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CHAPTER 11

Islamic Private Equity

Mohamed Ali Chatti & Ouidad Yousfi

Islamic Private Equity

The Islamic private equity (IPE) market has grown dramatically over the last few years. There are some similarities between venture capital (VC) and some traditional methods in Islamic financing. In medieval Islamic societies it is hard to pinpoint the starting of IPE but there were partnership arrangements similar to those practiced in conventional private equity (PE). But both academicians and professionals argue that the VC activity started in 1946 when General Doriot, a French born and a Harvard educated businessman, established the American Research and Development Corporation (ARDC). It grew in Silicon Valley in the 1970s. Intel and Microsoft are amongst the most famous projects financed through VC. Without the intervention of venture capitalists none of these would have seen light of day or at least achieved such a spectacular rate of development in such a short period (Queyrel, 2006).

CONVENTIONAL PRIVATE EQUITY

Definition

PE may be defined as a partnership with non-listed companies. The objective with PE is to raise capital to invest in many types of firms, for example, innovative or start-up firms, firms operating in the middle market, firms in financial distress, public firms that want to go private through buyout financing etc

Over the past forty years, PE investment has grown dramatically, by an order of magnitude over markets such as the public equity and bond markets, and the market for private placement debt (Fenn et al., 1995). Today, the amount of money raised by PE investors has sometimes exceeded capital raised through initial public offerings (IPOs). Despite the increase of funds issued in PE investments and its important role in corporate finance, only venture capital and buyout investments have received considerable attention in the academic literature.

Note that PE financing is provided by professional intermediaries who invest in all the stages (creation, development, buyout, recession...) with the objective being to exit quickly the target company and to maximize their profit. The investors seek to get their money back to invest in a new deal.

Why PE financing?

PE plays a major role within the economy. At a microeconomic level, it accelerates the growth of SMEs through financing, sharing experience and skills and, ultimately, benefits from the professional network and contacts of the PE fund. In fact, PE contributes significantly to the increase of the overall productivity of the economy. Entrepreneurs are usually wealth-constrained and very often have no business experience. They have no real guarantees and no collateral to get credit financing. PE investors provide financing and, in turn, they share the benefit as well as the control of the firms they are investing in. PE guarantees also:

- i) *building an active partnership with the entrepreneur*: PE funds are active investors and professional managers, in contrast with passive financiers. They very often have past experience, in contrast with that of the entrepreneur. To solve agency conflicts and to make risk-taking less attractive for the entrepreneur, they use convertibles, preferred stocks, monitoring and other related elements.
- ii) *Sustainable partnership with the contractor*: The entrepreneur and the PE investors have a partnership based on confidence. In fact, after the initial review, which is often very severe and leads to the rejection of many proposals, the residual proposals are subject to a second review which takes a few days. Many details in the business plan are scrutinised. If the entrepreneur's proposal belongs to the surviving ones, the PE investors organise meetings and telephone discussions with the key staff of the firms and even with some customers, suppliers and creditors.
- The intervention of the investor, alongside the entrepreneur, creates a real dynamic for the company which will benefit from financial resources, complementary skills and some modern and effective modes of management and governance.
- iii) *Financing and supporting companies*: the PE industry satisfies the specific needs of growing companies which cannot get financing through banks. For each stage, it provides specific services and skills to enable the firm to move to the second stage (for example, from the starting stage to the development stage).

Some features of PE financing

Providing financing: PE funds can issue equity or convertible debt in exchange for shares and control. There are three types of PE securities: common stocks, convertible preferred stocks, and subordinated and convertible debt. If the project does not meet its short-term objectives the PE fund can convert their securities into common stocks which diminishes the entrepreneur's profit.

Quick exit of the PE fund: In general, the fund keeps the project in his portfolio for a period of time between 2 and 8 years. Institutional investors, wealthy individuals and families, and professional managers assign to the fund a certain amount of money for a fixed period of time. Consequently, the fund cannot keep the entrepreneur's project for a longer period than the money provided by the Limited Partners (LP). The PE fund can exit the entrepreneur's project through three main vehicles:

- Initial Public Offering IPO for the more successful projects, called high-flyers,
- Trade sale, and
- Withdrawal which occurs before the end of the first year showing the ability of the fund to filter good projects from bad ones.

