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The Role of Islamic Investment Funds in Activating the Islamic Financial Market

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Abstract:

This study examines the role and performance of Islamic investment funds in enhancing and revitalizing the Islamic financial market. These funds serve as key instruments for mobilizing and channeling savings into Shari'a-compliant investments. Using a descriptive-analytical approach, the study analyzes data on both Islamic investment funds and the Islamic financial market. Results indicate that Islamic investment funds are innovative financial tools that meet the growing demand for Shari'a-compliant instruments, generate added value, and help mitigate investment risks. Moreover, the underwriting activities of these funds provide liquidity and purchasing power within the Islamic financial market. The study recommends promoting investment funds as a mechanism to support Islamic banking and the broader Islamic financial industry, emphasizing the need for a regulatory environment that incentivizes their operations.

Keywords: Islamic investment funds, Islamic financial market, Islamic financial industry

JEL Classification: G11, G23, G28

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1. Introduction

Islamic investment funds are among the most prominent investment mechanisms in international financial markets. They represent innovative financial instruments that help attract savings and stimulate investment. This industry has spread significantly due to the advantages it offers compared to direct investment, most notably: risk reduction, providing good returns to investors, and relying on specialized management expertise not available to many investors. "Islamic investment funds reflect broader trends in financial innovation and the increasing integration of Islamic finance into global capital markets …" (Khan & Bhatti, 2008).Additionally, Islamic investment funds play a role in deploying excess liquidity in banks and stimulating financial markets by attracting a larger number of investors (El Hammami & Hassan, 2022; Iqbal & Mirakhor, 2011).

Research Problem

How do Islamic investment funds contribute to activating the Islamic financial market?

Research Sub-questions

1. What are Islamic investment funds, and what are their types?
2. What is the financial market from an Islamic perspective?
3. What is the economic role of Islamic investment funds in activating the Islamic financial market?

Research Methodology

This study relies on a descriptive and analytical approach to analyze data related to Islamic investment funds, the Islamic financial market, and the relationship between them.

Research Structure

The study consists of an introduction, three main axes, and a conclusion:

- **Axis One:** The intellectual framework of Islamic investment funds.
- **Axis Two:** The nature of Islamic financial markets.

- **Axis Three:** The economic role of Islamic investment funds in activating the Islamic financial market.

1. Axis One: The Intellectual Framework of Islamic Investment Funds

1.1. Emergence of Islamic Investment Funds

The emergence of Islamic banks more than 30 years ago significantly influenced the establishment of Islamic investment funds, especially given the existence of substantial savings among small investors who refuse to invest in conventional funds or lack the capacity for direct investment in the stock market due to limited income or insufficient experience. The development of Sharia-compliant financial products and instruments also contributed to the idea of establishing Islamic investment funds (Abu Bakr Omar Ali, 2015; Qashout, 2014).

1.2. Definition of Islamic Investment Funds

Definitions vary according to scholars and researchers:

- They are "Islamic financial institutions that pool investors' funds in the form of investment units or Sukuk, managed by specialized experts, invest the savings according to Sharia-compliant investment formulas, and distribute net returns according to the prospectus and the contract" (Hamza & Saidi, 2022).
- Some define them as "an investment instrument independent of its founders, consisting of contributions in the form of shares or units, managed through Mudarabah or agency contracts, with participant rights defined according to the common interest and applicable laws and regulations" (El Hammami & Hassan, 2022).
- They are also defined as "a portfolio that pools funds from multiple parties to benefit from diversification and risk reduction, managed under specialized supervision according to the prospectus" (Iqbal & Mirakhor, 2011).

1.3. Characteristics of Islamic Investment Funds

- They have a legal personality independent of investors and managers.

