



EXPLORING SRI MODEL TO STIMULATE
INVESTMENT: THE CASE OF JCORP

BY

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ABSTRACT

This research sought to explore the potential of Socially Responsible Investment (SRI) in stimulating economic growth. Few decades back, SRI concept gaining its root in investors preference especially those from developed country like United States and European Union (EU) (Nicholls, 2009; USSIF, 2016). This preference comes with dual investment objectives offered by SRI which are financial returns and social benefits (USSIF, 2016; Gunnar et.al, 2015; Pathik and Pratik, 2014). SRI comes in many forms, it includes financial and non-financial instruments such as bonds, equities, and funds that invested for betterment of socio-economic and environmental preservation or green projects. Another significant distinction features, the element of governance gradually become a concern for investors in order to make investment decisions (Sullivan, 2015). These entire elements will be observed in JCorp SRI Model. In the case of Johor Corporation Berhad (JCorp), this entity fulfils their Corporate Social Responsibility (CSR) uniquely compared to other corporate entity where JCorp incorporating SRI element while at the same time adopting Islamic approach. This has been done through formation of endowment scheme launch by the JCorp under the concept of corporate waqf. By establishing an entity called Waqaf An-Nur Corporation Berhad (WANCorp) which is a specialized institution that supervise, manage and administer all endowed assets contributed, JCorp could efficiently and effectively perform its role as state conglomerate that contribute not only to improve economic conditions of Johor, but also improve the welfare of the public through its waqf benefits. In order to fully understand SRI structure used by JCorp in its endeavour towards CSR, this paper use case study method to perform analysis on documents and materials related to JCorp SRI waqf model. Notably, other than financial returns, JCorp SRI waqf model manage to make continuous contributions to the public by developing socio-economic of the public, nurturing human capital development in entrepreneurship, healthcare services, education, Islamic religious activities, real estate management, charity and donations. In later part of the analysis, comparison on investment return between JCorp and other financial institution reveal significant potential financial returns and stability. It is also possible for JCorp to extend and explore more possibilities of waqf model in enhancing its current form in order to become exemplary corporate entity that utilize SRI model.

Keyword: JCorp, WANCorp, SRI, Waqf, Case Study

خلاصة البحث

سعى هذا البحث إلى استكشاف إمكانات الاستثمار المسؤول اجتماعيا (SRI) في تحفيز النمو الاقتصادي. وبعد عقود قليلة، اكتسب مفهوم "SRI" جذوره في تفضيل المستثمرين، خاصة أولئك من البلدان المتقدمة مثل الولايات المتحدة والاتحاد الأوروبي (نيكولز، 2009؛ أوسيف، 2016). ويأتي هذا التفضيل مع الأهداف الاستثمارية المزدوجة التي توفرها سري والتي هي عوائد مالية ومزايا اجتماعية (Gunnar et.al, 2015; Pathik and Pratik, 2014; USSIF, 2016).

ويأتي هذا النظام بأشكال عديدة، ويشمل الأدوات المالية وغير المالية مثل السندات والأسهم والصناديق التي استثمرت لتحسين المشاريع الاجتماعية والاقتصادية والبيئية أو المشاريع الخضراء. وهناك سمات مميزة أخرى للتمييز، وهي عنصر الحكم يصبح تدريجيا مصدر قلق للمستثمرين من أجل اتخاذ قرارات استثمارية (Sullivan, 2015) وستلاحظ هذه العناصر بأكملها في نموذج جسورب SRC في حالة جوهور كوربوراتيون برهاد) جكورب (، فإن هذا الكيان يفي بمسؤوليته الاجتماعية للشركات مقارنة بشكل فريد مع الكيانات الأخرى التي تقوم فيها شركة جسور بدمج عنصر سري مع تبني النهج الإسلامي في الوقت نفسه. وقد تم ذلك من خلال تشكيل خطة الوقف من قبل JCorp تحت مفهوم الوقف المؤسسي. ومن خلال أصول الممنوحة وتديرها، يمكن أن تقوم JCorp بكفاءة وفعالية بدورها ككتلة حكومية تساهم ليس فقط في تحسين الظروف الاقتصادية جوهور، ولكن أيضا تحسين رفاهية الجمهور من خلال فوائد الوقف. من أجل فهم كامل هيكل سري التي تستخدمها JCorp في مسعاها نحو المسؤولية الاجتماعية للشركات، تستخدم هذه الورقة طريقة دراسة الحالية لإجراء تحليل على الوثائق والمواد المتعلقة نموذج وقف JCorp. وتجدر إشارة إلى أن نموذج "SRI JCorp"، الذي يعتبر عائدا من العائدات المالية، يسهم في تقديم مساهمات مستمرة إلى الجمهور من خلال تطوير المجتمع الاجتماعي والاقتصادي، وتنمية رأس المال البشري في ريادة الأعمال، وخدمات الرعاية الصحية، والتعليم، والأنشطة الدينية الإسلامية، وإدارة العقارات، التبرعات. وأخيرا ان التحليل، كشفت مقارنة عائد الاستثمار بني JCorp ومؤسسة املاية الأخرى عن عوائد مالية واستقرار هامني. ومن الممكن أيضا أن تقوم شركة JCorp بتوسيع واستكشاف المزيد من إمكانات نموذج الوقف في تعزيز شكلها الحالي لكي تصبح كيانا مؤسسيا نموذجيا يستخدم نموذج سري.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a thesis for the degree of Master of Science (Islamic Banking and Finance).