No immediate compensation: The choice of the exit route is the last way to earn money since dividend distribution is usually random. The PE fund earns money by selling the shares they hold. "These are third parties who, by acquiring the shares, will allow investors to realize capital gains, there is no drain on financial resources of society, nothing comparable to a bank loan that he must pay and reimburse."¹

Professional Skills and an Active Involvement in management

The PE fund is not only financially competent but it has professional experience in the areas in which it invests. The participation, in addition to be financial, is strategic. It provides a network of knowledge, know-how and address book/contacts. Thus, it is an active partner. For instance, the PE fund is present in the board of directors and votes on all strategic decisions.

Modes of Financing

PE is divided into four activities:

Venture Capital (VC): Issuers of VC are usually innovative firms developing innovative technologies where the entrepreneur is wealth-constrained and very often has no business experience to manage alone the project (the current proposal is often a first experience). VC funds accept financing projects with long-term growth potential and with firms which are in the research and development stage, trying to grow quickly in order to reach the commercialization stage (Fenn et al., 1995).

Development Capital: only more established and mature firms can be financed through development capital which enables them to move to the development stage such as doing business with other countries and establishing new subsidiaries. Note that these projects are costly, and must be fast-growing firms.

Leveraged Buy-Out (LBO): it finances listed firms that want to go private to consolidate a subsidiary before going public, or to ensure the passing of family firms to the heirs. The acquired firms should be at a mature stage and able to generate important cash-flows to cover the debt's payments. LBO projects have a high level of debt: it often represents 75 per cent of the financial structure of capital.

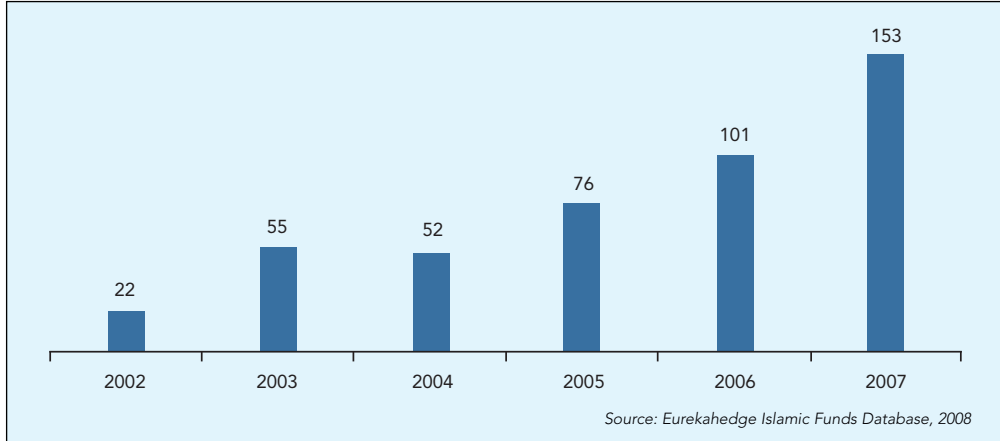
Other activities: for example firms in financial distress, or firms looking to update their technologies and to replace their equipment.

ISLAMIC PRIVATE EQUITY – WHAT'S NEW?

It is hard to pinpoint the start of Islamic PE. In fact, financial transactions existed from the early 14th century but without institutions exclusively devoted to banking or PE financing. Conventional PE funds played a major role in financing firms even in Muslim countries. The long colonisation of Muslim countries delayed the development of Islamic finance in general, in particular the Islamic PE (IPE) industry.

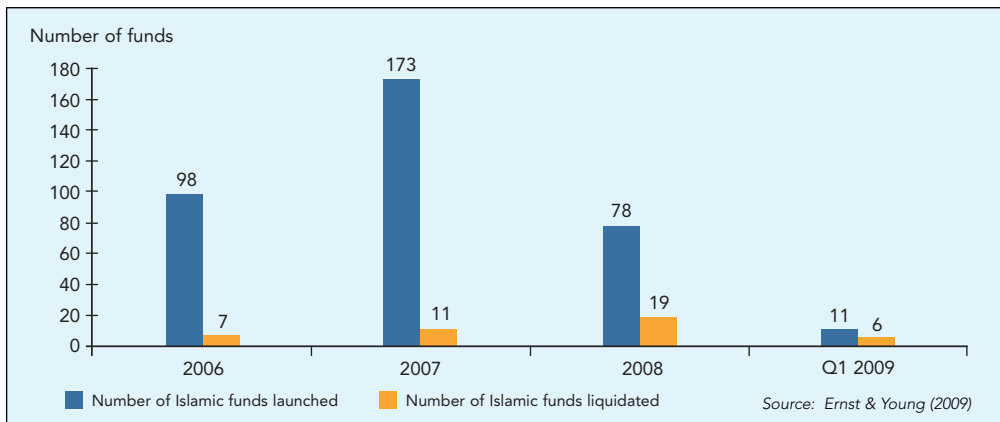
While the first Islamic banks were established in the 1970s, the first IPE funds appear only in the last decade. According to EurekaHedge Islamic Funds Database, the first IPE funds have existed since 2002. Between 2002 and 2007, their number was multiplied by a factor of near to seven (see Figure 1).

