deal, both merger and acquisition could be slow or quick processes. It can be beneficial for both the companies due to possible synergy benefits. Venture capitalists whose stake is involved in the resulting company may gain appreciation in the value of their investment and can exit either during the process of M&A or afterwards.

Systematic liquidation occurs when a company winds up operations by systematic distribution of its assets to the owners. Once a company reaches the stage of maturity, it may be generating substantial cash flows which may exceed the amount needed to maintain the venture's sustainable growth. Alternatively, the owners may intentionally reduce or stop growth by not reinvesting in the working capital, plant and equipment. The resulting cash flows can then be distributed by giving lucrative dividends or through stock repurchases. As there are no more growth opportunities available, the companies may go for voluntary liquidation and assets can be sold for employment in new avenues. However, this strategy is risky, and the company's decline will not remain unnoticed by its employees, competitors and customers, which may significantly shift their attitude toward it. Therefore, systematic liquidation is considered the least attractive exit strategy unless an industry is in a declining state.

Mixed structure is suggested by Ahmad Farid (2012) and involves issuing fixed-rate preferred shares for VCs in the early stage and ordinary shares for investors in more mature stages. Although this strategy carries lower risk, it has some serious issues with respect to Islamic finance principles. First, preferred stocks face criticism by various Sharīʿah scholars, and AAOIFI Sharīʿah Standard No. 21 declares them Sharīʿah non-compliant (AAOIFI, 2010). Although the Shariah Advisory Council of Securities Commission Malaysia (2006) declares the basic preference share (non-cumulative) permissible based on the concept of *tanāzul* (to forego a right), it is hard to neglect the argument of AAOIFI that mentions two main reasons for this ruling:

(1) Preference cannot be given to preferred shareholders over ordinary shareholders while distributing dividends.

(2) The fixed nature of dividends paid is tantamount to *ribā* (interest).

MM is a new hybrid product that combines the features of *bayʿ* (sale) and *mushārakah* (partnership). It has been introduced to tackle the requirements of modern day financing (Ahmad Farid, 2012). The traditional use of *mushārakah* or *muḍārabah* was mainly for either short-term trading or project-based financing (where both *muḍārabah* and *mushārakah* would be more appropriate). It was also used for long-term, sometimes life-long, partnerships (where *mushārakah* would be more appropriate). VC strives for medium-term harvesting objectives, and none of these contracts is appropriate. The MM contract starts as a partnership between the entrepreneur and the venture capitalist, with sharing of both profit and loss according to a profit-sharing agreement between the partners. The venture capitalist gradually exits the partnership by selling his shares back to the original entrepreneurs in different phases, making it easier for the entrepreneur to subsequently buy the enterprise. It is also less risky for the venture capitalist, leaving counterparty risk very low.

Wilson (2009) argues that the regular MM financing structure is more appropriate for home financing rather than IVC financing and suggests *tiered* MM as more appropriate for IVC. In this structure, the company starts purchasing its share after some grace period (a minimum of two years). It starts with small fractions of shares, and the proportion gradually increases as the company achieves the capacity to spend more cash for share repurchases. Figure 1 illustrates how VC shares can be repurchased in both regular and tiered MM cases.

MM financing, in general, is subject to an important issue from the Sharīʿah perspective. In the case of IVC using traditional *mushārakah* or *muḍārabah* structures, the valuation of each partner's share is convenient as the value of shares is determined after liquidation takes place. However, in the case of MM financing, the valuation is performed during the life of the company. It is not appropriate to assign a predetermined value to the shares of the company. Therefore, fresh valuation should be performed at the time of each transfer to avoid any Sharīʿah issues (Asadov *et al.*, 2018). There should be a clear and explicit agreement between the entrepreneur and the venture capitalist on how to value shares of the firm in case they want to apply MM financing for a private company. Even for a publicly listed company, the application of MM becomes challenging if it is used for a particular

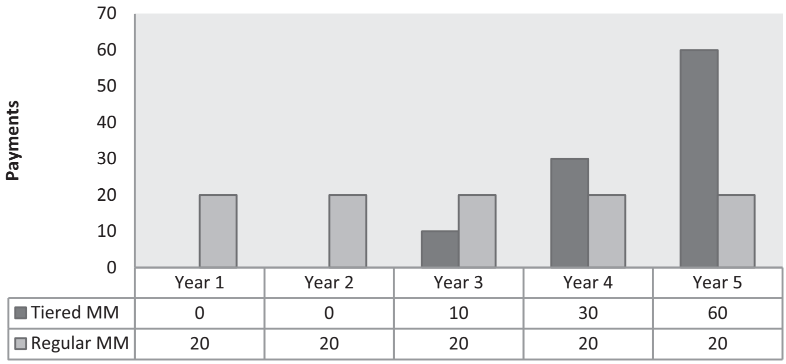

Figure 1.
Ordinary vs tiered MM

Source: Wilson (2009)

project rather than to finance the company as a whole. Nevertheless, MM can still be considered better than an IPO, especially for countries with underdeveloped financial markets or for companies that want to stay private.