- Managed according to a Sharia-compliant Mudarabah contract, where investors provide the capital and agree to appoint the manager (Rab Al-Mal) (Ayub, 2007).
- Compliant with Sharia provisions and local laws, with periodic evaluation of investment units.
- Investment of funds according to Sharia-compliant formulas such as Mudarabah, Musharakah, Murabaha, Ijarah, and Istisna, adhering to AAOIFI standards (Hasan & Dridi, 2010).
- "Islamic investment funds adhere to Sharia and regulatory standards and show resilience during financial crises …" (Hasan & Dridi, 2010).

1.4. Difference Between Islamic and Conventional Funds

Table (1): Difference Between Islamic and Conventional Funds

Criterion	Islamic Funds	Conventional Funds
Investment Fields	Compliant with Sharia	No specific restrictions
Relationship with Founder	Legal Sharia contract	Management company with fixed fees
Sharia Supervisory Board	Subject to Sharia committee	No Sharia committee
Handling Interest	Avoid interest and prohibited activities	Deals in all securities

Source: Hamza & Saidi, 2022

"Sharia governance structures increase investor confidence and ethical commitment …" (Hussain et al., 2019).

1.5. Types of Islamic Investment Funds

- **Islamic Equity Funds:** Purchase shares of companies compatible with the fund's objectives (El Hammami & Hassan, 2022).
- **Commodity Funds:** Buying and selling halal goods with actual sale transactions (Ayub, 2007).
- **Ijarah Funds:** Purchase and lease of assets to generate fixed income.

- **Murabaha Funds:** Financing the purchase of goods and reselling them in installments with a Sharia-compliant profit margin.
- **Salam Funds:** Forward contracts for goods specified in the contract.
- **Fixed-Income Funds:** Investment in Sukuk issued by companies or government entities.

1.6. Sharia-Compliant Management Formulas

- **Mudarabah:** The fund manager invests the funds within limits specified in the prospectus.
- **Agency (Wakala):** The manager receives a fixed fee for managing the fund.
- **Partnership (Joint Mudarabah):** Partners contribute to the capital and share profits and losses (Qashout, 2014).

1.7. Sharia Structuring of Contractual Relationships

- Relationship between the fund and founder: The founder legally represents the fund.
- Relationship between the fund and investors: Investors contribute and deal with the board as agents.
- Relationship between the fund and manager: Based on ownership contract or performance-linked fees.
- Relationship between the fund and custodian (treasury): Management and safekeeping of documents and marketing operations, often via Islamic banks (Hamza & Saidi, 2022).

2. Axis Two: Nature of Islamic Financial Markets

2.1. Definition of Islamic Financial Markets

A regulated market where parties interested in dealing with Sharia-compliant financial instruments meet (El Hammami & Hassan, 2022).

A Sharia framework for issuing and trading financial instruments with oversight from a Sharia board.

"Islamic investment funds bridge the gap between traditional markets and Sharia-compliant investment opportunities …" (Choudhury & Hoque, 2020).

2.2. Characteristics of Islamic Financial Markets

- Reduces speculation due to Sharia prohibitions.
- Focuses on financing productive projects rather than mere trading volume.
- Enhances fairness and Sharia compliance.
- Opens diverse investment opportunities for Muslim investors with minimal risks and higher returns (Hasan & Dridi, 2010).
- "Islamic financial markets demonstrate resilience to global shocks due to their asset-backed and risk-sharing nature …" (Archer & Karim, 2007).

2.3. Elements and Requirements of the Islamic Financial Market

- Availability of liquidity.
- Presence of Sharia-compliant securities (Sukuk and halal shares).
- Specialized Sharia-compliant financial institutions.
- Sharia and financial market experts.
- Founding requirements: legal amendments, issuing alternative securities, creating a charter among Islamic countries, and expanding Islamic financial institutions (Ayub, 2007).