Despite its young age, IPE attracted a considerable attention. To meet the growing demand of Muslims and, recently, non-Muslims in both Muslim and non-Muslims countries, the Islamic finance industry has grown significantly over recent years not only in terms of the volume of the entire industry but also in terms of the development and the creation of innovative and sophisticated products which are *Shari'ah* compliant. Estimates presented in ANIMA (2009)

Figure 1: The number of IPE funds between 2002-2007

of the expected volume of funds that would be raised in 2011 were \$41 billion while the funds raised in 2008 were almost \$28 billion. This is why the main international financial centres have established benchmarks, like for example the Dow Jones Islamic Market Index² in New York and the FTSE Global Islamic Index³ in London.

Finally, a number of Islamic banks (including Arcapita, Gulf Finance House and Unicorn Investment Bank) are creating investment funds to take stakes in growing companies (often unlisted) and to generate high yields through active management of the assets acquired. In recent years they have generated high yields in some business lines which were for a long time dedicated to conventional players. However, the number of financed deals and the average capital per deal in both Islamic and conventional PE decreased after the subprime crisis. Many IPE funds were wealth-constrained and some of them were liquidated (see Figure 2).

Figure 2: Global Islamic Funds Industry: Annual launches and liquidations

Definition of Islamic Private Equity

According to Sheikh Taqi Usmani⁴, an IPE fund involves the pooling of investors who can be high net worth individuals (such as retired managers) or business families, corporations and institutions. Their aim is to diversify their portfolios and to raise capital in exchange for high returns. The creation of these funds leads to a substantial concentration of capital. In fact, there are savings of hundreds of millions of Muslims who never deposit their money in banks, such as farmers and artisans. These savings are increasing dramatically and are being captured by these funds.

An IPE fund provides financing to a larger range of investments than would be accessible to each investor alone. Of course, these investors have lower risks when they are operating together. In contrast with conventional PE funds, IPE funds must invest in companies that are *Shari'ah* compliant to make a *halal*⁵ profit.

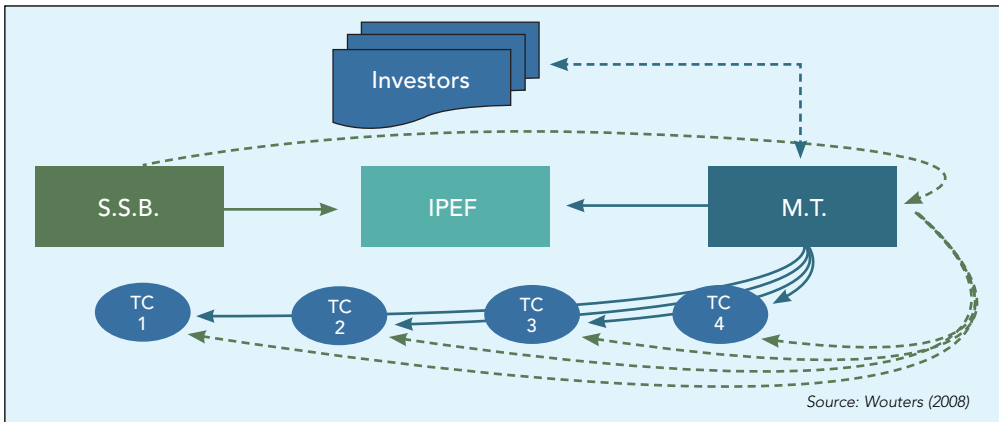
Organisation of a PE fund

PE firms are structured as partnerships with two key components:

- The General Partners (GP); the management team responsible for the selection and management of the target company and, ultimately, the exit strategy.
- The Limited Partners (LP); the providers of the capital. They provide funding and allow the GP to draw down funds as required for investments that meet an agreed profile.

At this point, IPE appears more restrictive than conventional PE. In fact, there are many investments which are not in accordance with *Shari'ah* principles (*haram* investments) including no investment in interest-bearing instruments.