Issues in the application of Islamic venture capital

IVC entities are now in need of closing the gaps at the corporate governance level in various jurisdictions for better planning, organizing, controlling and monitoring of these investments (Elsiefy, 2014). First, there is a lack of transparency and the absence of a uniform legal framework; thus, foreign investors perceive greater risk and avoid investing in these funds. Second, the legal structure does not guarantee the protection of intellectual property rights and patents, and there is a possibility of the failure of innovative ventures. Third, an effective mechanism of dispute resolution is missing, and specific laws/regulations are not in place to settle disputes between partners in IVC, hindering the growth of equity-based contracts. Fourth, there is a dearth of educational programs that can enhance the skills required to develop unique ideas and produce young entrepreneurs. Fifth, governments, in general, do not support these ventures through incentives and tax exemptions. Finally, many Muslim countries are facing a shortage of high-caliber individuals and management teams who have expertise in investment strategies and who are simultaneously well versed with Sharīʿah rules related to business.

It is suggested that a multi-fold strategy should be adopted to address these challenges. The first step in this respect is to introduce different types of shareholdings in IVC, i.e. voting/non-voting, ordinary *vis-à-vis* preference shareholdings, modified preference shareholdings to promote transparency and lesser agency issues. Moreover, Muslim countries should introduce legislation focused on the protection of property rights, dispute resolution and fast processing of court cases related to equity-based investments. To raise awareness, regulators should encourage the offering of educational programs on IVC investments in educational institutions and professional training institutes with an aim to educate investors about the returns and risks characteristics of these investment styles. Finally, governments should contemplate offering tax incentives and duty waivers to IVC enterprises that contribute to human welfare in addition to seeking profit. Sharīʿah scholars and standard setters should come forward and develop guidelines for Sharīʿah compliance requirements.

Conclusion and recommendations

This study finds that IVC possesses features such as risk sharing, the potential of incorporating Sharīʿah-compliant investment modes and higher than average returns. It could be ideal for the Islamic finance industry, which is in dire need of equity financing products. However, VC is traditionally practiced as an alternative asset class, and the capital is provided by large institutions and wealthy individuals, and thus, IVC is perceived to follow the same path. Therefore, even though some initial steps have been taken in the implementation of the concept in practice, this industry still lacks general public recognition. The major cause is not only the lack of awareness among investors but also the absence of viable investment opportunities for small- and medium-scale investors. IVC has the scope to attract the general public if the ventures can be established, such as mutual funds, which require a lot of research aimed at introducing innovative products.

Therefore, it is recommended that stakeholders should sit together and build a road map to introduce, evolve and support the IVC industry through new research in areas of weakness such as valuation and exit strategies. Governments can also play an active role by providing the required support for further development of the IVC industry.

The IVC industry can achieve many of the desired objectives of Islamic finance if it works on the principles of equity and fairness. This involves a careful selection of investment avenues and giving preference to projects that promote public welfare. The returns on investment are very important for the survival of these entities. One way to achieve them is through collaboration with government agencies on projects such as provision of clean water or recycling of waste to earn handsome profits through innovative ideas.

Governments can also use charity funds to invest in IVC, with an objective of creating employment and reducing poverty through establishment of new industries and commercial entities. They can use zakat (compulsory almsgiving) and other welfare taxes to support this venture. It is the responsibility of Muslim governments to alleviate poverty and provide all the facilities (such as trade promotion) to achieve this goal, and they can fulfil this by supporting the establishment of IVC funds.

For the IVC funds to gain their due share in the investment industry, it is very important that they be run on a truly Sharīʿah-compliant basis. Nonetheless, they have to make themselves more acceptable to the general public by making it easier to invest in them and by choosing preferred business sectors.

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About the authors

Zaheer Anwer, PhD, is an Assistant Professor and the Director of Lahore Centre of Excellence in Islamic Banking and Finance, University of Lahore, Lahore, Pakistan. He is a banker-turned-academician and an International Centre for Education in Islamic Finance (INCEIF) alumnus. His research interests include Islamic finance, corporate finance and monetary economics. Zaheer Anwer is the corresponding author and can be contacted at: zmanwar@gmail.com

Alam Asadov, PhD, is an Assistant Professor at Prince Sultan University, Riyadh, Kingdom of Saudi Arabia. He holds PhD from INCEIF, Malaysia, and his research focus is on quantitative finance and economic modelling.

Nazrol K.M. Kamil, PhD, is an Assistant Professor at the Kulliyyah of Economics and Management Sciences, International Islamic University Malaysia (IIUM), Kuala Lumpur, Malaysia. He holds an extensive track record of teaching, and his research interests include Islamic investments and portfolio management.

Mehroj Musaev is the Assistant of the Head of International Cooperation Department, Tashkent Islamic University, Tashkent, Uzbekistan, and an INCEIF alumnus.

Mohd Refede is an ACCA affiliate, United Kingdom and Chartered Accountant of Malaysia, a final year student of INCEIF, Kuala Lumpur, Malaysia, and the Executive Director at PMZ Permai Sdn. Bhd.