2.4. Types of Islamic Financial Markets

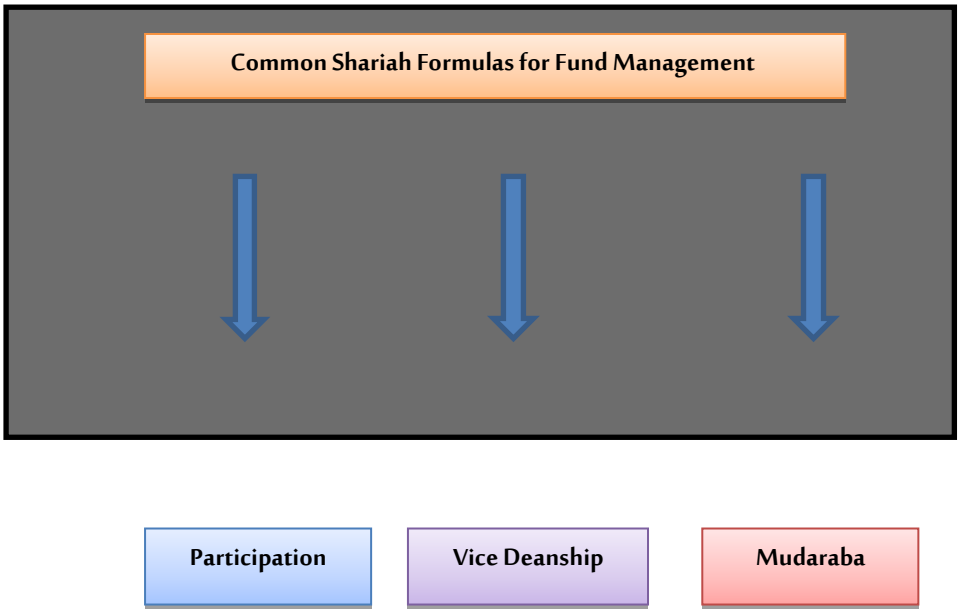
- By instrument type:
    - **Money Market:** Short-term investment (≤ 1 year).
    - **Capital Market:** Medium- and long-term investment.
- By issuance and trading:
    - **Primary Market:** New issuance of securities.
    - **Secondary Market:** Trading previously issued securities (El Hammami & Hassan, 2022).

3. Axis Three: Economic Role of Islamic Investment Funds in Activating the Islamic Financial Market

3.1. Activating the Islamic Financial Market

Islamic investment funds encourage attracting small savings and reducing risk through diversification, contributing to the formation and trading of financial portfolios (Boudjallal & Zaidi, 2013).

Figure(1): Common Shariah Formulas for the Management of Islamic Investment Funds



Source: Hisham Kamel Qashout, "Introduction to Investment Management from an Islamic Perspective: An Original Study of Scientific Concepts and Practical Practices", Dar Al-Nafais, Amman, 2014, p. 233.

3.2. Sharia Adaptation of Islamic Investment Funds:

The Shariah adaptation of Islamic investment funds means the nature of the contractual relationship between the parties to investment funds, and they are mainly represented in the originator of the fund and investors, the fund manager and the treasurer, and contractual relations between the parties to Islamic investment funds can be adapted in more than one form, but the predominant form that shows the nature of the relationship between these parties and the Islamic Investment Fund is represented in the following form (Walid Huwaimel Aujan; p. 99) :

- The relationship between the fund and its originator: The originator of Islamic investment funds may be an Islamic bank, Islamic Takaful companies, or even a group of businessmen, called the

founders and linked to the fund by the relationship of the ownership contract and they represent the fund legally before others.