Figure 3: An overview on the structure of IPE funds



In contrast with conventional PE fund, in addition to the LP and GP, the IPE fund must ask for the approval of Islamic authorities before making any investment decision (see Figures 3, 6). In fact, they operate in the following way:

1. The *Shari'ah* committee also called the *Shari'ah* Supervision Board (SSB) sets the *Shari'ah* policy of the fund. It recruits a *Shari'ah* Compliance Officer (SCO) to supervise target companies.
2. Investors raise funds for a fixed period of time to finance the selected IPE fund (IPEF).

3. The management team (MT) of the selected fund invests only in the more profitable target companies.
4. The SSB checks whether the project is *Shari'ah* compliant or not and that it is in accordance with their policy.
5. MT and SCO control target firms and report irregularities to the SSB.
6. MT has to disclose information about the progress of target companies to investors.
7. The IPE fund exits the target company at a fixed date and shares the losses and profits with the entrepreneur.

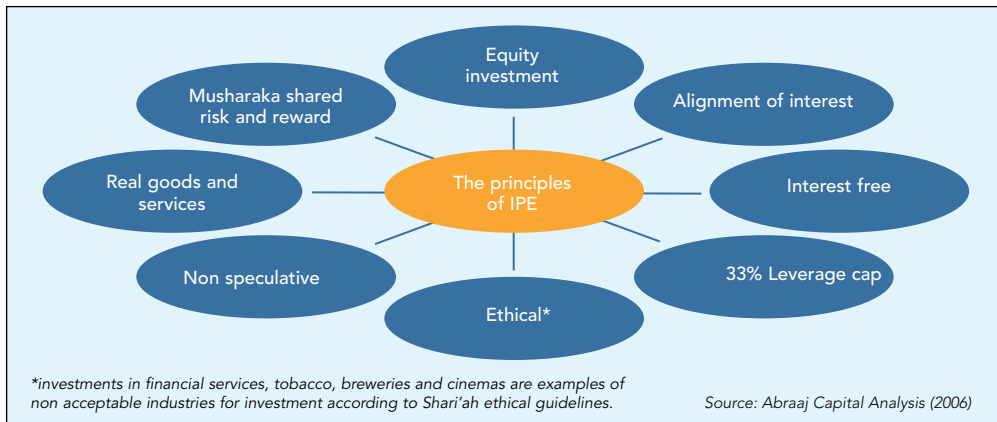
THE ROLE OF THE SHARI'AH SUPERVISORY BOARD (SSB)

The target companies are chosen by the executive committee of the fund. The LP assigns this function to this committee to preserve their interest. Often, they do not have business experience.

In Islamic finance, in addition to the traditional executive committee, the *Shari'ah* committee must approve the decisions of the executive committee; they retain and select only *Shari'ah*-compliant projects.

Figures 4 and 5 set out the principles of Islamic PE and the *Shari'ah*-compliant investment process.

Figure 4: The Principles of Islamic Private Equity



The *Shari'ah* Board is an independent committee and contains at least three scholars who specialise in Islamic jurisprudence (*Fiqh al Muamalat*) as well as experts not only in the Islamic religion and its applications but also in financial law. This committee must:

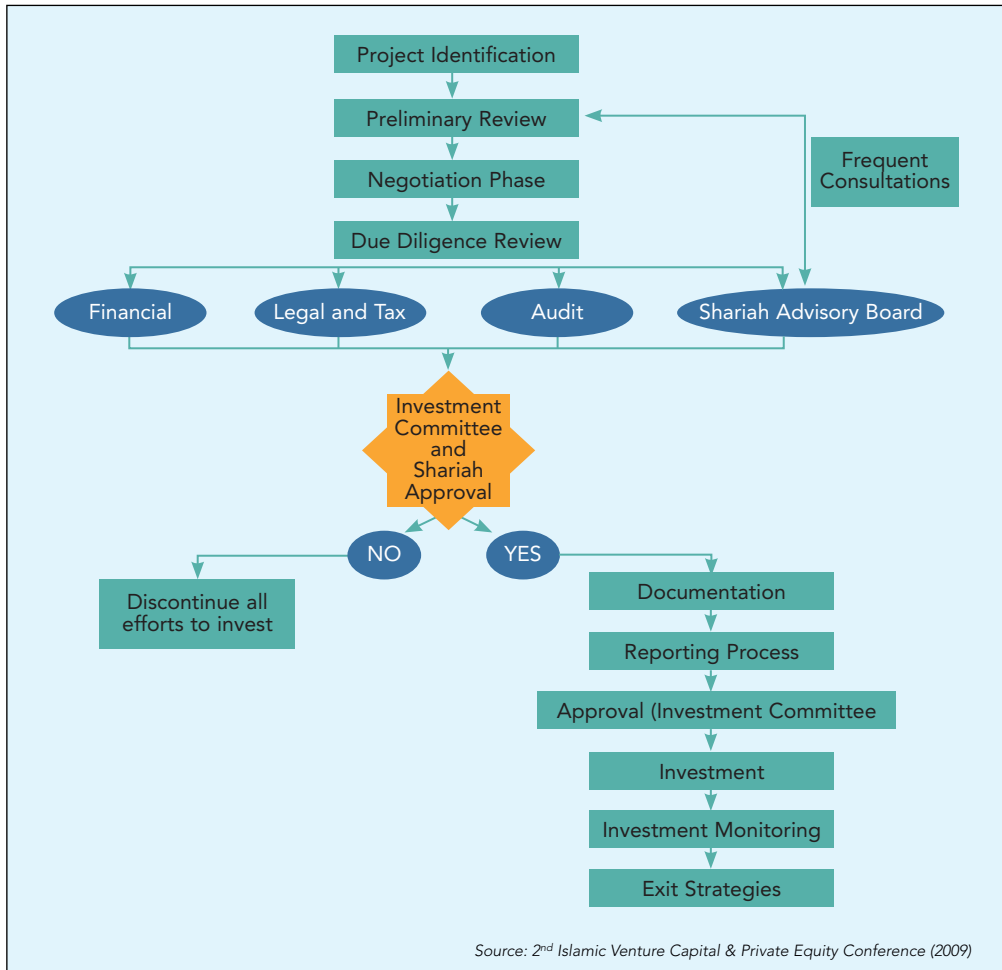
- Check whether the selected projects are in accordance with the principles of *Shari'ah* or not. Some scholars argue that the *Shari'ah* and executive committee should be independent to avoid conflicts of interest.
- Interpret the *Qur'an*, the *Sunna*⁶ and the *Hadith*⁷ which are the source of Islamic law, and *Ijma*⁸, *Qiyas*⁹ and *Ijtihad*¹⁰ which are used to provide interpretation and thereby facilitate future development and implementation of the Islamic judicial system (Pervez, 1990).
- Review all the stages of the investments to ensure that they are *Shari'ah* compliant. At the

end of the year, this committee will control the financed enterprises and check whether they are *Shari'ah* compliant. Some projects can become ineligible when new elements occur such as research and development activities that can be useful to the weapons industry. Malaysia recommends the appointment of a SCO who will do the following tasks daily:

- ◆ check that all aspects of the business are in accordance with the *Shari'ah* (portfolio management, trading practices, operational matters etc);
- ◆ report any non-compliance to the *Shari'ah* Board;
- ◆ provide *Shari'ah* expertise on documentation, structuring, investment instruments and ensure compliance with the general *Shari'ah* principles and the standards, regulations and resolutions of the regulator.

Shari'ah and Economic Criteria

Figure 5: *Shari'ah*-compliant investment process



Source: 2nd Islamic Venture Capital & Private Equity Conference (2009)

There are many activities in which an IPE fund cannot raise capital but there is no exhaustive list of them. This list varies from one country to another, from one region to another and even from one Shari'ah committee to another. The following list summarises those industries which are known to be clearly not *Shari'ah* compliant:

- Any transaction related to pork products and blood;
- Drugs, tobacco, alcohol and in general any activity related to intoxicant products;
- Pornography or obscenity in any form;
- Gambling, casinos, lotteries;
- Any activity related to the arms' industry;
- Some non-compliant financial activities based on interest, speculation and insurance;
- Trading on human cloning, human foetuses.

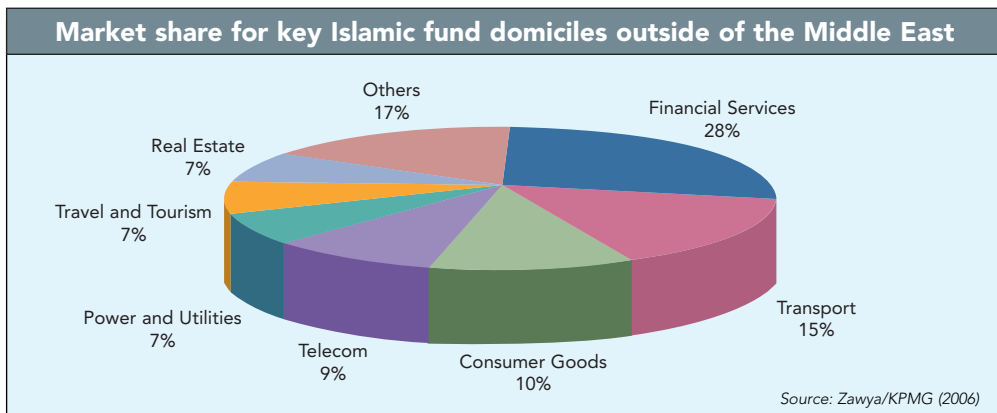
Note that some activities are not completely forbidden (see Figure 4 and Table 1), but should be avoided because they could lead to problematic situations, e.g. the hotel industry. In some countries, they are accepted and not permitted in other countries. It depends on the decision of the *Shari'ah* board. Scholars pay particular attention to companies that could derive marginal returns from some haram activities such as the hotel industry and supermarket chains. Sometimes, they finance such companies under the condition that the *haram* income does not exceed five per cent and sometimes 15 per cent of the whole gross income. This is why many Islamic scholars consider additional financial criteria when they have publicly listed companies to finance:

Total debt: IPE funds do not raise capital when total interest-based debt divided by assets exceeds (or is equal to) 33 per cent.

Total interest-bearing securities and cash: if the ratio of total cash and interest-bearing securities to assets is higher than 33 per cent, the investment cannot be financed through IPE.

Accounts receivable: if the ratio of accounts receivable against total assets is higher than 33 per cent.

Figure 6: Sector Focus of Islamic Private Equity 1997-2006



Threshold haram income: Any *haram* income of a non-compliant company that does not exceed five per cent of the overall gross income is considered marginal or accidental. Consequently the IPE fund can issue equity provided that sufficient cleansing is made according to the guidelines set forth by the *Shari'ah* adviser. Such monies originating from *haram* income should be isolated and given to charity.

Even if the target company satisfies some of the ratios, it does not automatically become *Shari'ah* compliant (see table 1). In fact, “The essential criterion for this type of financing is the entrepreneur because the mutual trust and the chances of success depend on it. The evaluation of the promoter overrides the development plan and sometimes even the outlook of the market and the products. We should give a critical importance to human factors because *Mudaraba* financing is made without banking collateral. The guarantees are sought primarily in the qualities of promoter, his competency, honesty, integrity and personality” (Islamic Development Bank, IDB, 1992).

Table 1: Financial screening ratios

	Debt ratio (%)	Receivables ratio	Cash + interest-bearing ratio	Non-permissible income/total income
DJIM ¹	33	33%	33%	≤ 5%
FTSE ²	33	50%	33%	≤ 5%
S&P ³	33	49%	33%	≤ 5%
MSCI ⁴	33	70%	33%	≤ 5%
Parsoli ⁵	33	45%	33%	≤ 10%
HK Islamic Index ⁶	33	49%	33%	≤ 5%

¹ Trailing 12 months average market capitalisation

² Total assets

³ Market value equity

⁴ Total assets

⁵ Trailing 12 months average market capitalisation

⁶ Trailing 12 months average market capitalisation

¹ Guide to DJIM Indexes November 2007

² Ground Rules for the Management of FTSE Shariah

Global Equity Index Series Version 1.2 March 2008

³ S&P Shariah Indices Index Methodology June 2007

⁴ Morgan Stanley MSCI Islamic Index Series Methodology April 2007

⁵ Parsoli Islamic Equity Index PIE

⁶ Hong Kong Islamic Index

Source: Wouters (2008)

Target companies

An IPE fund prefers companies with high potential growth. This type of company has a low leverage (their debt level must be very low or zero, making it favorable for Islamic investment).

The sectors most served by Islamic investors are real estate projects and infrastructure (see Figure 4). Examples of such funds include Al Ahli Global Real Estate Fund (funded by National Commercial Bank) and Al Qasr GCC Real Estate and Construction Equity Fund (financed by Saudi Fransi Caam - Banque Saudi Fransi). In addition, other funds specialise in venture capital and in the technology sector. Injazat Technology Fund (Dubai, 2001, \$50 million of capital raised) describes itself as the first *Shari'ah*-compliant venture capital fund, dedicated to technology, media and telecommunications in the MENA region.

Capital investors are looking for projects that are *Shari'ah*-compliant, economically viable and capable of providing financial returns better than other asset classes. In addition to financial and religious criteria, target companies must also satisfy economic conditions, even though these may not be prerequisites of *Shari'ah*. The management team selects projects that have both economic and social aims.

Economic aims

- To satisfy the demand and the financial operations of Muslims today in the framework of the principles and precepts of the Shari'ah.
- To invest the capital of Muslims into projects that are not forbidden by Islamic law in order to generate licit profits.
- To establish subsidiaries of Islamic banks in Muslim and non-Muslim countries through the implementation of innovative and varied activities.