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This research paper was submitted to the IIUM Institute of Islamic Banking and Finance and is accepted as a fulfilment of the requirement for the degree of Master of Science (Islamic Banking and Finance).

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Banking and Finance

DECLARATION

I hereby declare that this research paper is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

This study is driven by the idea to unlock Socially Responsible Investment (SRI) potential in developing and stimulating investment growth in Johor compared to mainstream method of investment that more common in this era. Investors in developed country like Europe and United States of America (USA) have developed new segment of investment preference where it focus on the social impact rather than financial return (Nicholls, 2009). In fact, the current practice of SRI is largely dominated by mainstream institutional investors like pension funds and insurance companies, controlling around 92 and 75 percent of the total SRI in Europe and USA, respectively (USSIF, 2016). It shows the trend in SRI is overwhelmed by the concern over investment that benefits the public as whole. The concept in SRI varies as it was determined by the investment objectives but largely concern over Environmental, Social and Governance (ESG). This holistic principle could guide investors to not only benefit them from financial return, but also to make contribution to the welfare of the society. Looking at the current situation in Johor, Iskandar Malaysia (IM) - formerly known as Iskandar Development Region (IDR) – provides a suitable opportunity for investors to diversify their investment through many asset classes offered. However, the concern is the existence of SRI platform which could support the society welfare which could capture the eyes of the investor with good investment prospect in terms of returns and also the impacts to social development.

In order to overcome this issue, this paper offers an insight to suitable SRI model where it is not only satisfy primary objective of investment in generating financial return, but also provide positive impact to environment and social. Apart

from that it could lead to better social and public financing through equity based investment that conform to the principle of Shariah. This could be fundamental difference between conventional and Islamic SRI model which explored by this paper that overshadowed by capitalism and socialism values.

1.2 STATEMENT OF PROBLEM

SRI provides benefits that far more valuable to investor compared to mainstream investment where it emphasize social impact. Social impact can be defined as the net effect of an activity on a community and the well-being of individuals and families (Centre for Social Impact, 2017). Normally when there is a boom of economic growth prospect in certain area, in this context Johor as a state where prices of goods and services gradually increased due to direct and indirect impact of inflations, interest rates, and other economics and financial factors. If this happen, without putting the public interest as the main focal, investment made and development planned will only in favour of the investors and shareholders. Their main concern is likewise, financial benefits which unlikely will consider society welfare especially the locals where most of the projects are offered to foreign investors. In 2016, it is reported that 100 billion worth of investment in real estate have been sealed in IM (Iskandar Regional Development Authority, 2016). This caused the prices of properties in Johor to increase rapidly due to the demand from foreign residents. It caused spill-over effects even to area outside IM region.

Apart from that, the execution of Good and Services Tax Act 2014 (GST) contributing in putting pressure to the public where it caused prices of goods and services to increase instead of decreased as claimed by the Government. Indeed, GST has been employed in developed country like United Kingdom (UK), Singapore and USA in order to provide effective tax regime. But in the case of Malaysia,

manipulation of prices by middlemen and other irresponsible parties cause the end user of the goods or services to suffer extra cost increased in price. Not only with that, other pressure in healthcare and education also noticeable where some group of the society still unable to get access to this facility especially the aborigine and the poor where they are not exposed to this due to their limited capacity to access it. Consequently, SRI model is required in order to balance out the negative effects from development which failed to safeguard the interest of the public especially the locals. In response to these issues, this paper provided not only a possible SRI solution in order upheld public welfare but also profitable investment model where it could generate economic growth by employing equity based investment that guided by Shariah principle.