- The relationship between the fund and investors: Investors are the shareholders in the fund, but do not start managing it, and they do not themselves contract with the manager who chooses investments for them, but rather they rely on the fund's board of directors, which often assigns this to a bank, the fund is then an agent for those investors and he gets in return for his agency a certain percentage of the fund's net assets, the contract here is a paid agency contract, but that wage is not known when the contract is initiated, but at its expiry.
- The relationship between the fund and the manager: The relationship between the investment fund and its manager is often adapted on the basis of the royalty contract, so that shareholders ask the manager to manage the fund's assets by buying and selling to achieve periodic profits and returns for shareholders in exchange for making it worth it if it achieves a certain goal, and what exceeds this goal is his, or achieving a monthly periodic return and what is more than it is his.
- The relationship between the fund and the cashier: Each investment fund has a treasurer or the so-called depositor, he saves the fund's documents and undertakes marketing operations for the fund's assets and investment units, and this process may be granted to some financial institutions, which are often Islamic banks specialized in this type of operations, and the cashier may link the fund itself to a leasing relationship, as the cashier is considered a tenant with the Islamic Investment Fund in exchange for carrying out marketing operations carried out on behalf of the fund, and it can also In some cases, they are bound by a royalty contract, but the work of this contract is very little compared to the lease contract.

The second theme: The nature of Islamic financial markets

Financial markets play an effective role in the process of economic development, and the concept of the Islamic financial market does not differ from the concept of the traditional financial market in terms of substance and nature, but it is characterized by its discipline by the provisions of Islamic Sharia, and this is what we explain through this axis.

3.3. Market Stability

Funds help prevent sharp fluctuations by forming balanced portfolios and avoiding high-risk speculation.

3.4. International Globalization

Funds contribute to the market's globalization by enhancing the international position of the Islamic market.

3.5. Increasing Market Efficiency

Fund management relies on scientific analysis and well-considered buy/sell decisions, increasing market efficiency and stability (Rashad & Hussein, 2017).

3.6. Absorbing Liquidity and Providing Financing

Funds help absorb liquidity, reduce inflation, and provide companies with investment funds without relying on bank loans.

3.7. Protecting National Savings

By opening Sharia-compliant investment opportunities, preventing capital outflow, and encouraging small investors to participate (Bataher Bakhta, 2023).

4. Methodology

This study relied on a **descriptive and analytical approach** to examine the relationship between Islamic investment funds and the Islamic financial market. "The study adopted a descriptive-analytical approach based on secondary data sources …" (Saunders et al., 2019).

Data were collected from both **primary and secondary sources**, including academic books, journal articles, reports, and online databases. The methodology included:

- **Descriptive Analysis:** Defining Islamic investment funds, their types, and the nature of Islamic financial markets.
- **Analytical Approach:** Studying the economic role of Islamic investment funds in activating the Islamic financial market, including their effects on liquidity, market stability, and investor participation.

- **Comparative Study:** Highlighting differences between Islamic and conventional funds, as well as analyzing case studies where applicable.

The research framework aimed to provide a clear understanding of how these funds function and their impact on market efficiency.

5. . Results

The study reached several key findings regarding the role of Islamic investment funds in activating the Islamic financial market:

- **Market Activation:** Islamic investment funds attract small and medium investors, diversify investments, and stimulate trading in financial instruments.
- **Market Stability:** By forming balanced portfolios and avoiding speculative activities, these funds reduce market volatility.
- **Global Integration:** Islamic funds enhance the international position of Islamic financial markets, contributing to their globalization.
- **Market Efficiency:** Fund management relies on scientific analysis, improving decision-making in buying and selling assets, which increases market efficiency and stability.
- **Liquidity Absorption and Financing:** These funds absorb excess liquidity, reduce inflationary pressures, and provide financing to companies without relying solely on bank loans.
- **Protection of National Savings:** Islamic investment funds provide Sharia-compliant investment opportunities for Muslim investors, preventing capital outflow and encouraging participation by small investors.

6. Conclusion

The study concluded that Islamic investment funds are a modern tool for enhancing the Islamic financial market by:

- Directing savings toward Sharia-compliant investments.
- Providing necessary liquidity to investors and companies.

- Increasing market efficiency and encouraging participation of small investors.

6.1. Practical Recommendations:

- Activate funds to support Islamic banks and the financial market.
- Provide an encouraging regulatory and legislative environment.
- Ensure compliance with Sharia to gain investors' trust.
- Promote awareness of Islamic funds through seminars and educational institutions.

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