Social aims

- To promote and consolidate co-operation amongst Muslims.
- To promote social development through almsgiving (*Zakat*¹²) and the creation of funds employed in charitable works.

Modes of financing

Despite the similarities between conventional and Islamic PE, there are some differences between them (see Table 2). In fact, by using IPE, companies can be financed through two possible contracts: *Mudaraba* and *Musharaka* in which the IPE fund is not a banker who lends money.

Both are based on the Profit and Loss Sharing principle (PLS). The entrepreneur and the IPE fund share profits if the project is successful, and losses otherwise. But if the entrepreneur is misbehaving and is responsible for the project's failure, then the losses will be in their charge.

Mudaraba is a partnership in which one or more parties (here the IPEF) contribute to the project the remaining parties (here the entrepreneur) brings their efforts/know-how to the project. The IPE fund has no control over the project and no right to participate in the managerial decisions. However, it will monitor the project and establish a system of regular reporting: at least once every three months, the target company should disclose commercial, human and financial information. The information system and its content are fixed at the date of the signature of financial contracts. In conclusion, we can say that the IPE fund plays the role of an alert partner.

Profits are shared in the following way: if the project is successful, the entrepreneur is paid for their work and know-how while the IPE fund gets the remuneration of their capital. Otherwise, both parties lose their contribution even if the entrepreneur is misbehaving. Notice that the *Mudaraba* principle is very close to the VC's principle in conventional PE. *Mudaraba* is used to finance innovative SMEs and start-ups.

In contrast with *Mudaraba*, in *Musharaka* all parties must contribute jointly to the funding of the project and all of them are involved actively in the project. Losses are shared between them according to the financial contribution of each one. So, the IPE fund is present in the board of directors. The *Musharaka* principle looks like non-venture private equity (buyout, development, etc.) in conventional PE.

Guarantees

In both *Mudaraba* and *Musharaka*, the IPE fund has no tangible assets as guarantees. The IPE fund faces therefore higher risk than conventional one. This is why only few projects can be selected and financed through IPE. The IPE manager pays considerable attention to the quality of assets, the company's ability to generate important cash-flows to cover the investment's

Table 2: Conventional versus Islamic Private Equity

Conventional	Islamic
Equity investment	Equity investment
Partnership-shared risk & reward	<i>Musharaka</i> -shared risk & reward
Alignment of interests	Alignment of interests
Long term value	Long term value
All industries	<i>Shari'ah</i> -compliant industries

Source: Abraaj Capital Analysis (2006)

costs, and implementation. The only fund guarantee is the quality of the assets of the project and its ability to generate high returns. Moreover, the managers in *Musharaka* or the *Mudarib* (when the IPE fund contributes to *Mudaraba* projects), are not required to guarantee the losses unless they are responsible for them.

Risks

The risk of bankruptcy is the most important risk that could be faced by the IPE fund. If the project is not successful, the fund may lose the monies initially raised. Indeed, according to the PLS principle, IPE operators do not have the right to ask for the restitution of funds.

Second, the IPE fund selects target companies operating not only in their own countries but also in foreign countries. Consequently, they are exposed to foreign exchange risk.

The IPE fund is also subject to liquidity risk in the sense they hold shares for the medium and long term (five years on average) and cannot immediately convert their shares into cash. Furthermore, the entrepreneur may behave in an opportunistic manner to get non-transferable and private benefit particularly under asymmetric information. Consequently, the IPE fund may face excessive risks. One solution is the use of a diminishing *Musharaka* contract: this is a special kind of *Musharaka* in which the IPE fund sells its shares gradually to the entrepreneur. Thus, the money invested will be recovered gradually and the fund will not be constrained to wait for the exit date in order to get its money back.

HOW ISLAMIC PRIVATE EQUITY IS FINANCED

The relationship between LP and GP

The management team should not be too broad and should be ready to make the business profitable. The managed portfolio should be within the scope of the managerial expertise as well as skills of the team.

The management team plays a major role in extracting returns in the deals they are investing in. First the GP must identify companies that meet the investment strategy of the IPE fund particularly those that match the return on investment (ROI) criterion. Second, in addition to new financial resources brought to the target by the IPE fund, the management team must assess the opportunities to create value and to make the business as profitable as possible. This is why the members of the management team should have a range of skills and experience.