1.3 PURPOSE OF STUDY

This research sought to provide a solution for better investment model that are balanced between financial and social values. The SRI model proposed take form by combining a mechanism used in Shariah where the wealth will be redistribution, circulated and generating future financial returns in order to safeguard the social welfare through appropriate investment asset classes. Also, the paper provides insight to fundamental differences in conventional and Islamic SRI model and principles.

1.4 RESEARCH OBJECTIVES

The main objective of this research paper is generally to provide suitable SRI model that conform to the principle of Shariah. Apart from that, this paper also aimed to achieve the following objective:

1. To analyze the potential investment growth using JCorp SRI Waqf model.
2. To extend an integrated SRI model involving Waqf REITs as financing mechanism to solve social responsible issues.

1.5 RESEARCH QUESTIONS

In conjunction to the research objectives, this research paper tries to solve the question to find feasible SRI model that not only able to provide social benefits but also conform to Shariah principles. Also, below are the following research questions which become the focal point of this paper:

1. What are the potentials investment growth that could be provided from JCorp SRI Waqf model?
2. How is it possible to use integrated SRI model involving Waqf REITs as financing mechanism in solving social responsible issues.

1.6 SIGNIFICANCE OF THE STUDY

This study will contribute to the authority and decision makers in order to balance the development impact by providing viable options for investors to make their investment decision for better returns in terms of financial and social benefits. This paper also gives the opportunity for the investors, foreign or local to contribute actively in projects or investments that support the public welfare. Subsequently, the society could enjoy better living where part of their burden have been lifted through SRI model and economic growth that enjoyed by the state and its populations.

Ultimately, the model developed by integrating Waqf REITs could help in solving current social issues pertaining affordable housing for public which become grave concern nowadays where prices of properties hiking in conjunction to higher cost of living derived by increasing inflation and interest rates in debt society. Even though The scope of the study was confined geographically to focus on Johor region and SRI model used by JCorp, this integrated model served as pilot study which could be extended to national level in order to similar issues.

1.7 ORGANIZATION OF THE RESEARCH PAPER

This research paper contains a total of 5 chapters as follows. Chapter 1 focused on introduction, Chapter 2 literature review, followed by Chapter 3 research methodology and Chapter 4 will be the findings. Finally Chapter 5 will be the conclusion of the research.

CHAPTER TWO

LITERATURE REVIEW

2.1 INTRODUCTION

Socially responsible investing (SRI) or social investment comes with many variants in name which carries comparable values and objectives, which seeks to consider both financial return and social benefits to bring about a social development. It an investment model that gives benefits to both shareholder and stakeholders alike where it covers broader area compared to other investment model. In recent development, it has also become known as "sustainable investing" or "responsible investing". There is also a subset of SRI known as "impact investing", dedicated to the conscious creation of social impact through investment. This principles somehow share similar objective to ESG principle where sometimes summarized under the heading of environment, social justice and corporate governance. This phenomenon becomes more evident with participations from institutional level, both private and public, coming from various parts of the world (USSIF, 2016; Sullivan, 2015).

In this chapter, SRI is further discussed in order to deepen the understanding of underlying concept and issues which related to this research. It also discussed convergence and divergence of values between SRI concepts between conventional perspectives and Islamic perspectives in order to support economic and social sustainability.

2.2 ECONOMIC GROWTH

Economic growth can be defined as the increase in the inflation-adjusted market value of the goods and services produced by an economy over time. It is conventionally measured as the percent rate of increase in real gross domestic product, or real GDP,

usually in per capita terms (Bjork, 1999). Measurement of economic growth uses national income accounting. Since economic growth is measured as the annual percent change of gross domestic product (GDP), it has all the advantages and drawbacks of that measure. The "rate of economic growth" refers to the geometric annual rate of growth in GDP between the first and the last year over a period of time. Implicitly, this growth rate is the trend in the average level of GDP over the period, which implicitly ignores the fluctuations in the GDP around this trend. In national income accounting, per capita output can be calculated using the following factors: output per unit of labor input (labor productivity), hours worked (intensity), the percentage of the working age population actually working (participation rate) and the proportion of the working-age population to the total population (demography). These economic growth is derived from Keynesian economic model where it illustrate the relationship between supply and demand which translated into aggregate demand-expenditure model that used by most developed countries after Great Depression during 1930s.