Finally, they also have to choose and finalise the exit strategy since it is the ultimate way to ensure gains. According to the structure of the IPE fund the GP will take a profit share or management fee that may be dependent on a mixture of performance-based criteria and a fixed fee.

Liquidity management

A significant share of the available cash in the fund must remain liquid at the beginning of the investment for some period of time (one or two years) since the capital raised by the fund is invested gradually. About 20 per cent of the capital is kept liquid to finance short-term strategies if the target company still needs to be financed. However, the money collected by the fund cannot be deposited in interest-bearing banks (since interest is one form of *Riba*). However, if the depositors agree to invest their savings, they can be used to finance some *Shari'ah* compliant projects such as commodity *Murabaha*. In fact, customers may ask their bank to buy specific assets and, in turn, the bank sells them on a deferred sales basis. The difference between the acquisition and sale prices is the bank's profit.

Legal challenges of Islamic Private Equity

The organization and the working of the Islamic fund must be *Shari'ah* compliant. There are some restrictions in the form and the content of the legal documents to make them in accordance with the *Shari'ah* principles.

For example, the guarantee of the exit price (thus ensuring the benefits and excluding the risks of losses) is contrary to the *Shari'ah*. One example is the guarantee used to fix the exit price and exclude the risks of losses. This is contrary to the *Shari'ah*. At the exit date, the value of the target company is given by the fair market value, in contrast with conventional PE where this value may be fixed at the date of signature of financial contracts. In capital development and LBO, even IPE funds use debt, but leverage must be structured in a specific way to be accepted by SSB: companies which have high level of debt must restructure their capital such that total debt does not exceed 33 per cent of the capital.

CONCLUSION

Islamic private equity is a booming industry and endeavors to meet the demand of both Muslims and non-Muslims all over the world.

The lack of liquidity in the West, the recent oil boom, the opportunities in the Gulf region and the rapid rise of credit demand are among the reasons that lead to the development of IPE. Despite the fact that it is more restrictive than conventional PE, it has shown a persistent performance in the recent crisis.

To conclude, there are still some difficulties in implementing IPE particularly in non-Muslim countries because of regulation and they must be *Shari'ah* compliant in a dynamic market.

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FOOTNOTES

¹ Battini (2006), *Financing your business from creation to transmission by the Private equity*, Maxima Editor, p32.

² The Dow Jones Islamic Market Index was the first benchmark of investment performance for the global

universe of Shari'ah compliant equities. Since the launch of this global index in 1999, the DJIM index has expanded to provide a wide variety benchmarks tracking Shari'ah-compliant securities including indexes for specific countries, regions, industries and market capitalization ranges.

³ The FTSE Global Islamic Index Series (GIIS) are equity benchmark indices designed to track the performance of leading publicly traded companies whose activities are consistent with *Shari'ah* law. In essence, it is an indicator of the performance of global stocks that are available to an Islamic investor.

⁴ Muhammad Taqi Usmani is an eminent Hanafi Islamic scholar from Pakistan. He is an expert in Islamic Jurisprudence (fiqh), economics and hadith. He has also held a number of positions on the *Shari'ah* Boards of prestigious Islamic institutions, and is one of the most influential Islamic authors.

⁵ *Halal*: strictly conforming to the precepts of *Shari'ah*.

⁶ This is the second source of the Islam faith and refers to the Prophet's acts and words which are related to his practice of faith. It explains and transmits the *Qur'an*.

⁷ These refer to traditions or stories of the Prophet. In contrast with the *Sunna*, which was practised, the *Hadith* are records of what was practised. They have become a controversy between Islamic groups since there are a number of interpretations of them.

⁸ This is the consensus of the Islamic community, the *Umma*. It is through this principle that democracy makes its impact on the conduct of Islamic polity.

⁹ This is a deductive analogy by which a jurist applies to a new case a ruling made previously in similar cases.

¹⁰ This is independent judgment provided by scholars of Islamic law for which clear principles and procedures are stipulated in the *Qur'an* and *Sunna*.

¹¹ Islamic Development Bank, 1992, *Introduction aux techniques islamiques de financement*, Edition Institut Islamique de Recherches et de Formation, Acte de séminaire N°37, p.56-71.

¹² *Zakat* institutionalises the systematic giving of certain percentage (~2.5 per cent) of one's wealth each year to benefit the poor. It does not include charitable gifts given out of individual generosity and is not a replacement for taxes, but is seen as a form of compulsory worship, purification and redistribution. As it necessitates a regular reassessment of net wealth, *Zakat* is thought to help concentrate the mind in encouraging compliance with *Shari'ah* in all financial dealings (Alam, 2004).

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