Given the role of both demand and supply which is used to emphasized the determination of prices, prior to Keynes (d.1946) Islamic scholars realized many centuries ago the importance of demand and supply in causing inflation. Al-Jahiz (d.869), Taymiyyah (d. 1328) and Ibn Khaldun (d. 1406) explained one way or another how the movements of demand and supply cause the price level to go up and down (Chapra, 2008). Both fiscal and monetary policies affect aggregate demand and supply. Consequently, they can cause a sustained rise in prices. A higher government expenditure results in an upward shift in the aggregate demand causing the price level to go up. When the government expenditure is financed with issuing debt a further shift in aggregated demand is possible if the outstanding debt is considered by the debt holders a net wealth. The monetization of the debt will further caused a rise in the price level as it creates another shift in the aggregate demand. In an Islamic

framework, when there is no imported inflation, inflation should be zero. However, it should be mentioned that a very low inflation rate was experienced in early Islamic history. The main reason for such a rise in price levels was the influx of gold and silver. Furthermore, there were brief periods of rising prices due to an interruption in the supply in the third and fourth decades of Islamic history. According to Siddiqi (1996), there are four 'built in stabilizers' in the Islamic economic system which guarantee zero inflation or at least minimize its incidence. They include:

1. One of the main determinants of inflation is the debt financing which is replaced by equity and share based financing
2. The existence of *Zakat* and the inheritance laws affect the distribution of income in favour of a less fortunate population. Consequently, they influence the composition of aggregate demand in such a way it reduces the fluctuations in aggregate demand.
3. Islam discourages waste and encourages moderation in consumption. This will result in a decrease in aggregate demand.
4. Islamic governments consider public money as trust. Consequently, they must keep public expenditure within the bounds set by the available means. Public financing of government debt is very rare as predetermined interest rates do not exist and in case of financing debt/deficits the rate should be attached to the growth of the economy. Monetization of debt/deficits in an Islamic economic system is almost nonexistent.

2.3 ECONOMIC SECTORS

An economy involves complex exchanges between not only individuals and businesses, but also governments and residents of the rest of the world (BEA, 2015). These interactions can be perceived between certain economic sectors. Economic sectors can be defined as a division of a country's population based upon the economic

area in which that population is employed (BusinessDictionary.com). In classical definition, Fisher (1939) categorizes economic sectors into three: Primary, Secondary and Tertiary. In late 1980s, a new sector has been reclassified under quaternary which represent by knowledge based economic activities. (Kenessey, 1987; Tor, 1990). It is important to describe economic sector involved in order to simulate their interaction in real economic system. This interaction can be shown using Circular Flow Model (Daraban, 2010; BEA 2015).

Economic activities that come from interactions form all sectors could create wealth, business, jobs, goods and services, that could satisfy the needs and wants of the participants in the economy which can be individual, institutional or even a country. In order to measure economic growth generated from economic activities, Keynesian economists employ Aggregate Expenditure Model (Barry, n.d; Gwartney et.al, 2014). Barry (n.d) explained that AE model components are:

1. Total consumption expenditure (C), which includes the purchase of final goods and services by individuals but does not include things like the purchase of a home as it would be considered as investment.
2. Government Expenditure (G) will include all expenditure by each level of government.
3. Investment expenditure (I), includes capital and inventory investment by individuals or institutions.
4. Net Export (X - M) which represent the net export and import value in the economy.

Based on those components, the model can be explained with following formula:

$$AE = C + I + G + (X - M)$$

Where

C = Total consumption expenditure

I = Investment expenditure

G = Government expenditure

X = Export expenditure

M = Import expenditure

In this model, there are two assumptions which are (Gwartney, 2014):

1. First, the *AE* model assumes that there is a specific rate of output associated with full employment.
2. Second, following in the Keynesian tradition, the *AE* model assumes that wages and prices are completely not flexible until full employment is attained.

This model can be used to measure Gross Domestic Products (GDP) of an economy which is a monetary measure of the market value of all final goods and services produced in a period where Aggregate Expenditure (AE) equal to GDP. In a context of a country, GDP can be used to measure its economic growth (OECD, 2001; Zeira, 2015).

2.4 SOCIALLY RESPONSIBLE INVESTMENT

The origins of SRI are often traced to the investors in the USA in the early 1900s who avoided – for religious reasons – companies which invested in the production of tobacco, alcohol, or operated gambling establishments (Michael, 2009). Taking investment decisions based on these considerations, Socially Responsible Investment (SRI) has entered the policy sphere in two main forms. First, using social criteria directed to funds owned and managed by the public sectors. Second, in many

countries, governments are adopting indirect regulatory methods by preferring to mandate disclosure of the effects of investment activity on society and environment rather than requiring companies to invest in particular ways (USSIF, 2016; Sullivan 2015; Gerhard and Gregor, 2015). As a difference to conventional investments, SRI, sustainable investment or ethical investment apply ethical, environmental and social criteria which are also referred to as extra-financial criteria (Saeed and Kabir, 2013; George, 2016; Michael, 2009; Neil and Adam, 2007). Michael (2009) emphasize on the nature of SRI preference based on these criteria which used as negative screens and positive asset selection criteria. All SRIs have in common that they do not primarily aim for maximization of financial returns (Richard et.al, 2010; Benjamin, 2014). It rather offer investment choices that reflect the ethical preferences and individual investment motives of the investors (Benjamin, 2010; George, 2016) and then aim at achieve the best investment return within the specified boundary. While intention of the investors differs, they are not focused on wealth only.

The welfare of society and the environment are not considered at significant level as the nurturing of a sustainable development even dominates personal financial aspects (William, 2016; Malin, 2014). Therefore, currently the main consideration for SRI among institutional investors such as pension funds is motivated by mounting evidence that the social, environmental and corporate governance (ESG) factors affect a firm's long-run specific and non-diversifiable risks (Michael, 2009). Substantial interest from the public and scholars has been ignited by social finance, socially responsible investing (SRI), ethical investing, or broadly, the incorporation of sustainability criteria into capital market investment decisions activities which captured under the umbrella term sustainable investing (SI)(Gunnar, 2015). In terms of growth and performance, SRI model does not fall short to conventional counterpart. According to USSIF (2016), the US, Canada and Europe account for almost all of the

global sustainable investing assets which show potential for development for Malaysia, especially Johor to tap market share for SRI in this region (Securities Commission Malaysia, 2017). The initial development of the Islamic funds industry also marked the start of the Malaysian capital market's involvement in SRI as the Shariah principles underlying Islamic investing have significant commonalities with the principles underlying SRI. Islamic funds are also recognized as sustainable investments as Shariah principles promote the pursuit of positive social effects alongside financial investment returns (Securities Commission Malaysia, 2017). . In addition, Islamic investing is often associated with ethical practices and requires the application of screening where it has been enhanced using Shariah screening methodology employed by Shariah Advisory Council of Securities Commissions ((Securities Commission Malaysia, 2017; Saeed, 2013). Apart from similarities, SRI in Islamic need further refinement to emphasize the difference in perspectives and approach in coming to their investment objectives. This paper further discuss the matter under Islamic Social Finance (ISF) paradigm to suit the model used in case study and analysis section.

2.4.1 SRI and Financial Investment Decisions

The concept of financial investment that dominates the mind of today's investment decision is based on financial theory like Modern Portfolio Theory (Markowitz, 1952) and Capital Asset Pricing Model (Sharpe, 1964). Statman (2005) elaborate on how it has changed the view of an investor as a human being with emotions and non-financial objectives into a measuring entity value based on its decisions on return, risk and their respective interactions in the portfolio. It is often for optimization algorithms applied in order to identify the portfolio compositions with the best level of risk diversification (Markowitz, 1998). However, this concept is at least partially not

compatible with socially responsible investment (SRI) (Benjamin, 2014). According to Benjamin (2014) as a difference to conventional investments, Socially Responsible Investment applies environmental, social and governance aspect in making their decisions which later used as negative screening to select appropriate investment. All SRIs have in common that they do not primarily pursue a maximization of financial returns (Benjamin, 2014; Malin, 2014; George, 2016; Yared, 2006; William, 2016). Investment institutions that want to market SRI products rather offer investment choices that reflect the ethical preferences and individual investment motives of the investors and then aim at achieving the best investment return within the given boundary (William, 2014; Malin, 2014; Gunnar, 2015). While motives of the investors differ, they are not focused on wealth alone. The welfare of public and the environment are at least important constraints for some investors since the idea of fostering sustainable development even dominates personal financial aspects (Beal et al., 2005). Benjamin (2014) highlights incompatibility of SRI and the concept of financial investment and its alleged weakness on three different levels which are:

1. The applicability of an assessment criterion for financial investment in the present. Any lack of compatibility on part of SRI would be put into perspective if it would refer to an aspect of financial investment that in itself was set about.
2. As a second level of discussion, the concrete aspects have to be laid out where SRI actually is in conflict with financial investment.
3. Third, is the importance to analyze each aspect of the investment in order to point out lack of adherence that can be considered as a weakness to SRI investment.

This brings forth two important considerations in to SRI model. First, both the economic circumstances and the sociopolitical targets have very much changed from